



MEXICO

FINANCIAL SECTOR ASSESSMENT PROGRAM

DETAILED ASSESSMENT OF OBSERVANCE OF BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

March 2023

This Detailed Assessment of Observance of the Basel Core Principles for Effective Banking Supervision for the Mexico FSAP was prepared by a staff team of the International Monetary Fund and the World Bank as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on February 2023.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: <http://www.imf.org>
Price: \$18.00 per printed copy

International Monetary Fund
Washington, D.C.

MEXICO

FINANCIAL SECTOR ASSESSMENT PROGRAM

February 21, 2023

DETAILED ASSESSMENT OF OBSERVANCE

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

Prepared By
Monetary and Capital
Markets Department, IMF,
and Finance,
Competitiveness and
Innovation Global Practice,
World Bank

This report was prepared by Jorge Cayazzo (IMF external expert) and Juan Ortiz (World Bank) in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in Mexico in March and June 2022, led by Vikram Haksar, IMF and Ilias Skamnelos, World Bank, and overseen by the Monetary and Capital Markets Department, IMF, and the Finance Competitiveness and Innovation Global Practice, World Bank. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>, and www.worldbank.org/fsap.



INTERNATIONAL MONETARY FUND



THE WORLD BANK

CONTENTS

Glossary	3
INTRODUCTION AND METHODOLOGY	5
INSTITUTIONAL AND MARKET STRUCTURE—OVERVIEW	7
PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION	10
A. Soundness and Sustainability of Macroeconomic Policy	10
B. Financial Stability Policy Framework	11
C. Public Infrastructure	11
D. Crisis Management, Recovery, Resolution and Appropriate Level of Systemic Protection	13
MAIN FINDINGS	14
DETAILED ASSESSMENT	15
A. Supervisory Powers, Responsibilities, and Functions	16
SUMMARY COMPLIANCE WITH THE BASEL CORE PRINCIPLES	158
RECOMMENDED ACTIONS AND AUTHORITIES' COMMENTS	165
A. Recommended Actions	165
B. Authorities' Response to the Assessment	168
TABLE	
1. Total Assets of the Mexican Regulated System (MXN billion, As of December 2021)	8

Glossary

Banxico	<i>Banco de México</i> (Central Bank)
BCBS	Basel Committee on Banking Supervision
BCP	Basel Core Principles for effective banking supervision
LCR	Liquidity Coverage Ratio
CAR	Capital Adequacy Ratio
CEB	<i>Comité de Estabilidad Bancaria</i> (Banking Stability Committee)
CEFER	<i>Calificación de entidades financieras con enfoque en riesgos</i> (Risk-based Rating System)
CESF	<i>Consejo de Estabilidad del Sistema Financiero</i> (Financial System Stability Council)
CNBV	<i>Comisión Nacional Bancaria y de Valores</i> (National Banking and Securities Commission)
CNSF	<i>Comisión Nacional de Seguros y Fianzas</i> (National Insurance and Sureties Commission)
COFECE	<i>Comisión Federal de Competencia Económica</i> (Federal Economic Competition Commission)
CONAMER	<i>Comisión Nacional de Mejora Regulatoria</i> (Commission for the Improvement of Regulation)
CONDUSEF	<i>Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros</i> (National Commission for Financial Services Consumer Protection)
CONSAR	<i>Comisión Nacional del Sistema de Ahorro para el Retiro</i> (National Commission for Savings for Retirement)
CUAE	<i>Circular Única de Auditores Externos</i> (Consolidated External Audit Regulation)
CRLB	<i>Comité de Regulación de Liquidez Bancaria</i> (Banking Liquidity Regulatory Committee)
CPEUM	<i>Constitución Política de los Estados Unidos Mexicanos</i> (Mexican Constitution)
CUB	<i>Circular Única de Bancos</i> (Single Banking Circular)
DCG	<i>Disposiciones de carácter general a que se refiere el artículo 115 de la Ley de Instituciones de Crédito</i> (AML/CFT Regulations)
DOF	<i>Diario Oficial de la Federación</i> (Mexican Official Gazette)
FIU	Financial Intelligence Unit
IBM	<i>Instituciones de Banca Múltiple</i> (Commercial Banks)
HCO	Holding company
ICCAP	Internal Capital Assessment Adequacy Process
IPAB	<i>Instituto para la Protección al Ahorro Bancario</i> (Bank Deposit Insurance and Resolution Agency)

MEXICO

LCNBV	<i>Ley de la Comisión Nacional Bancaria y de Valores</i> (CNBV Law)
LIC	<i>Ley de Instituciones de Crédito</i> (Credit Institutions Law)
LOAPF	<i>Ley Orgánica de la Administración Pública Federal</i> (Federal Administration Organic Law)
LRAF	<i>Ley para Regular las Agrupaciones Financieras</i> (Financial Groups Law)
MOU	Memorandum of Understanding
MXN	Mexican Peso
NSFR	Net Stable Funding Ratio
PIN	<i>Portal Institucional de Supervisión</i> (Institutional Supervision Portal)
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
PTS	<i>Plataforma Tecnológica de Supervisión</i> (Technical Supervisory Platform)
RICNBV	<i>Reglamento Interior de la Comisión Nacional Bancaria y de Valores</i> (CNBV Internal Regulation)
RSCNBV	<i>Reglamento de Supervisión de la Comisión Nacional Bancaria y de Valores</i> (CNBV Supervisory Regulation)
RWA	Risk Weighted Asset
SHCP	<i>Secretaría de Hacienda y Crédito Público</i> (Ministry of Finance and Public Credit)
UAIR	<i>Unidad para la Administración Integral de Riesgos</i> (Integral Risk Administration Unit)
UBO	Ultimate beneficial owner

INTRODUCTION AND METHODOLOGY¹

1. This assessment of the implementation of the Basel Core Principles for effective banking supervision (BCPs) by the National Banking and Securities Commission (CNBV) is part of the Financial Sector Assessment Program (FSAP) undertaken by the International Monetary Fund (IMF) and the World Bank (WB). The assessment was performed during two missions between March 22 and April 4 and between June 21 and July 4, 2022, reflecting the regulatory and supervisory framework in place at the time of the completion of the assessment. It is not intended to represent an analysis of the state of the banking sector or crisis management framework, which are addressed in other parts of the FSAP.

2. It should be noted that the ratings assigned during this assessment are not directly comparable to previous assessments or to other jurisdictions. The current assessment of CNBV was against the BCP methodology issued by the Basel Committee on Banking Supervision (BCBS) in September 2012. The last BCP assessment was conducted in 2012 against the 2006 BCP methodology, which was revised and adjusted in 2012. There was an FSAP update in 2016 but it did not include a BCP assessment.

3. In the 2012 revision of the BCPs, the BCBS sought to reflect the lessons from the recent financial sector crisis, raising the bar for sound supervision reflecting emerging supervisory best practices. New principles² have been added to the methodology along with new essential criteria (EC) for each principle that provide more detail and additional criteria (AC) that raise the bar even higher. Altogether, the revised Core Principles (CPs) now contain 247 separate essential and additional criteria against which a supervisory agency may now be assessed. In particular, the revised BCPs strengthen the requirements for supervisors and the approaches to supervision and supervisors' expectations of banks, further focusing on effectiveness. While the BCPs set out the powers that supervisors should have to address safety and soundness concerns, there is a heightened focus on the actual use of the powers in a forward-looking approach through early intervention.

4. Mexico chose to be assessed and graded against Essential Criteria only. The 2012 methodology provides three options for assessment: (i) assessed and graded against only ECs, (ii) assessed against both ACs and ECs, but graded only against ECs, or (iii) assessed and graded against both ECs and ACs. In this report, only ECs are described and graded.

5. The assessment team reviewed the framework of laws, rules, and guidance and held extensive meetings with officials of CNBV, and additional meetings with Banxico (Central Bank), and banking sector participants. The authorities provided a self-assessment of the BCPs, as well as responses to additional questionnaires, and facilitated access to supervisory documents and files on a confidential basis as well as staff and systems.

¹ The assessment team comprised Jorge Cayazzo (IMF external expert), and Juan Ortiz (World Bank).

² Among the enhancements, a new Core Principle on corporate governance has been added, existing Core Principle on accounting and disclosure is expanded into two new ones dedicated respectively to greater public disclosure and transparency, and enhanced financial reporting and external audit.

6. The team appreciated the cooperation received from the authorities. The team extends its thanks to staff of the authorities, who provided excellent cooperation, including extensive provision of documentation and technical support.

7. The standards were evaluated in the context of Mexico's financial system's sophistication and complexity. The BCPs have been designed to be applied to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, a proportionate approach is adopted within the BCPs, both in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the BCPs must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, and risk profile and cross-border operation of the banks being supervised. In other words, the assessment must consider the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

8. The assessment focuses on the supervision of private banks. Six development banks (DBs) operate in Mexico, of which only two hold deposits from the public (1.9 percent of total deposits), which do not amount to a significant proportion of the system.³ DBs observe most of the legal and regulatory framework to which private banks are subject, either by legal requirement or by CNBV's instructions. Notable exceptions are liquidity requirements (LCR and NSFR) and solvency early warning thresholds (and prompt corrective actions). These exceptions are predicated on the provision of sovereign backstop for capitalization and explicit sovereign guarantees for liabilities. Private banks do not complain about an unlevelled playing field.

9. An assessment of compliance with the BCPs is not, and is not intended to be, an exact science. Reaching conclusions required judgments by the assessment team. Banking systems differ from one country to another, as do their domestic circumstances. Furthermore, banking activities are undergoing rapid change after the Global Financial Crisis, prompting the evolution of thinking on, and practices for, supervision. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the Mexican authorities with an internationally consistent measure of the quality of their banking supervision in relation to the revised BCPs, which are internationally acknowledged as minimum standards.

³ So called "traditional" deposits include from the public sector, non-financial corporations, and households.

INSTITUTIONAL AND MARKET STRUCTURE— OVERVIEW

10. The Mexican financial system is regulated and supervised by a number of institutions: the Ministry of Finance and Public Credit (SHCP), Banxico, CNBV, the Bank Deposit Insurance and Resolution Agency (IPAB), the National Insurance and Sureties Commission (CNSF), the National Commission for Savings for Retirement (CONSAR) and the National Commission for Financial Services Consumer Protection (CONDUSEF). SHCP is responsible for planning, coordinating, evaluating, and monitoring the banking system. Banxico's mandate is to promote the sound development of the financial system, foster the proper functioning of payment systems and protect the interest of the public, in addition to its priority objective of ensuring the stability of the currency's purchasing power. Banxico is the reserve bank and lender of last resort for credit institutions. IPAB guarantees savers' deposits in banking institutions and is the bank resolution authority. CONSAR and CNSF monitor and regulate the institutions that make up the financial system within the scope of their respective mandate: CONSAR supervises the companies managing retirement funds, and CNSF supervises the insurance and sureties institutions. CONDUSEF is the customer protection authority, responsible for the protection and defense of the rights of users of financial services.

11. The mandate of CNBV is to supervise and regulate, within its remit, the entities that make up the Mexican financial system, as described in the Law of Credit Institutions (LIC) and other relevant laws concerning financial institutions. According to its statute (CNBV Law) its main goal is to ensure their stability and proper functioning, as well as to maintain and promote the sound and balanced development of the financial system as a whole, in order to protect the interest of the public. The main sectors supervised and regulated by CNBV are:

- **Private banks** (Instituciones de Banca Múltiple). At present 50 commercial banks operate in Mexico, which CNBV groups in six categories for supervisory purposes: G-7, or the seven largest banks (of which 6 are domestic systematically important banks, or D-SIBs); eight medium-sized commercial; 14 small commercial; seven specialized in credit to households; four specialized in foreign exchange; and 10 investment banks. The total assets of private banks as of December 2021 amounted to MXN11,078 billion, or more than half of the total assets of the regulated sectors supervised by CNBV, equivalent to 42.2 percent of gross domestic product (GDP). The share of total assets the 21 Mexican foreign-owned banks amounted to 67 percent.
- **Investment funds.** 616 funds in operation, with total assets of 2,816 billion (10.7 percent of GDP).
- **Development Banks and Development Funds and Trusts.** Made up of 6 development banking institutions, the National Development Finance and 6 Trusts. Together they hold assets of MXN2,555 billion (9.7 percent of GDP). Just two DBs accept deposits representing 1.9 percent of total deposits from the public.⁴

⁴ It includes public sector institutions, households, and corporates.

- **Social Service Organizations.** Three entities that manage MXN2,149 billion (8.2 percent of GDP). They seek to facilitate workers financing for housing (purchase, repair, or improvement) or acquisition of goods and services. These organizations are financed through workers' contributions, loans from commercial and development banks, and securitization schemes.
- **Brokerage Houses.** Currently 36 brokers operate in Mexico. CNBV groups them in four categories: G6, or the 6 largest; Intermediation; Money market; and Limited activity. They hold assets of MXN 862 billion (3.3 percent of GDP).
- **Popular Savings and Credit Entities.** Made up of 155 Savings and Loan Cooperative Societies (SOCAPs), 82 Credit Unions, and 40 Popular Financing Societies (SOFIPOs). They hold total assets of MXN309 billion (1.2 percent of GDP).
- **Regulated Multiple Purpose Financial Companies (SOFOMs).** Divided in two groups depending on whether they are part of consolidated banking (14 entities) or not (29 independent entities). Together they have assets of MXN604 billion (2.3 percent of GDP).
- **Auxiliary Credit Organizations and Activities (OAAC).** 16 General Deposit Warehouses and 7 Exchange Houses that, combined, hold assets for MXN29 billion (0.1 percent of GDP).

As of December 2021, CNBV authorized 24 Fintech companies, of which 14 are electronic payment fund institutions and 10 collective funding institutions.

Table 1. Mexico: Total Assets of the Mexican Regulated System (As of December 2021)

Type	Volume (MXN billion)	Share (Percent)
Private banks (50)	11,078	54.3
Investment funds (616)	2,816	13.8
Development Banks and Development Funds (6 + 7)	2,555	12.5
Social Service Organizations (3)	2,149	10.5
Brokerage Houses (36)	862	4.2
Popular Savings and Credit Entities (273)	309	1.5
Regulated Multiple Purpose Financial Companies (43)	604	3
Auxiliary Credit Organizations and Activities (OAAC) (23)	29	0.2
Total	20,403	100.0

Source: Mexican financial authorities.

12. As of March 2021, the assets of commercial banks totaled MXN10.95 trillion, 9.2 percent smaller in real terms than March 2020. This reduction was mostly produced by the decline in economic activity produced by the COVID-19 pandemic, which appears to have started to show a gradual improvement.

13. The level of capitalization and the liquidity position of commercial banks is robust and have improved recently. Capital ratios improved due to strong profitability and pandemic-linked

suspension of dividend payouts,⁵ standing at 19.5 percent as of December 2021. This strong capital position also reflects the regulatory adjustment through which capital requirements were reduced for some credit segments (consumer, mortgages, and SMEs) as part of the adoption of Basel III standards; the decline in lending activity, which reduced the growth of risk-weighted assets, and the strengthening of the net capital by internal means. Mexican banks also managed to maintain an adequate liquidity position: in March 2022, the sector's median LCR was 233.4 percent.

14. Mexican banks are profitable; profitability in terms of ROE, which, suffered a reduction in 2020, due to the drop in the interest income and the larger preventive credit risk provisions appears to be recovering. Accumulated profit as of December 2021 totaled MXN182 million, 65.7 percent higher in real terms compared to the same period of 2020—the ROE reached levels of 14.6 percent in December 2021 (9.0 percent in December 2020). Two years after the start of the pandemic the solid solvency and liquidity conditions of the Mexican banking system allowed it not only to face the difficulties of the economic crisis without exacerbating it, but also to contribute to maintaining the stability of the system and return to the country's path of economic growth. It will also be crucial to weather the trends in macroeconomic conditions; namely the acceleration of inflation and the consequent increase in interest rates and their expectations; the continued weakness of investment; and the reactivation of economic activities at a level closer to that observed before the pandemic in the face of the significant reduction in COVID-19 cases.

15. CNBV adopted a number of regulatory measures related to COVID-19.⁶ In summary, the CNBV issued appropriate accounting flexibilities for credit institutions to provide payment facilities to clients who have taken consumer, mortgage and commercial loans that were fully performing as of February 28, 2020, these special accounting criteria was in place from April 2020 to July 2020. In a second phase, as the initial flexibilities came to an end, Mexican banks had the option to restructure or refinance—only once—credits (excluding to related parties) outstanding on April 31, 2020, applying the so-called “Covid additional accounting facilities.” Banks had to reassess ability to pay, as well as the new expected credit loss, and the new operations formalized no later than January 31, 2021. The regulations detailed risk classification and provisioning rules, which allowed to defer and prorate new allowances in 12 months; concessions to creditors (lower installments, longer maturity, or partial write-offs) could also be prorated. Possible surplus provisions could not be recognized as profits but as a new reserve to be used for future allowance for credit losses or to offset concessions. The new operations had to be reported to CNBV, and disclosed in the financial statement, including their impact on provisions and capital.

⁵ On March 31, 2020, CNBV recommended banking institutions not to pay dividends, carry out share buy-backs or conduct any other mechanism aimed at remunerating shareholders. Any banking institution or their respective financial group that intended not to follow this recommendation, must give written notice to CNBV, in order to make public said decision and its reasons. On April 19, 2021, CNBV issued a recommendation to private banks allowing the distribution of up to 25 percent of the combined net profits of 2019 and 2020, provided that, among other conditions, banks maintain at least a 13 percent capital ratio and that distribution by D-SIBs is consistent with their strategy to meet the TLAC requirements.

⁶ Regulations approved in the form of ‘oficios,’ issued by CNBV during April, September, and October 2020.

16. Private banks' credit portfolio amounted, as of December 2021, to MXN 5,549 billion. Credit to the private sector is recovering slowly and has not yet reached pre-pandemic levels, albeit not homogeneously. The strongest demand is from households, mainly consumer credit and housing, whereas credit to firms continues to drop. At the same time, the delinquency rate (IMOR) has been decreasing after reaching a peak in January 2021 (2.7 percent), ending December 2021 at 2.1 percent. The adjusted delinquency rate (IMORA) that includes write-offs went from 5.3 percent to 4.5 percent in the referred months.

PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION⁷

A. Soundness and Sustainability of Macroeconomic Policy

17. Mexico's fiscal framework contemplates different legal instruments and coordination mechanisms with a view to ensuring a responsible and sound fiscal policy. First, to guarantee the prudent management of the public debt, Article 73 of the Political Constitution of the United Mexican States (CPEUM or Constitution), states that the debt can only be used to finance productive infrastructure. This prevents any undesirable use of the debt, while limiting its use to activities that produce, directly or indirectly, an increase in public revenue. Second, Article 17 of the Federal Budget and Treasury Responsibility Law establishes the principle of balanced budget, aimed at ensuring a zero public deficit, and identifies clear circumstances and criteria to anticipate and solve any possible extraordinary deficit. In addition, the legislative has to approve the budget and the maximum debt ceilings.

18. A rich set of macroprudential tools has helped build resilience. Capital and liquidity tools and D-SIB buffers were introduced in line with Basel requirements (Table 11). A core funding ratio in FX has been effective for banks to manage FX risks. Measures to reduce vulnerabilities from exposures to related parties or liquidity risks in investment funds (e.g., swing pricing, redemption fees) are in place. The authorities could consider expanding the toolkit and enhancing its time-varying use. Plans for finalizing and publishing a guideline for the countercyclical capital buffer (CCyB) are welcome and action at the current early stage of the financial cycle would be helpful. Indeed, with no evidence of credit and housing booms, introducing limits on loan-to-value and debt-service-to-income ratios could be considered as a medium-term agenda to build the resilience of the financial system preemptively.

19. Banxico carries out a sound monetary policy and promotes the sound development of the financial system and fosters the proper functioning of the payment systems (Articles 28 of the CPEUM and Articles 1 and 2 of the Bank of Mexico Law). The operation of Banxico is conducive to the conservation of the purchasing power of the national currency. Banxico uses various tools to achieve its mandates and purposes that may have an impact on the structure or operations of

⁷ The preconditions are not assessed. Topics discussed in this section are drawn from other documents, such as Article IV report and other FSAP documents.

banking institutions. To achieve the appropriate level of the overnight interbank interest rate, Banxico uses different short- and long-term instruments to manage the liquidity of the financial system. Under normal conditions, the Central Bank seeks to offset the excess or lack of liquidity to prevent an impact on the interest rates of the money market and eventually on inflation. Banxico has several layers of liquidity providing facilities in place to address different levels of liquidity stress. First, to ease the potential liquidity pressures in the payment system, an intraday funding facility in the form of intraday repo operations, has been put in place. Second, a collateralized overnight overdraft facility, against banks' deposits in the central bank, or in the form of repo, is a backstop for liquidity shocks banks may experience at the end of the day up to a limit, equal to the amount of Monetary Regulation Deposits (DRM). Third, the Ordinary Additional Liquidity Facility, or FLAO is provided during the day, to address temporary and short-term liquidity needs. The FLAO has a higher funding cost than the reference rate and needs a special request to Banxico to be used. Banxico calculates and discloses to the general public the Interbank Equilibrium Interest Rate (TIIE) for different terms (overnight, month, three months, and six months), which is used as a benchmark by banks, and it is transaction-based. Also, its methodology is in full compliance with the IOSCO principles on financial benchmarks.

B. Financial Stability Policy Framework

20. The Macroprudential mandate is shared between the agencies that have legal powers and macroprudential tools. The Financial System Stability Council (CESF) has an explicit, formal mandate to promote the stability of the financial system. It comprises nine voting members: the finance minister (Chair) and the deputy minister; the Banxico governor and two deputy governors; the heads of three supervisors (CNBV, CNSF, CONSAR); and the chief executive of IPAB. The CESF does not have regulatory hard powers; instead, when a potential risk is identified, it makes recommendations coupled with a de facto comply or explain mechanism and coordinates the measures and actions that each authority may adopt, within the scope of their respective responsibilities and powers. The presidency of the Council rests with SHCP and its secretariat with Banxico. The CESF is supported by a Technical Committee, which analyzes possible threats to the financial system and prepares proposals and recommendations. In March 2020, the CESF created the Sustainable Finance Committee to analyze risks arising from climate change for the stability of the financial system. The CESF is mandated to meet at least once every quarter and publishes a press releases following each meeting and an annual report on the stability of the financial system to communicate to the public its risk assessments and policy intentions.

C. Public Infrastructure

21. The Mexican financial system operates under a legal framework that provides legal certainty to financial institutions. The Constitution instructs the State to ensure the stability of public finances and the financial system and to help generate favorable conditions for economic growth and jobs. A number of laws implement the constitutional mandate: (i) A first subset establishes the powers of the financial authorities in matters of policy, supervision, regulation and protection of the financial system and consumers. (ii) The second subset of financial laws and implementing regulations governs the operations and functioning of the intermediaries and

participants in the financial system. (iii) Finally, the commercial and mercantile laws help maintain a coherent interpretation of financial laws vis-à-vis general provisions from other laws, such as economic competition, tax issues, or commercial companies.

22. Mexico has implemented a comprehensive and well-defined accounting framework based on the IAS and IFRS standards. Mexico has adopted IFRS Standards for all listed companies other than financial institutions and insurance companies—which use Mexican reporting standards—since January 2012. This applies both to entities that prepare consolidated financial statements and to entities that are not required to prepare consolidated financial information. The Mexican Council for Financial Information Standards (CINIF) is the independent body that issues accounting regulations in Mexico, which are aligned with international standards. The accounting standard setter for Mexican financial institutions is CNBV, which issues rules generally aligned to the IFRS, and in some standards directly applying those issued by the CINIF by supplementation.

23. External audits are widespread in Mexico. Financial statements of listed companies, as well as certain sectors (financial, steel, industrialized food, automotive, energy, pharmaceutical, financial, mining and retail sales, among others) must be reviewed by external auditors. CNBV regulates the audit profession through the Consolidated External Audit Regulation (Circular Única de Auditores Externos, CUAE) which covers the rules for audit work, hiring of auditors, requirements, and certification of auditor. Additionally, CNBV regulates the certification of compliance officers and external auditors in matters of AML/CFT.

24. The payment systems, which are operated and regulated by Banxico, run smoothly in Mexico. The mandate of Banxico includes fostering the proper functioning of the payment systems. Banxico operates high value payment systems such as the Banco de México Account Holder Service System (SIAC) and the Interbank Electronic Payment System (SPEI), as well as low value payment systems such as Digital Collection (CoDi). The Board of Governors of Banxico adopted in January 2001 the Basic Principles for Systemically Important Payment Systems. Banxico regulates systemically important payment systems and yearly publishes the list of systems that meet those characteristics. However, the oversight of the SPEI payment system could be strengthened by establishing a more formalized oversight function for the SPEI system, improving transparency, and addressing some gaps identified through the CPMI-IOSCO PFMI implementation monitoring exercise.

25. Customers of financial services are protected by the Law for the protection and defense of the user of financial services, which is policed by CONDUSEF.

26. Mexico is reforming its civil and commercial justice system to enhance the resolution of commercial disputes by increasing the scope of oral procedures to resolve commercial disputes. However, most civil and commercial cases are still handled using the unreformed justice system, which faces shortcomings.

D. Crisis Management, Recovery, Resolution and Appropriate Level of Systemic Protection

27. The authorities have strengthened the financial safety net since the last FSAP and need to continue and accelerate enhancements. Recovery and resolution plans are in place for all commercial banks, D-SIBs are required to increase their loss absorbency complementing the critical Basel III reforms that the authorities have advanced, and the authorities progressed preparations for using the bridge bank tool, signed cooperation agreements with all major home jurisdictions of the Mexican systemic banks, clarified the emergency lending facilities including to banks in resolution. IPAB gained experience with its improved deposit payout and communication capabilities under challenging COVID-19 circumstances, with innovative solutions, including cardless ATM payouts.

28. Further enhancement of the resolution regime would enhance financial stability and give the Mexican financial authorities more flexibility and reduce the costs of resolution measures. The regime includes a range of resolution options, including administrative liquidation. Bail-in powers are the missing component and should be introduced while appropriately protecting creditors; the creditor hierarchy should be revised to make the newly introduced requirements for banks' loss-absorbing capacity more effective. The foregoing would ensure that shareholders and unsecured and uninsured creditors absorb losses prior to using public funds. Furthermore, the authorities should trigger resolution when they deem a bank 'nonviable' instead of waiting for certain quantitative thresholds to be met. Moreover, the authorities should remove barriers to the effective use of two critical resolution tools: purchase and assumption transactions; and bridge banks. A (partial) purchase and assumption transaction with a bridge bank—likely preceded by bail-in—will need to become the primary resolution strategy for systemic banks instead of open bank assistance. Lastly, financial holding companies dominate the Mexican financial system and should be brought under the resolution regime, which would address build-in contagion risk and reduce the risk of concurrently applying diverging liquidation procedures for distressed group members.

29. As the Mexican financial authorities have been operationalizing important past reforms to the recovery and resolution framework, deficiencies in banks' recovery plans and impediments to banks' resolvability have become clearer and need solving. The resolution authority does not have the power to remove impediments to banks' resolvability, such as changes in banks' business practices, structure, or organization, to reduce the complexity and cost of resolution, and to ensure that critical functions can be segregated legally and operationally. Therefore, it should continue to identify impediments to resolvability and measures to mitigate these impediments—while shortening the resolution planning cycle for systemic and mid-size banks—and clearly articulate and discuss with banks the resolution capabilities that they should develop to effectively support their orderly resolution as planned by the resolution authority. While awaiting statutory powers for the resolution authority to remove impediments to banks' resolvability, the banking supervisor should actively support this process.

30. The Mexican financial authorities should continue to increase the deposit insurance fund for an effective and prompt response to the concurrent failures of larger banks. Despite

the legacy debt from the 1990s financial crisis weighing heavily on its finances, the resolution and deposit insurance agency has built a fund that could cover the resolution and payout of most smaller banks. The authorities project that the deposit insurance fund will reach 3.4 percent of insured deposits in 2027 and 5.1 percent in 2032, which would position it better for the concurrent failures of several of the largest non-systemic banks.

MAIN FINDINGS

31. The FSAP has collected and reviewed information on all 29 BCPs. The last full BCP assessment was carried out in 2012 under the 2006 methodology and resulted in a broadly positive evaluation, with only two principles categorized as materially non-compliant or non-compliant (i.e., independence and legal protection, operational risk). Subsequently, the 2016 FSAP recommended strengthening the independence and budgetary autonomy of CNBV, providing effective legal protection for supervisors, and enhancing CNBV's ability to perform consolidated supervision.

32. There is ample room for improving the risk-based supervisory approach. CNBV updated its risk-based rating methodology (CEFER) in November 2015, and it has been the cornerstone of the supervisory approach since then. Some progress on supervisory techniques and methodologies has been achieved, particularly concerning quantitative techniques to assess banks' risk exposures and vulnerabilities. However, with a few sensible refinements, the CEFER methodology could be turned into a sharper instrument upon which risk-based supervision would hinge.

33. Prospects for issuing amended regulations on large exposures are welcome. This amendment has been delayed due to the COVID-19 outbreak and is expected to be issued by 2022. The revised regulation includes new definitions and revised limits for "common risk" and "related parties" which will be more aligned with Basel III standards and best international practices.

34. CNBV is yet to establish an effective consolidated supervision framework. The issuance of the Financial Groups Law (LRAF) in 2014 has increased CNBV's powers to exercise consolidated supervision, but it falls short of ensuring effective implementation. Financial Holding Companies (FHCs) are actively operating in Mexico but fall out of the current consolidated supervisory umbrella. This gap is also important from an AML/CFT supervision perspective. To strengthen the consolidated supervision, the authorities could consider: (i) Making the application of the consolidated supervision legal framework mandatory for those financial groups operating in Mexico; (ii) introducing legal amendments to grant the authorities the legal power to impose a set of prudential regulations at group level, or (iii) amending the current legal framework so that the perimeter of the consolidated supervisory framework could be discretionally determined by the authorities.

DETAILED ASSESSMENT

35. The assessment of compliance of each principle is made based on the following four-grade scale: compliant, largely compliant, materially non-compliant, and non-compliant. A “not applicable” grading can be used under certain circumstances.

- **Compliant:** a country will be considered compliant with a Principle when all essential criteria⁸ applicable for this country are met without any significant deficiencies. There may be instances, of course, where a country can demonstrate that the Principle has been achieved by other means. Conversely, due to the specific conditions in individual countries, the essential criteria may not always be sufficient to achieve the objective of the Principle, and therefore other measures may also be needed in order for the aspect of banking supervision addressed by the Principle to be considered effective.
- **Largely compliant:** A country will be considered largely compliant with a Principle whenever only minor shortcomings are observed that do not raise any concerns about the authority’s ability and clear intent to achieve full compliance with the Principle within a prescribed period of time. The assessment “largely compliant” can be used when the system does not meet all essential criteria, but the overall effectiveness is sufficiently good, and no material risks are left unaddressed.
- **Materially non-compliant:** A country will be considered materially non-compliant with a Principle whenever there are severe shortcomings, despite the existence of formal rules, regulations and procedures, and there is evidence that supervision has clearly not been effective, that practical implementation is weak, or that the shortcomings are sufficient to raise doubts about the authority’s ability to achieve compliance. It is acknowledged that the “gap” between “largely compliant” and “materially non-compliant” is wide, and that the choice may be difficult. On the other hand, the intention has been to force the assessors to make a clear statement.
- **Non-compliant:** A country will be considered non-compliant with a Principle whenever there has been no substantive implementation of the Principle, several essential criteria are not complied with, or supervision is manifestly ineffective.

36. In addition, a Principle will be considered not applicable when, in the view of the assessors, the Principle does not apply given the structural, legal and institutional features of a country.

⁸ For the purpose of grading, references to the term “essential criteria” in this paragraph would include additional criteria in the case of a country that has volunteered to be assessed and graded against the additional criteria.

A. Supervisory Powers, Responsibilities, and Functions

Principle 1	Responsibilities, objectives, and powers. An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. ⁹ A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns. ¹⁰
Essential criteria	
EC1	The responsibilities and objectives of each of the authorities involved in banking supervision ¹¹ are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings of EC1	<p>The Mexican banking system is regulated by three main governmental agencies: the National Banking and Securities Commission (CNBV), the Bank of Mexico (Banxico) as the Mexican central bank, and the Ministry of Finance and Public Credit (SHCP) as the ministry within the executive branch in charge of regulating financial institutions.</p> <p>The main bank regulator in Mexico is CNBV, which is an independent agency of SHCP¹². Among its many roles and functions, it serves as the primary supervisory authority over banking activity and regulates the organization and operation of banking institutions. Its responsibilities and objectives are clearly set in Art. 117 of the Credit Institutions Law (LIC), which is the main body of law governing banks and their transactions. The role, authority, and obligations of CNBV are clearly described in CNBV Law (<i>Ley de la Comisión Nacional Bancaria y de Valores</i>.)</p> <p>In addition to the LIC as the main body of banking law, there is an additional regulation that is of importance for banking institutions: the general rules applicable to banks issued by CNBV (compiled in the Single Banking Circular, known as CUB: Circular Única de Bancos).</p> <p>Banxico is an autonomous body created by constitutional mandate. The main purpose of the Central Bank is to provide Mexico's economy with its national currency. In complying with such purpose, it also has as a primary objective to promote the sound development of</p>

⁹ In this document, “banking group” includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example nonbank (including non-financial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

¹⁰ The activities of authorising banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

¹¹ CNBV is called “the supervisor” throughout this paper, except where the longer form “the banking supervisor” has been necessary for clarification.

¹² Or ‘*desconcentradas*’. In Mexico these agencies have limited decision-making powers and can manage their budget and assets autonomously, but within the hierarchical structure of government; in short, they are technically—but not budgetary—autonomous. Conversely, ‘*descentralizadas*’ institutions (Banxico, for instance), are technically and budgetary autonomous.

	<p>the financial system and foster the proper functioning of the payment systems within Mexico. The role, authority, and obligations of the Central Bank are clearly set out in the <i>Ley del Banco de México</i>.</p> <p>SHCP has the authority to issue rules to develop the provisions of the LIC. One of the main functions of SHCP is to issue anti-money laundering rules, to license development banking institutions, and to authorize the formation of financial groups for consolidated supervision purposes. The integration of additional financial entities into an already-formed financial group also requires the authorization of SHCP.</p> <p>Additionally, IPAB (Institute for the Protection of Bank Savings) is the bank resolution authority in Mexico and CONDUSEF (National Commission for the Protection and Defense of Users of Financial Services) protects financial services customers.</p> <p>The overall legal framework, as well as the set of regulations enacted for its implementation by the industry are very comprehensive and available on the websites of CNBV, Banxico, and SHCP.</p>
EC 2	The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.
Description and findings of EC2	<p>According to its Art. 1, the LIC (the main body of banking regulation) is a public order Law of general observance within the United Mexican States and its purpose is to regulate the banking and credit service, the organization and operation of credit institutions, the activities and transactions that these institutions may carry out, their sound and balanced development, the protection of the public interest and the terms in which the State shall conduct the financial governance of the Mexican Banking System.</p> <p>In terms of its primary objective, Art. 2 of CNBV Law establishes that the mandate of CNBV is to ensure the stability and adequate operation of the financial system, and to foster its sound and balanced development, while protecting the interests of the public. To that end, CNBV is empowered with supervision and regulation of financial institutions.</p> <p>The assessors have evidence that the CNBV clearly considers financial stability the main objective guiding its activities, while the protection of the interests of the public is fulfilled by promoting the financial safety of supervised institutions, being therefore subordinated to the financial stability objective.</p>
EC3	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile ¹³ and systemic importance. ¹⁴
Description and findings of EC3	Article 117 of the LIC governs the general obligation of banking institutions regarding the observance of prudential regulations. It also establishes CNBV's regulatory powers. Using

¹³ In this document, "risk profile" refers to the nature and scale of the risk exposures undertaken by a bank.

¹⁴ In this document, "systemic importance" is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.

	<p>these powers, CNBV issues and amends periodically a broad set of prudential regulations, which have been compiled in the CUB, which covers all relevant prudential matters. Likewise, CNBV may establish any additional requirement to specific banks if deemed necessary because of deficiencies in aspects such as: composition of capital and assets, quality of internal control systems, risk exposure, risk management and failures or weakness in processes or policies for the recognition of specific risks, etc. (Article 2 bis 117, of the CUB).</p> <p>In addition, Article 74 of the LIC sets that for the protection of the interests of the saving public, of the payments systems, and to ensure the solvency, liquidity, or stability of the commercial banks, CNBV may require additional capital requirements for individual banks, if deemed necessary for prudential considerations.</p> <p>However, supervisory powers to impose prudential measures only apply on individual basis from the bank downwards and do not encompass banking groups operating in Mexico.¹⁵ The Law on Financial Groups (LRAF) regulates financial conglomerates and empowers SHCP to request relevant information to authorize the registration of the leading financial holding company to be subject to consolidated supervision at group level. However, this legal arrangement is insufficient to warrant effective consolidated supervision due to:</p> <p>(a) <i>Several domestic financial conglomerates fall out of the scope of the current legal arrangements for consolidated supervision.</i> Financial conglomerates can legally exist only if they request on a voluntarily basis being authorized by SHCP to operate as such. Most of the financial conglomerates operating in Mexico are structured as authorized financial groups. However, at the time of this assessment, there were 7 domestic financial conglomerates that have not requested being authorized by SHCP to operate as such. Accordingly, these groups are not subject to consolidated supervision. Some of these <i>de-facto</i> financial conglomerates not only are very active in the domestic financial market but are also actively operating in various Latin-American countries through banks owned by the same holding company under the same brand. The share of total bank deposits of the banks belonging to non-supervised financial groups amounts to around 4 percent.</p> <p>(b) <i>Financial conglomerates authorized by SHCP to operate as such are not subject to effective consolidated supervision.</i> Authorized financial groups are required to report financials on a consolidated basis but are not subject to prudential requirements on a consolidated basis. This is because the current legal arrangement is primarily aimed at gathering consolidated information regarding the activities carried out by financial conglomerates, while the authorities are not empowered to apply prudential regulation at group level, which is a fundamental prudential piece for effective consolidated supervision.</p> <p>Additionally, the current legal arrangement needs to be amended to allow for an effective and empowered lead supervisor of authorized financial conglomerates. Current legal arrangement allows the responsible supervisor only to gather information from other authorities and coordinate specific supervisory actions, which prevents the responsible</p>
--	--

¹⁵ This shortcoming is further detailed in BCP 12 on Consolidated Supervision.

	supervisor from autonomously designing an applying supervisory actions to all the components of the groups.
EC4	Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.
Description and findings of EC4	<p>Prudential standards are updated following the adoption agenda set by the BCBS. As members of the Committee, the Mexican financial authorities are committed to implement and apply BCBS standards in Mexico to promote the stability and resilience of the financial system.</p> <p>The LIC establishes the need for, and gives CNBV powers to, issue the prudential secondary regulations required to supervise the banking system effectively. Regulating topics related to Banxico mandate, such as capital, needs consultation with central bank. Liquidity requirements are a joint power between Banxico and CNBV.</p> <p>Accordingly, CNBV's regulatory norms have been in practice continuously updated to ensure that they remain effective and relevant to the changing economic environment and international best practices.</p> <p>There is a public entity responsible for the public disclosure and consultation of regulatory proposals (CONAMER, or National Commission for Regulatory Enhancement). In addition, CNBV regularly consults and discusses regulatory proposals with the industry to anticipate potential areas of opportunity and to receive industry feedback.</p>
EC5	<p>The supervisor has the power to:</p> <ul style="list-style-type: none"> (a) have full access to banks' and banking groups' Boards, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations; (b) review the overall activities of a banking group, both domestic and cross-border; and (c) Supervise the activities of foreign banks incorporated in its jurisdiction.
Description and findings of EC5	<ul style="list-style-type: none"> (a) Article 97 of the LIC grants powers to the financial authorities, including CNBV, to request information from supervised institutions and allows for information sharing among the authorities. This power is deemed sufficient and is exercised without any restrictions, including to address board members, management, and staff. Information on banking conglomerates not subject to consolidated supervision is not available and CNBV lacks the legal power to require it. (b) CNBV has the power to only supervise the activities of regulated financial conglomerates, about which there is a good understanding of their structure and activities. However, it should be noted that some few domestic regulated financial conglomerates are also part of a broader mixed-activity group. Mixed-activity groups are not regulated in Mexico, hence CNBV has no direct access to their activities. In most cases these groups have either a nonregulated mixed-activity holding company placed above a regulated institution, or a series of companies, which control both financial and nonfinancial entities. As mentioned, the information about the activities of non-regulated financial conglomerates is not available to CNBV. (c) The financial regulatory laws permit the entry of non-Mexican financial groups and financial intermediaries, through Mexican subsidiaries, to engage in various activities

	<p>in the Mexican financial system, including banking, securities, and insurance activities. In fact, foreign banks mainly from developed countries are operating in the country and hold a central place in the Mexican financial sector. The law prescribes that prudential regulations and supervisory powers over foreign banks are the same as domestic institutions.</p>
EC6	<p>When, in a supervisor's judgment, a bank is not complying with laws or regulations, or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the bank or the banking system, the supervisor has the power to:</p> <ul style="list-style-type: none"> (a) take (and/or require a bank to take) timely corrective action. (b) impose a range of sanctions. (c) revoke the bank's license. (d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.
Description and findings of EC6	<p>CNBV enjoys an ample range of legal powers set out in the LIC to address noncompliance and mismanagement issues. These powers include, among others, imposing limitations on dividend payments, limitations on operations, as well as changes in management. Sanctioning powers include mandatory fines for serious law violations and also encompass imposing fines on individuals such as bank directors and managers.</p> <p>The regulation sets trigger points for implementation of corrective action in case of declining capital levels and liquidity. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements.</p> <p>CNBV has established a corrective and remedial regime that facilitates timely corrective actions. Remedial measures range from informal instructions directing a particular response by management, to the severe action of intervention and, if needed, liquidation (through the suspension of the institution's license), in which case MOUs with other relevant authorities are activated to coordinate and facilitate the resolution of the bank. The supervisory letters reviewed by the assessors show that these powers are used in practice.</p>
EC7	<p>The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.</p>
Description and findings of EC7	<p>As mentioned on EC3 and EC5, CNBV is empowered to review the activities of parent companies and affiliates of parent companies only in case of regulated financial conglomerates. Hence, in the case of non-regulated financial conglomerates, as well as mixed groups with a non-regulated portion of its activities, the authorities do not have access to their activities and related information.</p>
Assessment of Principle 1	Largely Compliant
Comments	<p>The opinion of the assessors is that compliance with the essential conditions of this CP has been achieved. However, compliance may be further enhanced by implementing an affective consolidated supervision framework by means of:</p>

	<p>(a) Making the application of the consolidated supervision legal framework mandatory for those financial groups operating in Mexico.</p> <p>(b) Introducing legal amendments to grant the authorities the legal power to impose a set of prudential regulations at group level.</p> <p>(c) Amending the current legal framework so that the perimeter of the consolidated supervisory framework could be discretionally determined by the authorities.</p>
Principle 2	Independence, accountability, resourcing, and legal protection for supervisors. The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.
Essential criteria	
EC1	The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.
Description and findings of EC1	<p>CNBV's governance, powers, accountability, and supervisory authority are derived from its law. Being part of the Federal Government, CNBV is subject to surveillance and control by the Secretariat of Civil Service ('Secretaría de la Función Pública'—SFP). CNBV is a <i>deconcentrated</i> body of SHCP, with formal technical autonomy and executive powers (CNBV's Law, Article 1).</p> <p>CNBV's Board has 13 members, of which SHCP has direct authority to nominate or remove 10 at its discretion, including the President of the Commission. By Law, the president of CNBV is appointed by SHCP, and its vice-presidents and general directors are appointed by the Board upon the president's nomination.</p>
EC2	The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.
Description and findings of EC2	The president and vice-presidents of CNBV are not appointed for a specific term. The Minister of Finance and Public Credit can remove them without specific reasons (CNBV's Law Article 14). In addition, CNBV senior staff, such as directors, can be removed at the sole discretion of the president of CNBV, with no obligation disclosing the reasons for removal.
EC3	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives. ¹⁶

¹⁶ Please refer to Principle 1, Essential Criterion 1.

Description and findings of EC3	<p>CNBV's objectives are defined in its law (Article 2) and guide its overall operations. CNBV publishes an annual report of its activities and is held accountable through the oversight powers of the General Audit of SHCP and the SFP (Ministry of civil service).</p> <p>Additionally, CNBV has a Strategic Plan containing long-term objectives and specific lines of action concerning its financial stability mandate and main responsibilities, which is not available to the general public.</p>
EC4	<p>The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.</p>
Description and findings of EC4	<p>CNBV has administrative bodies and units for the processing and resolution of matters within its competence, whose powers are established in CNBV Law. Article 10 establishes the bases for the organization of CNBV. Article 11 states that the Governing Board is composed of ten members plus the President of CNBV, who will also be President of the Board, and two Vice-Presidents of the Commission designated by him. SHCP shall appoint five members; the Bank of Mexico three members; and CONSAR and CNSF, one member each. An alternate shall be appointed for each member. The members must occupy, at least, the position of general director of the Federal Public Administration or its equivalent. The powers and periodicity of sessions of the Governing Board are established in articles 12 and 13; and the appointment, requirements, and powers of the President of CNBV are set out in Articles 12 to 17 of the LCNBV.</p> <p>Articles 6 to 10 of CNBV's Internal Regulations (RICNBV) detail the functions and powers of the Governing Board and establish that the members of the Governing Board shall deliberate freely and may request, where appropriate, that their opinion or individual vote on the matters in question be recorded in the respective minutes, that in all cases must be supported. The members of the Governing Board must excuse themselves for the deliberation of one or more items on the agenda of the sessions of said collegiate body, when there is a legal impediment or conflict of interest that does not allow them to deliberate, resolve or vote, in specific matters.</p> <p>Article 13 of the LCNBV stipulates that the Governing Board shall hold sessions whenever convened by its President and shall meet at least once every two months. There shall be a quorum with the presence of at least seven members of the Board. Resolutions shall be taken by a majority vote of those present, and the President has the casting vote in the event of a tie.</p> <p>CNBV has established an Ethics and Conflicts of Interest Prevention Committee and adopted a Code of Conduct, which is disseminated to all CNBV employees and aims to guide and give full certainty to CNBV's public servants about the ethical behavior they must observe in their daily work.</p> <p>Additionally, the senior management of CNBV defines a medium-term strategic plan, in order to establish objectives and lines of action for the following years, which will govern the strategic projects of CNBV.</p>

	<p>Likewise, the supervisory areas, in coordination with the General Directorate of Supervisory Methods and Processes, define the Annual Supervision Plan and the supervision priorities, which are presented annually to the Governing Board of CNBV. In addition, within CNBV, manuals have been developed to guide the actions of the different areas of CNBV, which are published on the institution's intranet. The operational manuals of the supervisory areas are also published in the Institutional Supervisory Portal (PIN).</p> <p>Routine supervisory actions are approved by managers of CNBV, not requiring board endorsement, facilitating thus the smooth functioning of the supervisory process.</p>
EC5	<p>The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.</p>
Description and findings of EC5	<p>CNBV's staff has credibility among market participants based on high professionalism, competence, and integrity.</p> <p>The General Law on Administrative Responsibilities (Ley General de Responsabilidades Administrativas)¹⁷—a comprehensive code of conduct for public servants—establishes the principles and obligations that govern the actions of public servants, as well as determine serious and non-serious administrative offenses and the sanctions applicable to them. Article 7 establishes that public servants will observe in the performance of their employment the principles of discipline, legality, objectivity, professionalism, honesty, loyalty, impartiality, integrity, accountability, effectiveness, and efficiency that govern public service.</p> <p>The Code of Conduct of CNBV, in its section "Conflict of Interest", states the responsibility to prevent personal, family or business interests from affecting the independent and impartial performance of the job, position, commission or function. Likewise, in section "Transparent and Responsible Use of the Information," the Code states that the information and documentation obtained under the responsibility of the supervisory functions must be safeguarded, preventing and avoiding its improper use, subtraction, reproduction, concealment, or destruction, in accordance with the applicable regulations. Additionally, the Code establishes obligations regarding the confidentiality of information, in which sense the public servant will refrain from disclosing the information or documentation obtained in connection with the supervision activities and the performance of the job, position, commission or function.</p> <p>CNBV has established an Ethics and Prevention of Conflicts of Interest Committee, which among other matters, participates in the resolution of irregularities, non-observances or failures to comply with the Code of Conduct.</p>
EC6	<p>The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes:</p>

¹⁷ <https://www.diputados.gob.mx/LeyesBiblio/pdf/LGRA.pdf>

	<ul style="list-style-type: none"> (a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised. (b) salary scales that allow it to attract and retain qualified staff. (c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks. (d) a budget and program for the regular training of staff. (e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups. (f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g., supervisory colleges).
Description and findings of EC6	<p>CNBV's budget is approved by SHCP and subject to fiscal austerity measures adopted by the federal government. In practice, CNBV has no autonomy to establish/modify its own budget. The budget also relies on supervision fees paid by the regulated entities, but CNBV receives just a fraction from the Government. These fees pay for the supervision that the regulated entities receive (LCNBV, Article 18).</p> <p>The budget of CNBV is allocated each year according to the determination of the general budget of the nation (PEF).</p> <p>The following limitations of the current budgetary legal arrangement have been identified:</p> <ul style="list-style-type: none"> (a) CNBV's dependence on the PEF makes it difficult to create new positions that are required to meet the growing regulatory and supervisory responsibilities. (b) The structure of CNBV's salary scale depends on the authorization of the Federal Government, being comparable in the different dependencies of the federal government, which makes it difficult to attract and retain experienced and qualified personnel, compared to the salary level and benefits offered by the supervised entities. (c) The hiring of external experts to perform supervisory tasks requires the approval of SHCP and, where appropriate, is determined by the annual budget granted to the supervisor. <p>Traditionally this arrangement gave CNBV the ability to carry out its duties with no constraints. However, the 2019 Federal Law of Republican Austerity (that aims to regulate the austerity measures that must be observed in the exercise of federal public spending and is applicable to all agencies, entities, and other bodies that make up the Federal Public Administration), together with the 2021 Law of Public Servant Compensation (that in practice has reduced the salaries of CNBV officials), has affected this ability of CNBV. Therefore, to preserve the effectiveness of supervision, CNBV has had to rearrange its expenditure, prioritizing core activities. As a result, for instance there has been a substantive reduction in training activities and seminars for staff abroad; likewise, the resources for carrying out on-site domestic supervisory activities is quite limited; and the average job tenure of supervisors has dropped from 12.4 years in 2018 to 8.4 years in 2021.</p>

EC7	As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill-sets identified.
Description and findings of EC7	<p>The Internal Regulations of CNBV describe the functions of its three higher levels of the administrative units: (i) President, (ii) Vice Presidents and (iii) General Directors. The functions defined in the aforementioned internal regulation determine professional profiles of the employees within each administrative area.</p> <p>Annually, the administrative area reviews the vacancies and work requirements of each unit, and determines the budget allocations to meet the requirements, subject to budgetary availability.</p> <p>Within each general management unit, the distribution of functions is carried out, considering the experience and skills of the team, to better meet the requirements of regulation, supervision, and analysis.</p> <p>Additionally, there is a process to detect training requirements, which uses two main detecting tools: (i) Training Needs Form ("Training Needs Detection Card"), through which each employee provides information on perceived individual gaps; (ii) institutional consultation for the strengthening of human capital ("Human Capital Strengthening Survey"), which each Director General updates annually, considering the operational and administrative needs of his area. The results of these tools are analyzed by the General Directorate of Organization and Human Resources, which then establishes the Annual Training Plan of CNBV. The objective of the Training Plan is to reduce gaps in terms of knowledge and skills, seeking to improve overall performance, based on new international supervision practices, as well as develop skills to meet new practices, supervisory priorities, and operational requirements of the supervisory areas.</p>
EC8	In determining supervisory programs and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.
Description and findings of EC8	<p>In the preparation of the Annual Supervisory Program (PAS), it is considered the results of the risks and controls resulting from the risk-based supervisory methodology used by CNBV (CEFER), as well as the supervisory priorities and criteria for selecting institutions, taking into account, among others, their systemic importance.</p> <p>The supervisory strategy contained in the PAS is based on a detailed segmentation of on-site and off-site supervision actions, seeking an optimal allocation of supervisory resources, in which the level of supervisory intervention is determined according to the relative risk level of each institution, along with methodologies and criteria that allow establishing the scope and modality of supervision.</p> <p>Supervisory horizontal units have been established to cover risks that require specialized skills, such as cybersecurity, IT and operational risk, risk modelling and stress testing.</p>
EC9	Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.

Description and findings of EC9	<p>Article 271 of the LIC mandates CNBV to provide the services of legal assistance and defense to actual and former managers and staff, in respect to the acts that the individuals referred to above carried out in the exercise of their function.</p> <p>However, legal protection arrangements need to be strengthened. Current arrangements for legal protection include a dedicated fund ('fideicomiso' or trust), which was established with a minimum amount of 30 million pesos to support supervisors being sued. The availability of such resources is commendable but does not ensure that supervisors, management, board members, and staff are truly protected for the bona fide discharge of official functions over time.</p>
Assessment of Principle 2	Materially Non-compliant
Comments	<p>CNBV governance structure results in a direct and significant influence of SHCP on CNBV affairs. The president of CNBV, as well as 5 out of a total of 13 members of CNBV's board, is appointed by SHCP. The remaining members are appointed by Banxico (three), and one each by CONSAR (pensions regulator) and CNSF (insurance regulator). The president and two vice presidents of CNBV are also members of the board. There are no independent members - all members are ex-officio. Moreover, there are no term appointments for CNBV and board members, no legally established reasons for dismissal and no requirements to disclose reasons for dismissal. Historically, changes in Government have resulted in replacing the President and board members of CNBV. Turnover has also been significant among members of the governing board, especially after presidential elections. CNBV has no autonomy to establish/modify its own budget, although supervisory fees collected from institutions have systematically exceeded its budget. CNBV should be granted effective operational independence, with strengthened governance as well as budget autonomy, becoming a decentralized body, in order to allow them to pursue their objectives more effectively. As discussed in EC6, the budget has been reduced by the 2019 Federal Law of Republican Austerity, somehow impacting the execution of some supervisory activities.</p> <p>The law does not grant statutory immunity to CNBV and its personnel for the bona fide discharge of their legal functions and powers; however, other operative protection is granted. Lawsuits against supervisors have been reported to be infrequent. Nonetheless, current legal protection provisions do not mitigate risks of frivolous actions by third parties—staff is not protected against lawsuits for actions taken while discharging their duties in good faith. The legal provisions established under the LCNBV and the LIC require CNBV to provide legal assistance for board members and officers that have discharged their duties according to the law. The assistance is extended to individuals nominated by CNBV to serve as special administrators in banks. Over the last five years there have been several lawsuits against CNBV but none against individuals. Since the establishment of the fund in 2005 there has been only one lawsuit against an individual (2006).</p> <p>Notwithstanding, nothing precludes the industry from filing lawsuits against CNBV supervisors related to actions taken in the course of discharging their duties.</p>
Principle 3	Cooperation and collaboration. Laws, regulations, or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and

	foreign supervisors. These arrangements reflect the need to protect confidential information. ¹⁸
Essential criteria	
EC1	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings of EC1	<p>As for the supervision of the banking institutions, Article 97 of LIC provides for the exchange of information (including confidential information) among SHCP, Banxico, CNBV, the National Commission of the Retirement Savings System (CONSAR), the Institute for the Protection of Bank Savings (IPAB), and the National Commission for the Protection of Users of Financial Services (CONDUSEF).</p> <p>In addition to the above, there are a suite of MOUs signed between CNBV and other financial authorities for supervisory purposes:</p> <ul style="list-style-type: none"> • MOU signed in 2000 for information exchange among SHCP, Banxico, CNBV, and IPAB. • MOU signed in September 2007 between CNBV and IPAB to establish the conditions under which IPAB may request CNBV assistance in verifying the proper management of deposit-insurance-covered liabilities. • MOU signed in October 2008 between CNBV and Banxico to facilitate stronger coordination in information sharing. • MOU signed in June 2012 between CNBV, CONDUSEF and SHCP to facilitate exchange of information and provide technical support in collective actions. • MOU signed in March 2013 between CNBV, CNSF and CONSAR to facilitate effective consolidated supervision of banking groups. • MOU signed in December 2014 between CNBV and IPAB to exchange information. • MOU signed in December 2017 between CNBV and Banxico to facilitate joint examinations between the two institutions. • MOU signed in May 2018 between CNBV, SHCP, CONDUSEF, CONSAR and CNSF to facilitate coordination regarding information security. • MOU signed in July 2020 between CNBV and Banxico to collaborate and exchange information on cybersecurity. <p>There is some evidence that these arrangements have adequately functioned since its inception.</p>
EC2	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work in practice, where necessary.

¹⁸ Principle 3 is developed further in the Principles dealing with “Consolidated supervision” (12), “Home-host relationships” (13) and “Abuse of financial services” (29).

Description and findings of EC2	<p>The law empowers CNBV to exchange information with foreign counterparts based on bilateral MOUs. These MOUs cover not only banking but also securities market activities and provide, among other things, for the exchange of public and nonpublic information, surveillance visits, and the provision of technical assistance. CNBV also participates in the supervisory colleges of large cross-border financial firms that have a significant presence in Mexico.</p> <p>CNBV has been very active on the international cooperation front. More than 80 MOUs have been signed to strengthen cross-border consolidated supervision for banks. The assessors have reviewed the reports of joint inspection visits with home supervisors and the extensive correspondence re information sharing with foreign authorities.</p>
EC3	<p>The supervisor may provide confidential information to another domestic authority or foreign supervisor but must take reasonable steps to determine that any confidential information so released will be used only for bank-specific or system-wide supervisory purposes and will be treated as confidential by the receiving party.</p>
Description and findings of EC3	<p>Article 143 of the LIC establishes that CNBV has the power to provide foreign authorities with the information they may require for the purposes of their supervision. If the information required is protected by banking secrecy, CNBV should require a reciprocity agreement to ensure that the information will be treated with due confidentiality. Similarly, Article 97 of the LIC allows SHCP, CNSF, CONSAR, CNBV, Banco de México, IPAB and CONDUSEF to exchange information (including confidential information).</p> <p>The MOUs subscribed by CNBV contain confidentiality sections indicating that exchanged information must be considered confidential and be used only for the purpose that was requested.</p>
EC4	<p>The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession. In the event that the supervisor is legally compelled to disclose confidential information it has received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information.</p>
Description and findings of EC4	<p>Article 143 of the LIC establishes that CNBV and the Bank of Mexico may refrain from providing the information when the intended use of it is different from that for which it has been requested, is contrary to public order, national security or the terms agreed in the MOU.</p> <p>The MOUs subscribed to by CNBV include a provision stating that any confidential information received from another supervisor will be treated as confidential and will be used exclusively for supervisory purposes. When the authority receiving the information wishes to transmit the information obtained pursuant to the MOU to a third party, or to</p>

	use it for a purpose other than that indicated in the original request, prior consent or permission from the authority should be granted.
EC5	Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.
Description and findings of EC5	<p>CNBV establishes that all commercial banks must have a recovery plan approved by CNBV, after obtaining the opinion of SHCP, IPAB and Banxico, which details the actions it will carry out to restore its financial situation, in the face of adverse scenarios that could affect its solvency or liquidity and that must comply with minimum requirements (Article 119 of the LIC and Articles 68, 172 Bis 37, 172 Bis 38, 172 Bis 39 and Annex 69 of the CUB). IPAB and Banxico may ask CNBV to require banks to update their recovery plans. Additionally, CNBV may request the realization of simulations of execution of the recovery plans, and, depending on the results of said drills, it may request changes to the plan if deemed necessary for its effectiveness.</p> <p>CNBV is empowered to revoke banking licenses. In particular, for the resolution of a commercial bank institution, Article 28 of the LIC states that CNBV, with the approval of its Governing Board, after hearing the affected entity, as well as the opinion of Banxico and IPAB, may declare the revocation of the authorization to operate.</p> <p>Likewise, prior to the revocation of a banking entity, there is an evaluation by the Banking Stability Committee (CEB) composed by appointed members of the financial authorities (SHCP, Banxico, IPAB and CNBV). The CEB assesses the systemic risk that a failing bank could impose to the participants of the financial system or the payment systems and the extent to which liabilities will need to be protected in resolution, which determines the resolution options and gives direction to their use by IPAB.</p> <p>IPAB, with the participation of CNBV, SHCP and Banxico, is in charge of preparing resolution plans for all commercial banks, detailing the form and terms in which they can be resolved in an expeditious and orderly manner (Article 120 of the LIC).</p>
Assessment of Principle 3	Compliant
Comments	CNBV has clear powers to exchange information with relevant authorities both domestically and abroad. Relevant MOUs are in place and actively used.
Principle 4	Permissible activities. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word “bank” in names is controlled.
Essential criteria	
EC1	The term “bank” is clearly defined in laws or regulations.
Description and findings of EC1	Art. 2 of the LIC stipulates that banking and credit services, defined as the ability to raise funds from the public, can only be provided by credit institutions, or other financial entities authorized by law, such as credit cooperatives. According to the Mexican banking law, credit institutions are either multiple-purpose banking institutions (“instituciones de banca múltiple”) or development banks (“instituciones de banca de desarrollo”) and their permissible activities are clearly defined.

EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
Description and findings of EC2	Permissible activities of credit institutions are described in Art. 46 of the LIC. There are 28 activities that banks can engage in, notably: (i) deposit-taking activities; (ii) issuing bonds; (iii) contract credits; (iv) issuing credit cards; (v) granting any type of loans; and (vi) acting as custodians.
EC3	The use of the word “bank” and any derivations such as “banking” in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings of EC3	Article 105 of the LIC reserves to banks the use of the words bank, so it may not be used in the name of legal entities and establishments other than authorized credit institutions; that is multiple-purpose or development banks.
EC4	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks. ¹⁹
Description and findings of EC4	Pursuant to Art. 2 of the LIC, the taking of deposits from the public is restricted to authorized credit institutions. In Art. 103, the LIC stipulates that individuals or legal entities are prohibited from taking—directly or indirectly— deposits from the public except those that are listed in the same article: (i) credit institutions; (ii) financial intermediaries properly authorized; (iii) savings and loan (S&L) cooperatives; and (iv) associations and companies that collect funds from their own members, all of which are regulated and supervised by CNBV. In other words, only supervised financial institutions.
EC5	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings of EC5	As set forth in Art. 8 of the LIC, all bank licenses granted by the competent authorities are made public in an official gazette (Diario Oficial de la Federación). Besides, CNBV keeps current a list of licensed banks and branches of foreign banks operating in Mexico (Padrón de Entidades Supervisadas ²⁰). The list is available online on CNBV website.
Assessment of Principle 4	Compliant
Comments	The Mexican regime for permissible activities of institutions that are licensed and subject to supervision is clearly defined in the law and the use of the word “bank” in names is properly controlled. The authorities pay particular attention to preventing illegal deposit-taking: there are several provisions in the LIC dealing with the prohibition of the unlicensed taking of deposits from the public.
Principle 5	Licensing criteria. The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing

¹⁹ The Committee recognizes the presence in some countries of non-banking financial institutions that take deposits but may be regulated differently from banks. These institutions should be subject to a form of regulation commensurate to the type and size of their business and, collectively, should not hold a significant proportion of deposits in the financial system.

²⁰ <https://www.cnbv.gob.mx/Paginas/PADR%C3%93N-DE-ENTIDADES-SUPERVISADAS.aspx>

	process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management) ²¹ of the bank and its wider group, and its strategic and operating plan, internal controls, risk management and projected financial condition-(including capital base). Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
Essential criteria	
EC1	The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.
Description and findings of EC1	CNBV is empowered to approve (Art. 8 of the LIC) and revoke (Art. 28 of the LIC) licenses to banking organizations, including the subsidiaries of foreign financial institutions. It is noteworthy that granting the license requires prior approval from CNBV's Board and a binding opinion from Banxico. This has resulted in a positive double-checking scrutiny over new entrants and, in practice, has not limited the ample discretionary legal powers of CNBV to exercise full authority in the licensing process.
EC2	Laws or regulations give the licensing authority the power to set criteria for licensing banks. If the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or supervisor determines that the license was based on false information, the license can be revoked.
Description and findings of EC2	The LIC establishes the criteria and requirements for licensing banks (Art. 8-10). Additional details are contained in the CUB issued by CNBV. For this purpose, CNBV receives information on the proposed entity, including the draft articles of incorporation, the list of planned activities, the list of aspiring managers with their personal information, income statements for individuals and financial statements for legal entities, as well as the source of paid-in capital. CNBV also receives the list of shareholders revealing the names of the individuals that directly or indirectly would own shares in the proposed institution. Further information is also required to ensure that the proposed business plan is realistic and sustainable. To this end, the applicant has to submit information on the projected activities and provide an analysis of the financial viability of the bank. Details on internal controls, IT

²¹ This document refers to a governance structure composed of a board and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier board structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, in contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific board structure. Consequently, in this document, the terms "board" and "senior management" are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

	<p>system, and internal organization and administration are also required. The bank is also required to obtain written approval from CNBV before starting its operations. The bank has 30 days to start operating; otherwise, CNBV can revoke the license. An on-site visit is carried out to ensure that all conditions are met. As indicated by CNBV, there is no licensing manual per se, but there is an internal procedure for processing and analyzing new applications as well as a list of documentation and information that must be submitted along with the application for authorization. In order to verify compliance with the above requirements, information and supporting documentation received from the applicant are shared with all relevant departments of CNBV (supervision, legal, AML and systems) and Banxico, who in turn will express a technical opinion on the application. Adequate legal basis for rejecting applications is provided by Art. 8 of the LIC with the explicit right of refusal by CNBV if it is not satisfied with the merits of the application. To the extent that licensing and informational requirements are not met, CNBV can reject applications.</p> <p>If the presentation of false or deceiving information is established after the authorization has been granted, the authorization will not be revoked. As explained by CNBV, once granted, the subsequent discovery of deficiencies would not lead to revocation. In Article 28, the LIC stipulates very clearly the different circumstances that can lead to the revocation of the license and there is no reference to the situation of false information. However, the fact that the application requirements are not only to be met at the inception of the bank, but rather consistently upheld throughout the bank's operation as part of the regular supervisory and regulatory regime, banks deviating from said standards would face remedial action and, eventually, dissolution.</p>
EC3	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Description and findings of EC3	The licensing criteria mainly include requirements for bank shareholders, Board members and senior managers, capital, organizational structure, risk management and internal control policies and procedures, business venues, etc. These criteria are consistent with those applied in ongoing supervision (capital requirements, fit-and-proper tests, internal controls, etc.). At any stage of the licensing process, the supervisory agency has the unrestricted right to request the applicant to provide any information considered relevant.
EC4	The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis. ²² The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.
Description and findings of EC4	In assessing the request for a license, the authorities assess the applicant's organization and management layout. To this end, CNBV is guided by the LIC, Art. 10, which defines the requirements to be met regarding the organization, management, and legal structure to be fulfilled in establishing a bank. These include having qualified directors and senior managers, sound organization and management systems, good corporate governance

²² Therefore, shell banks shall not be licensed. Reference document: BCBS paper on shell banks, January 2003.

	structures, and risk management systems. Further, additional information is required such as the names of shareholders, the proposed amount of capital contributions and shares, a declaration of good standing, and relevant documents of the shareholders who intend to hold 2 percent or more of the proposed capital. In the case of a foreign bank, CNBV examines materials on organizational structures of the shareholder or its wider group, the list of main shareholders, and overseas offices and affiliates.
EC5	The licensing authority identifies and determines the suitability of the bank's major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.
Description and findings of EC5	CNBV verifies the financial status and creditworthiness of the shareholders and other persons that may exert significant influence. According to Annex 53 of the CUB, aspiring shareholders that plan to hold 2 percent or more of the capital are subject to the following requirements: they should disclose all assets (property, bank accounts, securities) and liabilities along with their personal data (address, profession, professional background, citizenship, etc.). In addition, they should provide indications about the origin of their resources. Additional documents are also required such as a copy of the applicant's ID, diplomas, and credit history. For a legal entity, copies of financial statements are also needed. Annex 54 of the CUB subjects applicants to certify that (i) they have a good credit history; (ii) they have not been found guilty of serious violations of the financial laws in Mexico or abroad; and (iii) they have not been prosecuted for criminal acts and sentenced to more than one year in prison. CNBV is empowered to conduct investigations to determine the primary source of initial capital. Furthermore, Annex 53 of the CUB requires the applicant to provide details about assets, including property, securities, and bank account balances; moreover, documents should be submitted to support the application, such as a copy of IDs, reports from two credit agencies, and academic records.
EC6	A minimum initial capital amount is stipulated for all banks.
Description and findings of EC6	A minimum initial capital amount is established in Article 19 of the LIC. Banks interested in operating in Mexico must apply for a "multiple-service" bank license, which implies a minimum capital requirement of approximately US\$33 million (90 million unidades de inversión—UDIs—Mexico's inflation-adjusted units).
EC7	The licensing authority, at authorization, evaluates the bank's proposed Board members and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank. ²³ The licensing authority determines whether the bank's Board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks.

²³ Please refer to Principle 14, Essential Criterion 8.

Description and findings of EC7	<p>Under the LIC, fit-and-proper requirements are specified in Art. 10, 22-24. CNBV assesses the technical suitability of the members of the Board of Directors and senior management in terms of their experience in the financial sector. Members of the Board and senior management should have relevant knowledge and experience in financial, legal, and administrative matters, and possess sound technical skills. Furthermore, they should meet the requirements for moral suitability. The LIC also subjects directors and senior management to a series of incompatibility tests. For example, they cannot act as director if they have been declared bankrupt or if they have been excluded from engaging in commerce or holding a position in the financial system. Pursuant to LIC, Art. 25, CNBV is empowered to remove Board members, managers, and persons with power of attorney, as well as suspend from three months up to five years the abovementioned persons, when it deems they are lacking the necessary technical skills, good standing or when they do not meet the required eligibility criteria.</p> <p>Although during the licensing procedure CNBV evaluates the competences of individual directors as described, the assessors could not find evidence that an assessment of the Board's collectively is performed. However, the assessors did review onsite ongoing supervisory reports where collective competence of the Board is assessed.</p>
EC8	<p>The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.²⁴</p>
Description and findings of EC8	<p>Art. 10 of the LIC requires applicants to submit a set of information that will help CNBV evaluate the potential strategic, operational, control and risk management capabilities of the candidate. CNBV will review the following: (i) the strategic plan, which should include the objectives and mission of the institution, its strategies, product development plans, initial plan for opening offices, the outfitting of the installations and information systems (in this regard, CNBV places special attention on the integrity of the information); (ii) the organization plan that includes the corporate structure, the organization chart, and internal control mechanisms; and (iii) general policies and procedures in different areas, including for taking deposits and granting credit, as well as for profit-sharing. The review carried out by CNBV includes assessing the internal control system regarding AML/CFT prevention.</p>
EC9	<p>The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.</p>
Description and findings of EC9	<p>Pursuant to Art. 10 of the LIC, applicants must present a general plan for the operations of the proposed bank, one item of which is a financial viability study. CNBV reviews the feasibility study and requires that it includes an analysis of market prospects, a description</p>

²⁴ Please refer to Principle 29.

	of the business strategy and plans, projections on assets and liabilities, earnings, liquidity, capital adequacy, return on assets, and return on equity.
EC10	In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.
Description and findings of EC10	The financial regulatory laws permit the entry of non-Mexican financial groups and financial intermediaries, through Mexican subsidiaries, to engage in various activities in the Mexican financial system, including banking, securities, and insurance activities. In fact, foreign banks mainly from developed countries are operating in the country and hold a central place in the Mexican financial sector. The LIC, in Article 45-C stipulates that authorization to operate as a foreign bank in Mexico is granted by CNBV. In practice, CNBV requires confirmation that there is no objection from the home regulatory authorities and evaluates whether cross-border activities are under their effective consolidated supervision.
EC11	The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
Description and findings of EC11	Once banks start operations, they are subject to CNBV's continuous monitoring and supervision processes, which include on-site and off-site inspection to credit institutions, in order to review, verify and assess their activities, organization, operation, processes, internal control, risk management and information systems, as well as capital adequacy to risks, asset quality and, in general, everything that may affect the financial condition of the bank. Through these actions and regular communication with institutions, supervisors monitor the objectives and strategies of banks, including those of recent creation.
Assessment of Principle 5	Compliant
Comments	The organization and operation of a universal banking institution requires authorization by CNBV and the favorable opinion of Banxico. That is, the approval of the Central Bank is necessary to grant authorization. This has resulted in a positive double-checking scrutiny over new applicants, while it has not limited CNBV discretionary power to deny such authorization. Although the licensing authority for banking institutions is CNBV, the licensing authority for Development Banks and financial holding companies is SHCP. It should be mentioned, however, that development banks are authorized by law on case-by-case basis; furthermore, during the last 20 years no new development bank has been created. The operating plans, business strategy and projected financial statements are among the documents that are presented when requesting a bank license. These documents are examined by CNBV during the authorization process to determine the viability of the proposed institution. The fit-and-proper test of directors and managers includes skills,

	<p>moral suitability, experience in relevant financial activities and no adverse regulatory determination or poor credit record.</p> <p>The assessors had the opportunity to review a couple of licensing-related documentation, which is considered adequate and well-aligned with the EC of this principle.</p> <p>Some improvements in the current requirements are recommended. To ensure consistency over time, the licensing procedure would benefit from an internal guideline detailing explicitly the criteria to assess the financial soundness of significant shareholders, as well as their ability to support the bank if needed.</p>
Principle 6	Transfer of significant ownership. The supervisor ²⁵ has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Essential criteria	
EC1	Laws or regulations contain clear definitions of “significant ownership” and “controlling interest.”
Description and findings of EC1	Article 22 Bis of the LIC includes definitions of ‘control’ (capacity to impose –directly or indirectly– decisions in the general shareholders’ meetings; holding title of rights allowing to, directly or indirectly, exercise the voting right in regards to more than fifty percent of the corporate capital stock; or conduct, directly or indirectly, the management, strategy, or main policies of the institution) and decision- making power (ability to influence the resolutions adopted in a shareholders’ meetings or meetings of the board of directors or in the management, direction, and performance of the businesses—including a number of rebuttable presumptions). Article 17 LIC states three levels of equity stakes that have to be approved by CNBV: 5 percent and 20 percent (significant ownership) and control (majority) that are subject to CNBV approval.
EC2	There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.
Description and findings of EC2	CNBV’s notification or approval is required when changes in ownership or controlling interest are above a certain threshold. Any individual who wishes to purchase equities representing more than 2 percent of the paid-in capital of a bank must notify such purchase to CNBV (Art. 14 of the LIC) within three working days following the transaction. Any acquisition or pledge above 5 percent of the equity capital of a bank requires the formal approval of CNBV, which will take into consideration the opinion of Banxico (Art. 17). In that case, the applicant will have to meet the criteria used for approving new banks as set forth in Art. 10, paragraph II. If the acquisition represents 20 percent or more of the paid-in capital, it will also require (i) CNBV clearance; and (ii) the binding” opinion of Banxico. In addition, applicants have to meet not only the criteria set out in Art. 10, paragraph II, but also provide further details defined in LIC Articles 22 Bis-II on (i) the persons who will take control of the bank; (ii) the business plan; and (iii) all relevant

²⁵ While the term “supervisor” is used throughout Principle 6, the Committee recognizes that in a few countries these issues might be addressed by a separate licensing authority.

	information on the organization, administration, and internal controls of the applicant. According to the terms of Art. 17, section IV, entities shall be required to document all information that may be required by CNBV in accordance with the terms and conditions it may establish.
EC3	The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership meets criteria comparable to those used for licensing banks. If the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.
Description and findings of EC3	CNBV's capacity to object to any proposal for a change in significant ownership is contemplated in Art. 17 of the LIC, according to which the Commission has the discretionary power to grant its approval. Accordingly, CNBV can also deny an authorization if it considers that the potential shareholder does not meet the moral and solvency requirements established in the LIC.
EC4	The supervisor obtains from banks, through periodic reporting or on-site examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.
Description and findings of EC4	Banks are required to prepare and send twice a year to CNBV a report on the integration of capital, which includes the names and other relevant data of significant shareholders, including the percentage of their participation in total capital. Mexican banking regulation incorporates the expression "beneficial owners," although not as a formally defined concept (see the section on comments below). In the case of legal persons, they must disclose the identity of the 10 principal shareholders. In the case of these being other legal persons, a trust (fideicomisos) or other vehicle, the applicant should disclose the identity of the UBOs of said participations. (LIC: 17, CUB: 336, annexes 53 y 54).
EC5	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.
Description and findings of EC5	According to LIC Art. 18, transfers of shares in contravention of the law the property and corporate rights are suspended and therefore may not be exercised, until it is attested that the corresponding authorization or decision has been obtained. In addition, as set forth in LIC Art. 108, the violation of any of the provisions of Art. 17 through the purchase of shares without CNBV's previous consent is subject to administrative sanctions (e.g., a fine equivalent to up to 15,000 days of salaries).
EC6	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Description and findings of EC6	Article 74 of the LIC, stipulates the application of prudential actions to commercial banks, such as additional capital requirements, interruption of operations with related parties, limit the distribution of dividends or any other capital benefit, among others, when CNBV

	<p>becomes aware that persons or parties with significant influence or control over the bank are subject to some process of corrective actions for problems of capitalization, liquidity, bankruptcy, intervention and other similar. Moreover, if the above situation materializes, banks must immediately report it to CNBV.</p> <p>CNBV may use any source of information, including notification by the banks themselves or other financial authorities in Mexico or abroad. However, CNBV may directly request from banks information on the financial situation of persons with significant influence or control over the banks themselves.</p>
Assessment of principle 6	Compliant
Comments	The legal framework in place, as well as CNBV's supervisory protocols, are adequate to prevent transfers of significant ownership without prior control and authorization of the authorities.
Principle 7	Major acquisitions. The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	
EC1	<p>Laws or regulations clearly define:</p> <p>(a) what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval; and</p> <p>(b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank's capital.</p>
Description and findings of EC1	Limits on investments by banking institutions in nonfinancial firms are established in Article 75 of the LIC. For investments representing between 5 percent and 15 percent of paid-in-capital, the securities cannot be held for longer than three years without CNBV approval. If a majority of the members of a bank's Board of Directors decide to hold the investment for a longer period, the approval of CNBV is required. Approval by CNBV (with the nonbinding opinion of Banxico) is required for investments that are more than 15 percent of a company's paid-in capital and for investments that are to be kept for longer than three years. The sum of a bank's investments in nonfinancial institutions shall not exceed 5 percent of the bank's deposit base. Article 88 of the LIC states that all investments in, and acquisitions of, companies that provide ancillary services require approval by CNBV. Pursuant to Article 89 of the LIC, all investments in financial companies registered abroad, regardless of their amount, also require approval by the Commission, prior approval from CNBV's governing Board.
EC2	Laws or regulations provide criteria by which to judge individual proposals
Description and findings of EC2	The LIC establishes clear criteria by which to judge individual proposals. The criteria are the amount (in terms of share of issued capital) and nature of the investment and the holding period (shorter or longer than three years); in order to exceed the initial limits described

	above, special approval by CNBV is needed. The law establishes that CNBV may allow investments for larger stakes or longer periods if the companies being invested in are developing long maturity projects or are carrying out development activities. Therefore, applicants have to meet not only the criteria set out in Art. 10, paragraph II, but also provide further details defined in LIC Articles 22 Bis on (i) the persons who will take control of the bank; (ii) the business plan; and (iii) all relevant information on the organization, administration and internal controls of the applicant.
EC3	Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future. ²⁶ The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.
Description and findings of EC3	Investments by supervised entities in foreign financial institutions are regulated by Article 89 of LIC and require previous CNBV approval. The article also stipulates that when a Mexican bank owns at least 51 percent of the foreign financial institution's capital or has control over its Board or management, the Mexican bank shall ensure that the foreign institution adheres to the applicable foreign regulations and to the rules that Mexican financial authorities deem appropriate. Art. 89, paragraph 3 also stipulates the type of institutions in which Mexican banks are allowed to invest abroad. The same articles require applicants to provide indications on policies designed by the bank to resolve possible conflicts of interest that their conduct of operations with the public may cause. The procedure laid down in the LIC does not provide a framework through which the supervisor can ensure that no excessive risks are undertaken or that consolidated supervision is not hindered. In practice, however, CNBV pays attention to these issues during the examination of the projected investment. Article 88 of the LIC also establishes the obligation for companies that belong to credit institutions, to be subject to the general rules issued by CNBV, including its prudential supervision.
EC4	The supervisor determines that the bank has, from the outset, adequate financial, managerial and organizational resources to handle the acquisition/investment.
Description and findings of EC4	As indicated by CNBV, banks may carry out relatively small investments for relatively small periods of time; when the investments are to be kept for longer periods or involve the acquisition of financial entities abroad or non-financial companies, CNBV authorization is required. CNBV analyzes the proposal to determine if the bank has adequate financial and organizational resources on the basis of documents provided by the applicant; it can reject

²⁶ In the case of major acquisitions, this determination may take into account whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

	<p>the application if it is not satisfied with the proposal. CNBV has developed an internal procedure for processing and analyzing major acquisition applications, as well as a list of documentation and information that must be submitted along with the application. To obtain authorization of proposals to invest in companies indicated in articles 75, 88 and 89 of the LIC, the following information should be provided to CNBV as part of the application:</p> <ul style="list-style-type: none"> (a) Certified copy of the bylaws of the company. (b) List of shareholders of the company in question and their participation. (c) Detailed information of the general director or equivalent, as well as the high officials of the company. (d) Operational and business plan of the company, including a contingency plan to protect the functioning of the banks in case operational events. (e) Economic and operational viability, for a minimum period of three years. (f) Draft contracts in which the rights and obligations of the company are stipulated.
EC5	The supervisor is aware of the risks that nonbanking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in non-banking activities.
Description and findings of EC5	Paragraph 3 of Article 75 of the LIC requires banks to diversify their acquisitions as stipulated in LIC Art. 51, and in particular with respect to the rule of diversification of risks (concentration on credit, market, liquidity, and operational risk). Besides, such acquisitions or investments are subject to prudential measures or requirements as defined by CNBV. As indicated by CNBV, any deviation from this requires supervisory assessment and approval.
Assessment of Principle 7	Compliant
Comments	CNBV has the power to approve or reject on major acquisitions or investments by a bank including establishment of cross-border operations. The limits established for investments in non-financial companies—individual and global—seem adequate to prevent banks having high stakes in these types of investments.
Principle 8	Supervisory approach. An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.
Essential criteria	
EC1	<p>The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact, and scope of the risks:</p> <ul style="list-style-type: none"> (a) which banks or banking groups are exposed to, including risks posed by entities in the wider group; and

	<p>(b) which banks or banking groups present to the safety and soundness of the banking system</p> <p>The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment and the resolvability of banks, and permits relevant comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.</p>																
<p>Description and findings of EC1</p>	<p>To improve the supervision of institutions and strengthen the capacity of supervisors to take effective and consistent actions, in November 2015 CNBV introduced the enhanced supervisory rating methodology (CEFER, or Calificación de Entidades Financieras con Enfoque de Riesgos), a risk-based supervisory tool.</p> <p>The CEFER risk matrix is a methodology for assessing inherent risks, complemented by the supervisors' expert judgement, mitigating factors and complementary elements that impact the risk profile of institutions. The result and trend of this matrix helps to guide the supervisory strategy, as well as the resources that will be allocated to each bank and the depth and scope of the examinations.</p> <p>The structure of the CEFER matrix is as follows:</p> <div data-bbox="430 850 1396 1596" style="border: 1px solid black; padding: 10px;"> <p>The diagram illustrates the CEFER matrix structure in five steps:</p> <ol style="list-style-type: none"> Riesgos Inherentes (Inherent Risks): A table with categories and weights. <table border="1" style="margin-left: 20px;"> <tr> <th colspan="2">Calidad de Activos:</th> </tr> <tr> <td>Riesgo de Crédito</td> <td rowspan="4" style="text-align: center; vertical-align: middle;">80%</td> </tr> <tr> <td>Riesgo de Contraparte</td> </tr> <tr> <td>Riesgo de Mercado</td> </tr> <tr> <td>Riesgo Operacional</td> </tr> <tr> <td>Riesgo de Liquidez</td> <td style="text-align: center;">10%</td> </tr> <tr> <td>Riesgo Legal y Reputacional</td> <td style="text-align: center;">10%</td> </tr> </table> Mitigantes (Mitigants): A table with five categories. <table border="1" style="margin-left: 20px;"> <tr> <td>Gobierno Corporativo</td> <td>Equipo Gestión</td> <td>Admón. Riesgos</td> <td>Control</td> <td>Auditoría</td> </tr> </table> Riesgo neto (Net Risk): A blue box representing the sum of inherent risks. Ajuste por riesgo de negocio (Business Risk Adjustment): A dark red box added to the net risk. Riesgo neto ajustado (Adjusted Net Risk): A dark blue box representing the sum of net risk and business risk adjustment. Fortaleza financiera (Financial Strength): A green box containing Solvencia and Rentabilidad, added to the adjusted net risk. Calificación CEFER (CEFER Rating): A grey box representing the final rating, derived from the sum of adjusted net risk and financial strength. </div> <p>Each banking entity scores on a scale of 1- to 4+ (with 1- being the best possible value and 4+ being the riskiest score). The qualification process is carried out quarterly and is part of a comprehensive process at CNBV where several areas are involved.</p> <ul style="list-style-type: none"> Inherent risks. They are calculated using quantitative indicators related to the operation of the entity, which incorporate relevant risk characteristics. The assessment of the risks inherent in each of the relevant banking activities results in a score of 1 to 4, with 4 being the riskiest and 1 the least risky. The rating of the inherent risks is 	Calidad de Activos:		Riesgo de Crédito	80%	Riesgo de Contraparte	Riesgo de Mercado	Riesgo Operacional	Riesgo de Liquidez	10%	Riesgo Legal y Reputacional	10%	Gobierno Corporativo	Equipo Gestión	Admón. Riesgos	Control	Auditoría
Calidad de Activos:																	
Riesgo de Crédito	80%																
Riesgo de Contraparte																	
Riesgo de Mercado																	
Riesgo Operacional																	
Riesgo de Liquidez	10%																
Riesgo Legal y Reputacional	10%																
Gobierno Corporativo	Equipo Gestión	Admón. Riesgos	Control	Auditoría													

	<p>updated quarterly and is the result of the evaluation of quantitative indicators obtained from the operational and accounting information reported by the institutions. Expert judgment can change the rating +/- 2 notches. The use of expert judgment must be justified by the supervisor.</p> <ul style="list-style-type: none"> • Mitigants. They are mainly qualitative indicators used to assess the way in which an entity identifies, measures, monitors and controls each of the inherent risks. They are divided into four main types: corporate governance; management team; risk management and control and auditing. • Net risk. It is the result of subtracting (or adding) the effect of the mitigants over inherent risks. The final score is determined by adding financial strength and additional criteria. • Financial strength. It is evaluated by means of indicators that reflect the capacity of an institution to cope with unexpected losses or liquidity shortages. • Additional criteria. There are 3 further factors in the assessment: (i) if the institution's shares are traded on a formal stock exchange, (ii) if the institution has a holding company, and (iii) the institution's relevance within the financial system. <p>The results of the CEFER allow to:</p> <ol style="list-style-type: none"> (a) Categorize entities according to their level of risk and compare similar entities. (b) Allocate scarce monitoring resources. (c) Establish priorities for the annual supervisory plan (PAS), focusing on those institutions whose risks represent a greater threat to the stability and of the financial system. (d) Define the supervisory strategy for each institution, considering its risk and its management. (e) Determine how often on-site inspections should be performed.
EC2	<p>The supervisor has processes to understand the risk profile of banks and banking groups and employs a well-defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each bank is based on the results of this analysis.</p>
Description and findings of EC2	<p>Through ongoing risk monitoring and assessment, CNBV supervisors focus on signs of deterioration or emerging risks in both individual institutions and the financial system under its purview and take supervisory steps accordingly. CNBV uses (i) the CEFER risk matrix to evaluate each institution's inherent risk level and trend (increasing, stable, or decreasing), and (ii) an early warning system to promptly identify emerging risks. These results serve as important references for supervisors to develop or refine their supervisory strategies.</p> <p>Also, the supervisor has processes in place to verify that the risk profile defined by each institution includes all the risks to which it is exposed based on its business model. It is also verified that the deviations to the risk profile are reported to the Board of Directors and that actions have been implemented to correct these deviations.</p> <p>Additionally, regulatory stress testing exercises are carried out yearly, under adverse scenarios that allow to know the financial strength of the institutions.</p>

EC3	The supervisor assesses banks' and banking groups' compliance with prudential regulations and other legal requirements.
Description and findings of EC3	<p>Supervision over banks' compliance with prudential regulations and other legal requirements is constantly monitored through continuous surveillance processes and on-site examinations.</p> <p>Additionally, the supervisory teams carry out a monthly follow-up on the regulatory compliance of, among others, the following regulatory limits:</p> <ul style="list-style-type: none"> • Capital Adequacy Ratio (CAR/ ICAP) established in article 50 of the LIC. • Credits to related parties established in Article 73 Bis of the LIC. • Investments in real estate established in article 55 section I of the LIC. • Investments in adaptations and improvements to real estate established in article 55 section II of the LIC. • Investments in the capital of companies established in Article 55 section III of the LIC. • Sum of the investments established in Article 55 of the LIC. • Basic Capital Coefficient established in Article 2 Bis 5, section I and II; and 220 of the CUB. • Investments in listed and unlisted shares on the stock exchange established in Article 75 of the LIC. • Minimum capital in accordance with Article 46 of the LIC. • Liquidity Coverage Ratio (LCR / CCL) in accordance with Article 96 Bis of the LIC. <p>Regarding the financial and operational information of the Institution, CNBV receives on a regular basis the 66 regulatory reports listed in Annex 36 of the CUB (Reportes Regulatorios), which are used for the adequate surveillance and supervision of financial institutions.</p>
EC4	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also takes into account cross-sectoral developments, for example in non-bank financial institutions, through frequent contact with their regulators.
Description and findings of EC4	<p>CNBV uses the Capital Assessment Exercise (ICAAP) as a tool to incorporate the macroeconomic environment into its supervisory strategies. Banks carry out at least once a year an evaluation of capital adequacy to determine if the capital they have is sufficient to cover the possible losses they may face under different scenarios, including those in which adverse economic conditions prevail. To this purpose, CNBV applies two types of stress testing exercises: under supervisory scenarios (determined by the authorities) and under internal scenarios (determined by banks).</p> <p>Financial projections are made taking into account two macroeconomic scenarios, one base and one adverse, considering changes in macroeconomic variables such as: Gross Domestic Product (GDP), unemployment, inflation, trade balance, stock market performance, exchange rate and national and foreign interest rates.</p> <p>Based on the outcome of the Capital Adequacy Assessment, CNBV may request the banking institution to carry out corrective measures aimed at strengthening its capital position.</p>

	Likewise, Banxico and the CESF include in their reports the results of their stress tests under different macroeconomic scenarios. These results are analyzed by the different supervisory authorities and the central bank in order to assess the potential risks to individual institutions, as well as to the financial system as a whole.
EC5	The supervisor, in conjunction with other relevant authorities, identifies, monitors and assesses the build-up of risks, trends and concentrations within and across the banking system as a whole. This includes, among other things, banks' problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability.
Description and findings of EC5	<p>Within the evolving macroprudential surveillance activities of the Financial System Stability Council (CESF), CNBV exchanges information and analysis with other members of the Council. This allows CNBV to monitor the impact of macroeconomic and market developments on the financial and banking systems. For this purpose, CNBV communicates with other relevant government agencies responsible for macroeconomic and policy making; such communication is facilitated by means of multiparty and ad-hoc memoranda on cooperation.</p> <p>To address systemic risks, CNBV cooperates with other financial supervisory agencies (such as IPAB, CNSF, Banxico and CONSAR) to obtain a sufficient understanding of the development in nonbank financial institutions, as well as to share their respective risk assessments.</p> <p>In addition, institutions must have capital and liquidity recovery plans (RP) that detail the actions that will be carried out by the institution to restore its financial situation, in the face of adverse scenarios that could affect its solvency or liquidity CNBV approves the recovery plans (RP), after a binding opinion from IPAB, Banxico and SHCP.</p> <p>The Technical Vice Presidency of CNBV carries out monthly analyses of the risks faced by supervised entities, including:</p> <ul style="list-style-type: none"> • Credit risk. • Concentration risk (by counterparty and economic sector). • Liquidity risk. • Interconnectivity and interbank funding market risk. <p>Additionally, the supervisory areas monitor the entities under their supervision and periodically inform the president and the governing board of CNBV on the matters that must be submitted to their consideration and approval. The fact that CNBV Board is composed by SHCP, the Bank of Mexico, the CNSF and CONSAR facilitates the communication.</p>
EC6	Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank's resolvability where appropriate, having regard to the bank's risk profile and systemic importance. When bank-specific barriers to orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies,

	managerial, operational and ownership structures, and internal procedures. Any such measures take into account their effect on the soundness and stability of ongoing business.
Description and findings of EC6	Resolvability concerns are yet to be part of CNBV supervisory approach. There are no procedures in place to assess banks' resolvability.
EC7	The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.
Description and findings of EC7	CNBV has established a prompt corrective actions regime that facilitates timely corrective actions. Remedial measures range from informal instructions directing a particular response by management, to the severe action of intervention and, if needed, liquidation (through the suspension of the institution's license), in which case MOUs with other relevant authorities are activated to coordinate and facilitate the resolution of the bank. In the event of a capital deficit, CNBV must implement corrective measures in gradual progression until automatic resolution in case the capital ratio falls below 4.5 percent. When capital falls between 10.5 percent and 8 percent, CNBV will require a capital conservation plan and the application of corrective measures. In case the capital falls below 8 percent, but not below 4.5 percent, CNBV will require a capitalization plan and will dictate the application of specific corrective measures such as restrictions on the payment of dividends, the suspension of share repurchases; the amortization or convert subordinated debt into capital; and the cancellation of bonus payments. Likewise, the legislation clearly describes the grounds for revocation and the mechanisms for its prevention, indicating powers, communications and responsibilities of CNBV, SHCP, Banxico and IPAB, as well as the deadlines to trigger the actions of these authorities.
EC8	Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.
Description and findings of EC8	CNBV is vested with the obligation to investigate and report those acts that involve unauthorized entities carrying out bank-alike activities that require prior authorization from the authorities. In case of banks restructuring their activities to avoid the regulatory perimeter, CNBV dispose of an ample range of options to order the corresponding corrective measures, regardless the sanctions that may be applied.
Assessment of Principle 8	Largely Compliant
Comments	At the time of adoption, the CEFER was a major step forward towards risk-based supervision. The assessors reviewed the CEFER methodology and the outcomes resulting from its application and, as a result, concluded that this methodology is based on best practices and allows CNBV to classify banks according to their risk profile and identify areas to focus supervisory efforts.

	<p>However, the assessors recommend that the tool is enhanced to better assess the actual level of risks in banks. The indicators used to determine the inherent risks could be reduced to a number sufficient to assess risk, but not more, and the mitigants should rely more on expert judgement rather than on formal checks. Sharpening thus the tool would facilitate applying a more risk-based approach to supervision, facilitating the application of Pillar 2 measures.</p>
Principle 9	<p>Supervisory techniques and tools. The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.</p>
Essential criteria	
EC1	<p>The supervisor employs an appropriate mix of on-site²⁷ and off-site²⁸ supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between on-site and off-site supervision may be determined by the particular conditions and circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness and integration of its on-site and off-site functions, and amends its approach, as needed.</p>
Description and findings of EC1	<p>CNBV uses a mix of on-site and off-site supervision to evaluate the condition of banks. Banks' off-site and on-site supervision duties are split between two vice-presidencies (VPs); each VP has approximately the same number of departments (Direcciones Generales de Supervisión) and more or less the same number of examiners. Discussions with supervision team members showed that they have a good understanding of the risks in the banks in their portfolios.</p> <p>The Institutional Monitoring Portal (PIN) and other related documents (such as the "Mapas de Procesos" of the "Sistema Integral de Organización") include a description of the process for planning and executing on-site and off-site activities.</p> <p>To determine on-site inspections strategy, supervisors consider the following criteria:</p> <ul style="list-style-type: none"> • CEFER findings and results • Supervisory priorities • Findings from previous examinations • Relevant external events • New regulations <p>The results of these inspections are reported to the off-site inspection function for follow-up purposes, adjustments to the evaluation of the institutions and, where appropriate, the imposition of sanctions and corrective actions.</p>

²⁷ On-site work is used as a tool to provide independent verification that adequate policies, procedures and controls exist at banks, determine that information reported by banks is reliable, obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, monitor the bank's follow-up on supervisory concerns, etc.

²⁸ Off-site work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks and help identify the priorities, scope of further off-site and on-site work, etc.

	<p>CNBV has established internal controls in relation to oversight work. The objective is to determine the adequacy of the monitoring plan, the quality and effectiveness of on-site reviews and off-site surveillance reports to identify areas for improvement.</p> <p>In recent months on-site examinations have also been subject to sanitary conditions, healthy distance measures established in different areas of administration, evolution of the pandemic caused by COVID-19, as well as progress in the vaccination scheme at the national level.</p>
EC2	<p>The supervisor has a coherent process for planning and executing on-site and off-site activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that there is effective coordination and information sharing between the on-site and off-site functions.</p>
Description and findings of EC2	<p>CNBV has a coherent process in place for planning and executing on-site and off-site activities. There are manuals designed to ensure that these activities are conducted on a thorough and consistent basis. The MIS (Manual Institucional de Supervisión) and other related documents (e.g., Mapas de Proceso del Sistema Integral de Organización) describe in detail the policies and procedures to ensure that oversight activities are carried out in a consistent way.</p> <p>The rules for determining the inspection strategy and off-site/on-site supervision work are clearly established. At the beginning of an examination cycle, CNBV determines the supervisory strategies based on previous examination findings, supervisory ratings (CEFER matrix, which is quarterly updated), risk assessments, and other elements that may pose particular concern. The inspection planning is determined by each Deputy General Director in charge of the bank under review and meetings with all on-site and off-site staff involved are arranged to explain the examination's objectives. Off-site reviews are used to analyze prudential returns as well as other sources of information such as auditors' reports and published financial statements. This may result in the identification of areas within a bank that require detailed or specialized on-site review. Bank files are updated and monitored to identify which items require follow-up.</p> <p>Off-site work also entails performing a risk assessment. The supervisor analyzes the types, severity, and trends of risks faced by the bank. The Risk Matrix (CEFER) lists several inherent risk categories (e.g., credit, market, liquidity, operational, legal), and identifies the risk level (5 levels), risk trend (increasing, stable, or decreasing), and mitigating factors (internal controls, corporate governance). In case material deficiencies are identified during the supervisory cycle (for example, at the end of the on-site examination), rating results will be adjusted in the Risk Matrix.</p> <p>There is also a coordination and information-sharing mechanism between the on-site and off-site functions. Meetings with staff from both areas are organized at each step of the way to ensure that all people involved can (i) voice their concern on a particular matter; (ii) understand the objectives of the examination; and (iii) receive all relevant information. During the on-site visits, staff from the off-site and on-site areas are in constant communication. Moreover, the memo containing all observations and major findings (Oficio de observaciones) is prepared jointly. For the preparation of the memo for</p>

	corrective measures to be delivered to the bank (Oficio de medidas correctivas), off-site inspectors can request support or advice from on-site inspectors. Lastly, at a macro level, CNBV has set up a Supervision Committee (Grupo de Supervision) that aims to discuss horizontal and systemic issues.
EC3	The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, information on a bank's related entities, and publicly available information. The supervisor determines that information provided by banks is reliable ²⁹ and obtains, as necessary, additional information on the banks and their related entities.
Description and findings of EC3	<p>The more important source of information used by CNBV to regularly review and assess banking conditions is the ample set of information and regulatory reports received directly from banks. This information is thoroughly vetted and visits to the supervised institutions may take place to understand better the context of the information and check its validity. There is also a department within CNBV responsible for checking the consistency and accuracy of information reported by banks. More precisely, CNBV reviews banks' monthly financial reports, reports on related party transactions, reports on internal and external audit, capitalization index calculations, and other materials generated by the banks relating to risk management. The offsite supervision is conducted quarterly, through financial analysis, based on each bank's main risks derived from its core business activities. In conclusion, prudential returns are actively used in the supervision process and to develop and refine the individual supervisory strategies for each institution.</p> <p>Article 213 of the CUB establishes that institutions must send regulatory information to CNBV, electronically, through the Interinstitutional Information Transfer System (SITI). The information must comply with the validations established in the SITI, as well as the quality standards indicated by CNBV.</p> <p>Once the information is received, it is reviewed to verify compliance with quality control standards. In case the information is considered incorrect or incomplete, corresponding sanctions are imposed.</p> <p>Regulations in place also establish CNBV power to request any additional information, other than the periodic information that supervised entities must provide, required for supervisory purposes.</p>
EC4	<p>The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as:</p> <ul style="list-style-type: none"> (a) analysis of financial statements and accounts. (b) business model analysis. (c) horizontal peer reviews. (d) review of the outcome of stress tests undertaken by the bank. (e) analysis of corporate governance, including risk management and internal control systems.

²⁹ Please refer to Principle 10.

	<p>The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.</p>
Description and findings of EC4	<p>CNBV has different monitoring tools to periodically analyze and assess the condition of banking institutions, including:</p> <ul style="list-style-type: none"> • <i>Review of financial statements</i>, which must comply with the disclosure and quality criteria determined in the Financial Reporting Standards (NIF) and Chapter of the CUB: "Disclosure of financial information". • <i>CEFER results</i>, which identified the exposition of risks for each bank and the quality of control and risk managements practices. • <i>Risk reports</i>, which are prepared internally by the technical areas of CNBV and consist of an analysis of main trends risks, including -among others- credit, market and liquidity risk. • <i>Business model analysis</i>, which are prepared by CNBV technical areas based of all available information regarding the activities of banks (financials, minutes of the different relevant corporate governance instances of banks (Board, Risk Committee, Audit Committee, Business Committee, Etc.), press releases, and the relevant information obtained from continuous communication with the bank's management. • <i>Capital adequacy report</i>, which is the internal assessment of banks prepared under Basel standards (ICAAP). • <i>Peer groups analysis</i>, which is based on CEFER, financial statements and regulatory reports. <p>If, as a result of the assessment of the bank's financial situation, any potential risk or material situation is identified, the banking institution is informed, and corrective actions are required.</p>
EC5	<p>The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerabilities that have the potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.</p>
Description and findings of EC5	<p>CNBV supervisory tools result in an ongoing assessment aiming at identifying, assessing and mitigating emerging risks affecting banks. The technical and supervisory areas produce different reports related to individual entities, groups and for the financial system as a whole.</p> <p>Stress testing is one of the tools specifically prescribed for the monitoring process. CNBV carries out the annual Capital Adequacy Assessment of the banking sector in order to assess the resilience of banks to adverse economic scenarios.</p> <p>The CUB in its Chapter VI Bis (Internal Assessment of Capital Adequacy), establishes the obligation for institutions to carry out an internal assessment of its capital (ICAAP), including an analysis of the capacity of the bank to cover the possible losses they may face</p>

	<p>in different macroeconomic scenarios, including those in which adverse economic conditions prevail. The ICAAP includes a capital projection based on the different scenarios considered.</p> <p>Likewise, the institutions must have a capitalization plan when as a result of the aforementioned assessment there are capital shortages, identifying the origin and the terms of the resources required to cover the estimated capital shortages.</p> <p>To carry out their stress testing exercises, institutions must estimate the movements in all the components of their financial statements in accordance with both, their own internal scenarios and the supervisory scenarios that CNBV determines, which will be at least the following:</p> <p>(a) Base Scenario: in which the Commission will evaluate the performance of the institution under the expected macroeconomic assumptions considering the projections of Banxico and SHCP.</p> <p>(b) Adverse Scenario: in which the Commission will evaluate the performance of the institution under unfavorable macroeconomic projections.</p> <p>These stress testing exercises allow for an early identification of emerging risks, so that to include them into the macroprudential agenda of the authorities, including Banxico and the CESF, as well as into the supervisory strategies of CNBV.</p> <p>Additionally, to properly monitor troubled banks, CNBV has a "watch list" that serves as a basis for monitoring their behavior and preventing adverse scenarios well in advance.</p> <p>The results obtained by CNBV in its risk analyses of financial institutions are regularly presented at the CESF.</p>
EC6	<p>The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.</p>
Description and findings of EC6	<p>On-site examinations encompass the assessment of the internal audit function independence, as well as its effectiveness in enhancing the entity's overall risk management framework.</p> <p>The LIC contains detailed provisions regarding banks' internal audit functions (Section V "De la Auditoría Interna"). Based on these rules, CNBV supervisors evaluate the work of the bank's internal audit function during onsite examinations. The evaluation focuses on the independence of the function, the adequacy of the staffing, staff expertise, the frequency and scope of the coverage, and the adequacy of the audit plan. In addition, CNBV receives the internal audit plans and quarterly progress reports.</p> <p>As part of its on-site supervision CNBV verifies compliance with the internal audit (IA) and audit committee functions established in the CUB. To this end, supervisors verify that:</p> <ul style="list-style-type: none"> • The IA fulfills the minimum functions identified in the regulation. • The IA is independent with respect to the business and administrative areas. • The IA informs their findings to Audit Committee and the Board of Directors. • The IA have adequate planning and executions processes. • The IA covers main risks. <p>Additionally, in accordance with regulation, banks must send CNBV the following information:</p>

	<ul style="list-style-type: none"> • The annual internal audit plan, which must incorporate the findings observed by CNBV as a result of its supervisory examinations. • The reports elaborated by the AI in the execution of its responsibilities. <p>Internal audits reports are assessed as part of supervisory routines and relies on those deemed high-quality.</p>
EC7	<p>The supervisor maintains sufficiently frequent contacts as appropriate with the bank's Board, non-executive Board members and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls. Where necessary, the supervisor challenges the bank's Board and senior management on the assumptions made in setting strategies and business models.</p>
Description and findings of EC7	<p>CNBV has established different channels of communication with all levels of bank management. As part of the regular ongoing surveillance, CNBV supervision departments meet with banks' management and Board members. The frequency of the visits depends on the risk profile and systemic importance of the entity. Offsite supervisors also engage in discussions with the internal auditor, Risk Committee members, and compliance officers when they seek to follow up on certain emerging problems or trends.</p>
EC8	<p>The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses in a timely manner by means of written reports or through discussions or meetings with the bank's management. The supervisor meets with the bank's senior management and the Board to discuss the results of supervisory examinations and the external audits, as appropriate. The supervisor also meets separately with the bank's independent Board members, as necessary.</p>
Description and findings of EC8	<p>CNBV communicates findings on its on-site and off-site supervision through both written reports and discussion with management. When there are relevant and significant findings, CNBV brings these to the attention of the Board of Directors through an official letter; likewise, senior management receives an official letter with all the on-site examination findings.</p> <p>Moreover, CNBV supervisory team meets with the banking institution's Board members and senior management to advise them of the inspection results and recommendations. These meetings are attended by the supervision vice-president, director general, and deputy director general in charge of the specific banking institution's supervision. If necessary, the president of CNBV will attend the meeting.</p> <p>The supervisory reports delivered to banks are still mostly rule-based oriented and, concerning risk management practices and corporate governance issues, they lack the necessary deepness to truly report meaningful findings. See comments to CP8 and accompanying recommendations aimed at improving the CEFER methodology.</p>
EC9	<p>The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early escalation to the appropriate level of the supervisory authority and to the bank's Board if action points are not addressed in an adequate or timely manner.</p>

Description and findings of EC9	At the end of the on-site inspections or during the inspection process/off-site monitoring, the supervisor may demand specific measures or an action plan to attend observed irregularities and deficiencies. As a routinary part of the on-site and off-site supervision process, the supervisor follows up on the actions and measures taken by institutions to address the observations and requirements of CNBV. Special attention is given to the effectiveness of the bank's responses to resolve CNBV's observations.
EC10	The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure, and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.
Description and findings of EC10	Neither the LIC, nor the CUB, explicitly specify that changes in activities or structure that do not require explicit CNBV approval be notified to the Commission. Further, the Commission does not have explicit powers to oppose such changes if not explicitly regulated. In practice, the assessors are informed that CNBV gains knowledge of such events through its day-to-day contact with the institutions, through which its supervisors learn about any events that may lead to substantive changes in their activities, structure, and overall condition.
EC11	The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration the biases that may influence third parties.
Description and findings of EC11	In accordance with the provisions of article 16 of CNBV Supervisory Regulation (RSCNBV), supervisors may hire the services of auditors, as well as other professionals, to assist them in the performance of their supervisory duties. However, CNBV reports not to make use of external consultants to perform supervisory work.
EC12	The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.
Description and findings of EC12	CNBV maintains several supervisory information systems for its ongoing supervision of institutions and regulated groups. These facilitate the processing, analyzing, and monitoring of prudential information. The data and information generated from these databases are then used for follow-up supervisory actions. In addition to a uniform institution performance analysis, which enables peer group analysis, supervisors are able to monitor and analyze prudential information through alerts and stress testing results calculated and distributed by the technical vice-presidency. These alerts intend to automatically identify rule breaches or potential risks on data submitted by firms.
Assessment of Principle 9	Largely Compliant
Comments	The assessors reviewed a sample of materials discussed above, such as on-site examination reports, supervisory plans, and banks' financial assessment reports, together with other

	<p>inspection related documents (letters of observation and corrective measures). These supervisory reports were considered mostly rule-based oriented, which makes them effective to verify compliance with prudential regulations, but not as effective to convey meaningful findings concerning risk management practices and corporate governance issues.</p> <p>The deployment of supervisory resources has required to be adjusted in recent years as a consequence of budgetary restrictions (see CP 2), which so far has been adequately coped with by CNBV without seriously affecting core supervisory activities.</p>
Principle 10	Supervisory reporting. The supervisor collects, reviews, and analyses prudential reports and statistical returns ³⁰ from banks on both a solo and a consolidated basis, and independently verifies these reports through either on-site examinations or use of external experts.
Essential criteria	
EC1	The supervisor has the power ³¹ to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations (including by economic sector, geography, and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.
Description and findings of EC1	<p>In accordance with the last paragraph of Article 5 of CNBV Law, CNBV is empowered to request from all supervised entities, and any other person subject to its supervision, all kinds of information and documents relating to their activities.</p> <p>CNBV requires periodic financial reports through its inter-institutional information transfer system (SITI). Clear instructions have been disseminated on filling out the regulatory reports. In this regard, the information sent by banks must meet strict quality standards. Overall, periodic financial returns allow CNBV to capture data on and off-balance sheet liabilities and assets, profit and loss, capital adequacy, liquidity, large exposures, loan loss provisioning, foreign currency and exchange rate related contracts, loan classification, staffing, maturity of on- and off-balance sheet items and deposits by currencies of denomination. The periodic information gathered permits CNBV to get a fair picture of risk profiles and risk exposures of individual banks and the system as a whole.</p> <p>The periodic reports that are submitted through the SITI are the following: Financial Situation, Commercial Credit Report, Guarantee Report, Credit Risk Rating, Operational Risk Report, Consolidated Financial Information, Regulatory Capital Report, Qualitative Information, Risks, Claims, among others (Article 207 of the CUB).</p>
EC2	The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.

³⁰ In the context of this Principle, “prudential reports and statistical returns” are distinct from and in addition to required accounting reports. The former are addressed by this Principle, and the latter are addressed in Principle 27.

³¹ Please refer to Principle 2.

Description and findings of EC2	In Mexico, banks are required to submit their prudential reports based on the Accounting Standards defined by CNBV. The requirements are also in line with the relevant internationally accepted accounting principles, which call for banks to adopt prudent valuation methods and use current values as necessary (Annex 33 of the CUB).
EC3	The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and are consistently applied for risk management and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether the valuation used for regulatory purposes is reliable and prudent. Where the supervisor determines that valuations are not sufficiently prudent, the supervisor requires the bank to make adjustments to its reporting for capital adequacy or regulatory reporting purposes.
Description and findings of EC3	Article 102 of the LIC establishes that CNBV will establish rules to ensure an adequate valuation of assets and liabilities for accounting purposes. Accordingly, banking regulation includes valuation rules and other accounting and financial statement matters (included in Chapter II of title Three of the CUB, Articles 175 Bis to 175 Bis 8). In accordance with the aforementioned regulations, the Board of Directors is responsible for approving the contracting of a price provider, whose designation must be notified to CNBV. Regarding the internal valuation models, the Risk Committee is responsible for their approval (including modifications), considering the methods of estimating the variables applied to the models that are not provided by the price providers, as well as the securities and financial instruments to which the internal models will be applied. Within CNBV, there is a specialized department in charge of supervising pricing providers. This area maintains regular communication with other CNBV surveillance areas in order to ensure the proper use of prices in banking models. If those areas determine that valuations are inadequate, adjustments would be requested.
EC4	The supervisor collects and analyses information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank.
Description and findings of EC4	CNBV requires different returns to be submitted on a monthly, quarterly, and semi-annual or annual basis. Most schedules are required to be submitted monthly such as assets and liabilities, loan classification, and provisioning, while liquidity reports are submitted on a daily basis. The frequency of the returns is primarily based on the importance of information. All banking institutions are obliged to submit the same set of information regardless of their size.
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings of EC5	The technological platform designed by CNBV for regulatory reporting allows off-site examiners to make meaningful comparisons between banks and banking groups. The

	system permits management of information across institutions and sectors and facilitates the analysis and development of aggregated statistical data.
EC6	The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.
Description and findings of EC6	CNBV law (Art. 19) empowers CNBV to request and receive any relevant information from banks. This power is even broader than for any other agency, including the financial intelligence unit. CNBV has broad authority to obtain information from supervised banks, including quantitative information, such as prudential returns, and qualitative information, such as banks' internal management reports. In addition, CNBV is entitled to receive information on a bank's controlling shareholders (with some exceptions, e.g., in the case of mixed activity groups). Additionally, Article 120 of the LIC establishes that IPAB, with the participation of CNBV, Banxico and SHCP, may prepare resolution plans for banking institutions. Resolution plans shall be confidential, without prejudice to the exchange of information between authorities. For the design of the plans, IPAB may request from the banks all the necessary information, including that of the companies belonging to the same business group.
EC7	The supervisor has the power to access ³² all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management, and staff, when required.
Description and findings of EC7	CNBV is vested with the authority to review all the records of the bank that are considered necessary in connection with its mandate. Article 19 of the LIC states that banks are obliged to provide the data, reports and all the information required by CNBV.
EC8	The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines the appropriate level of the bank's senior management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended. The supervisors have full access to banks' staff, managers, and board members as warranted; in practice, supervisors have frequent working meetings with them.
Description and findings of EC8	According to the law, banks are required to provide all the legal, managerial, financial, and additional information required by CNBV. Failure to comply with these requirements, i.e., late submission or inaccurate information, can lead to monetary penalties and other enforcement actions. In practice, CNBV has imposed penalties on banks for failure to comply with reporting obligations. In this regard, CNBV has made efforts to increase the quality of reporting from banks. Article 108 of the LIC establishes economic sanctions for non-compliance with the obligations to report in the terms established in articles 181 to 183 of the CUB.

³² Please refer to Principle 1, Essential Criterion 5.

EC9	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a program for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts. ³³
Description and findings of EC9	Banks' information is received by specialized areas of CNBV; its content is quantitatively validated and subsequently processed and stored in CNBV systems, which are accessible to managers through the Intranet. Subsequently, according to internal guidelines contained in the institutional oversight manual (MIS), off-site supervisors proceed to the analysis of the information and assess the behavior of various basic indicators, such as liquidity, solvency, leverage, transactions with related parties, as well as profitability (ROE). Quarterly reports are prepared containing an analysis of the evolution of the main aspects of the risks incurred by banks, by comparing the trends with the previous 12-month period. If necessary, examiners meet with other specialized areas of CNBV in order to jointly analyze any relevant issue. With regard to the annual returns, CNBV verifies that they are reported in compliance with the accounting standards established in the CUB, and in conformity with the financial reporting standards issued by the CINIF. It should be added that on-site inspections also corroborate the accuracy of regulatory returns.
EC10	The supervisor clearly defines and documents the roles and responsibilities of external experts, ³⁴ including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated task(s) and the quality of the work and takes into consideration conflicts of interest that could influence the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.
Description and findings of EC10	To date there is no verification of such reports by an external expert, but CNBV can hire external consultants and/or instruct an external auditing firm to conduct supervisory tasks and monitor the quality of the work.
EC11	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
Description and findings of EC11	See EC 10 above. External Auditors are obliged to report to CNBV on acts carried out to the detriment of the bank regardless of whether they have an impact on its financial situation.
EC12	The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.
Description and findings of EC12	The process of receiving and validating information from regulatory reports is documented. The process establishes validations criteria applied by CNBV to determine the consistency of the information. All banks are ranked considering the opportunity in the delivery of the information, as well as the quality of it.

³³ May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

³⁴ May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be satisfied with the results of the reviews conducted by such external experts.

	CNBV is continuously evaluating whether the information is sufficient to meet supervisory needs, and new reporting requirements are frequently introduced to capture market developments. For instance, new templates were introduced to follow-up COVID-19 related risks, including classification and provisioning of refinanced and restructured operations.
Assessment of Principle 10	Compliant
Comments	CNBV has developed a sophisticated system for collecting, reviewing, and analyzing prudential reports and statistical returns from banks, which is updated as needed. The technological platform designed for regulatory reporting allows proper management of information comparable across institutions and sectors and facilitates the analysis and development of aggregated statistical information.
Principle 11	Corrective and sanctioning powers of supervisors. The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
Essential criteria	
EC1	The supervisor raises supervisory concerns with the bank's management or, where appropriate, the bank's Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank's Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.
Description and findings of EC1	In the course of the supervisory process, CNBV communicates continuously with the bank management, and on occasion with the bank Board and relevant departments, on the deficiencies brought out by the on-site, off-site or other examinations (external audits and AML/CFT inspections) and expects that the issues will be resolved satisfactorily. When there are significant findings, CNBV notifies the Board of Directors. A supervisory letter called Oficio de Observaciones is issued at the end of the examination to communicate major concerns. Senior management also receives an official letter containing all the on-site examination findings. The rectification of these deficiencies is followed up periodically by the staff in charge of off-site surveillance as well as during subsequent on-site examinations. Actions taken by banks in response are also taken into account in determining the scope of ensuing on-site examinations. When observations have been partially or improperly addressed, CNBV will send another letter (Oficio de Medidas Correctivas) instructing the bank to take prompt actions in a specific timeframe. As part of the ongoing surveillance, there is a mechanism to closely monitor corrective measures, through progress reports provided by the bank under scrutiny. In addition, a CNBV team meets with the bank's Board members and senior management to discuss issues of common concern and the status of the corrective measures. These meetings are attended

	by CNBV's supervision vice-president, the director general, and deputy director general responsible for overseeing the specific entity. The President of CNBV also participates whenever it is necessary. The LIC lays out the different measures that CNBV can take, particularly when capital begins to deteriorate. As a whole, all these elements give CNBV a good framework for its actions and some flexibility to use supervisory judgment and expertise. See Art. 117, 118, 121 and 126 of the LIC.
EC2	The supervisor has available ³⁵ an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory actions, is engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened.
Description and findings of EC2	<p>When a bank is in violation of laws or regulations, including improper risk management practices, CNBV is empowered to impose corrective measures independently of any sanction that can be taken. The assessors have evidenced the exercise of these powers when needed. The most significant measures are listed below:</p> <ul style="list-style-type: none"> • Present observations and order the application of corrective or remedial actions, as a result of its supervisory processes. • Impose minimum and additional corrective actions for the reestablishment of capitalization levels (within the prompt corrective actions regime). • Limit or order the suspension of operations. • Require adjustments in prudential policies and the corporate governance structure. • Require adjustments to the accounting records. • Determine and impose fines. • Order the dismissal of, and impose a temporary suspension of, members of the Board of Directors as well as managers. • Decide on the viability of capital restoration plans and the entry of a troubled bank into the Conditional Operation Regime. • Declare the managerial intervention of a bank. • If the bank repeats offenses to Article 106 (general prohibitions) or fails to adopt the prompt corrective measures set forth by CNBV, the supervisor can revoke the license. (See Art. 50, 122, 129 of the LIC; Art. 6 bis, 7, 25, 28, 29, 122, 128, 129, of CNBV Law).
EC3	The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.
Description and findings of EC3	CNBV carries out continuous monitoring of main prudential indicators and risk metrics of banking institutions, which allows the early identification of potential breaches of regulatory limits, which in turn leads to supervisory actions aimed at activating corrective measures (See CP 16).

³⁵ Please refer to Principle 1.

	<p>If a bank exceeds the regulatory limits, by issuing a corrective action formal letter CNBV determines the corrective actions the bank should implement to remain within the regulatory limits.</p> <p>When the commercial banks do not comply with the capitalization index or with the basic part of the net capital, CNBV must order the application of the following minimum corrective measures:</p> <ul style="list-style-type: none"> (a) Inform its board of the situation, as well as the causes that motivated it, for which they must present a detailed assessment regarding its financial condition. (b) Present to CNBV for approval, a capital restoration plan. (c) Totally or partially suspend the payment to the shareholders of dividends coming from the institution, as well as any other mechanism or act that implies a transfer of pecuniary rights. (d) Totally or partially suspend the repurchase programs of representative shares of the capital stock of the commercial bank. (e) Totally or partially defer or cancel the payment of interest and, if warranted, totally or partially defer or cancel the payment of the principal or convert into shares the subordinated debentures that are in circulation. (f) Suspend the payment of compensations and extraordinary bonuses additional to the salary of the general director and the officials of the two hierarchical levels below the latter. (g) Abstain from increasing credits to related parties. <p>Independently of the minimum aforementioned corrective measures, CNBV may order the commercial banks to apply the following additional special corrective measures:</p> <ul style="list-style-type: none"> (a) Define concrete actions to avoid deteriorating its capitalization. (b) Contract the services of external auditors or specialized third parties to carry out special audits on specific issues. (c) Abstain from agreeing on increases in the salaries and benefits of the officials and employees. (d) Replace officials, directors, examiners, or external auditors. (e) Any other determined by CNBV based on the results of their inspection and surveillance activities. <p>In the event that a credit institution does not comply with the liquidity prudential requirements or CNBV determines that it will not be possible to comply with said requirements in the future, it must immediately notify CNBV. CNBV may order the application of the following measure:</p> <ul style="list-style-type: none"> (a) Inform CNBV and Banxico of the causes that gave place to the default of the respective requirements. (b) Inform their Managing Board, through a detailed report, of its liquidity condition, as well as the causes that motivated the breach of the requirements. (c) Present a liquidity restoration plan in a term no greater than five business days from when said notice.
--	--

	<p>(d) Suspend the payment of dividends to shareholders that come from the institution, as well as any mechanism or act that implies a transfer of pecuniary benefits.</p> <p>(e) Limit or prohibit transactions in such a manner that compliance with the requirements is reestablished.</p>
EC4	<p>The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.</p>
Description and findings of EC4	<p>CNBV has established a corrective and remedial regime that facilitates timely corrective actions. Remedial measures range from informal instructions directing a particular response by management, to the severe action of intervention and, if needed, liquidation (through the suspension of the institution's license). The assessors have verified that in the last five years CNBV duly considers the seriousness of the situation, and has adopted corrective or remedial measures accordingly.</p> <p>As mentioned in EC2, remedial actions include:</p> <ul style="list-style-type: none"> • Present observations and order the application of corrective or remedial actions, as a result of its supervisory processes. • Require a Capital restoration plan. • Impose minimum and additional corrective actions for the reestablishment of capitalization levels (within the prompt corrective actions regime). • Restrict the payment of dividends or share repurchase. • Suspend interest and capital payments of subordinated debt. • Not increase lending to related parties. • Limit or order the suspension of operations. • Require adjustments in prudential policies and the corporate governance structure. • Require adjustments to the accounting records. • Determine and impose fines. • Order the dismissal of, and impose a temporary suspension of, members of the Board of Directors as well as managers. • Decide on the viability of capital restoration plans and the entry of a troubled bank into the Conditional Operation Regime. • Declare the managerial intervention of a bank by IPAB. <p>If the bank repeats offenses to Article 106 (general prohibitions) or fails to adopt the prompt corrective measures set forth by CNBV, the supervisor can revoke the license, with</p>

	<p>prior approval from CNBV's governing Board, after listening to the Bank, and the opinion of Banxico and IPAB. (See Art. 28 of the LIC).</p> <p>CNBV makes available to the public in its portal the penalties imposed to entities and individuals.³⁶</p>
EC5	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Description and findings of EC5	Sanctions and criminal definitions in the LIC can apply to institutions, Board members, shareholders, managers and individuals (Section 5, Chapter II).
EC6	The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related entities in matters that could impair the safety and soundness of the bank or the banking system.
Description and findings of EC6	<p>Article 74 of the LIC establishes that in the event that the actions taken by the parent company, an economic group to which the institution or companies related to the bank belong, could affect its solvency, liquidity, or stability, CNBV has the power to adopt the following measures:</p> <p>(a) Order additional capital up to 50 percent of the minimum capital requirements, in addition to those provided for in article 50 of the LIC.</p> <p>(b) Suspension of all operations with related parties.</p> <p>CNBV is empowered to request the information related to the financial situation of related parties. In case of failure to provide the required information in a timely manner, it will be presumed that the institution presents problems that affect his liquidity, stability or solvency and the Commission may discretionally adopt the measures indicated in paragraphs a) and b) above.</p> <p>As mentioned in BCP1 and BCP 12, in the case of unregulated financial conglomerates, the ring fencing options available for the authorities to effectively protect the bank from indirect risks steaming from the activities of non-regulated financial entities of the conglomerate are limited.</p>
EC7	The supervisor cooperates and collaborates with relevant authorities in deciding when and how to affect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings of EC7	As detailed in EC5 of BCP3, CNBV actively participates and collaborates with other authorities to resolve distressed banking institutions.
Assessment of principle 11	Largely Compliant
Comments	Mexico has established a supervisory regime that can deliver timely corrective actions. Remedial measures range from informal instructions directing a particular response by management, to the severe action of intervention and, if needed, liquidation (through the suspension of the institution's license). CNBV puts great emphasis on the early detection of problems. In this regard, CNBV has issued rules to classify banks in a particular category

³⁶ <https://sanciones.cnbv.gob.mx/>

	<p>based on their CAR in order to perform early detection, intervention and resolution of troubled banks. As for sanctions more specifically, CNBV is the authorized enforcement agency. It can apply both fines and administrative penalties, including revocation of the license in the most severe cases. Sanctions against individuals are also permitted by law. CNBV can apply fines under the LIC to banks' directors, managers, officers, and staff more broadly. Under the current regime, CNBV is empowered to take corrective measures against banks while IPAB is the lead agency in case of liquidation.</p> <p>As mentioned in EC6, ring fencing options available for the authorities to effectively protect the bank from indirect risks stemming from the activities of non-regulated financial entities belonging to the same group are limited.</p>
Principle 12	Consolidated supervision. An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide. ³⁷
Essential criteria	
EC1	The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including non-banking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings of EC1	<p>CNBV has a good understanding of the structure and the activities of banking groups under its supervision and subject to consolidated supervision, particularly the structure of regulated financial groups.</p> <p>As of June 2011, there were 21 regulated financial groups authorized by SHCP under the Law of Financial Groups ('Ley para Regular las Agrupaciones Financieras' or LRAF). Under the LRAF, the parent of a regulated financial group must be a regulated holding company (HCO) licensed at 'level 2' by SHCP, and above other financial sector institutions placed at 'level 1' (e.g., banks, insurance, and brokerage companies, etc.) regulated by CNBV and other financial sector supervisors. HCOs are non-operational companies whose activities are limited to holding the participations of the financial institutions that they control in two or more financial sub-sectors.</p> <p>HCOs cannot borrow to leverage their capital, which must be at least equal to the capital needs of the regulated financial entities under their control. Under the LAF, there are no additional prudential rules applicable at HCO level 2, such as consolidated lending limits, related party lending limits, or compliance with other corporate governance and risk management standards.</p> <p>Eight out of the 21 regulated financial groups are controlled by well-known international banks. In other 8 cases, the groups can be categorized as mixed-financial groups since,</p>

³⁷ Please refer to footnote 19 under Principle 1.

	<p>apart from a bank; these groups include insurance and brokerage companies, as well as SOFOMES and other types of companies.</p> <p>CNBV has good information to monitor regulated financial groups on a regular basis. However, CNBV has identified seven mixed-activity corporate groups with an associated bank and, in some cases, a financial group, which are unregulated since they are not subject to consolidated supervision (see EC3 of BCP1). In these cases, the regulatory and supervisory powers of CNBV are just limited to the regulated bank and CNBV lacks a sufficient understanding of the structure and activities of these unregulated groups.</p> <p>A good example of a case of unregulated group is the case of a well-known Mexican (parallel) bank and its unregulated holding company that conducts commercial activities domestically and abroad. Both constitute a horizontal mixed-activity banking group with banking subsidiaries across jurisdictions in the Latin American region. All of these banking units are controlled by the unregulated commercial company, and are not consolidated with the Mexican bank. The latter bank and the Latin American subsidiaries have the same banking name, constitute a parallel banking group, and are not supervised on a consolidated basis in Mexico given that the LAF does not empower CNBV to do so.</p>
EC2	The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, exposures to related parties, lending limits and group structure.
Description and findings of EC2	Authorized financial groups are not subject to prudential regulations at the holding level. CNBV is only vested with legal powers to impose prudential standards up to the level of the banking institution. All additional powers at level 2 of the HCO at the head of a regulated financial group belong to SHCP. A financial group at level 2 is not subject to prudential rules. Capital adequacy at level 2 is calculated as the sum of the respective capital needs of its members as per their respective sectoral regulations. If there are unregulated entities, or financial entities without explicit capital adequacy rules, there is no precise notional capital charge for them.
EC3	The supervisor reviews whether the oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks' policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.
Description and findings of EC3	Except for the case of a horizontal unregulated mixed activity banking group, referred to elsewhere in this CP, which is not under its jurisdiction, CNBV has the legal power to review the effectiveness of the oversight carried out by banks' management as regards their activities abroad.

	However, regulated financial groups operating in Mexico have no material activities abroad that might deserve CNBV to act as home supervisor.
EC4	The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.
Description and findings of EC4	As mentioned in EC3, in practice CNBV does not act as home supervisor since there are no operations abroad carried out by banks or authorized groups operating in Mexico.
EC5	The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group and takes appropriate supervisory action.
Description and findings of EC5	CNBV has no explicit powers to review the activities of unregulated parent companies acting as holding company and other associated companies.
EC6	The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it determines that: <ul style="list-style-type: none"> (a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed; (b) the supervision by other supervisors is not adequate relative to the risks the activities present; and/or (c) the exercise of effective supervision on a consolidated basis is hindered.
Description and findings of EC6	CNBV powers are limited to the groups regulated by the LAF and subject to the conditions discussed in EC2 to EC5. However, CNBV cannot confirm this power as being effectively carved out in the LIC or other enforceable legal instrument such as the LAF for other forms of conglomeration such as the mixed-activity groups and their HCO as discussed in EC2.
EC7	In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group. ³⁸
Description and findings of EC7	CNBV lacks the legal power to supervise banking institutions that operate abroad and are part of the non-regulated domestic financial group (see EC1).
Assessment of Principle 12	Materially Non-compliant
Comments	Even though the Financial Groups Law (LAF) was an important step taken in 2014 towards establishing a legal framework for consolidated supervision, it does not empower supervisors to impose prudential measures to financial conglomerates at group level. This legal shortfall prevents the LAF from allowing effective consolidated supervision.

³⁸ Please refer to Principle 16, Additional Criterion 2.

	<p>Additionally, several domestic financial conglomerates fall out of the scope of the authorities for consolidated supervisory purposes. Financial conglomerates can legally exist only if they request on a voluntarily basis being authorized by SHCP to operate as such; this authorization is limited to the firms declared by the banking group, which might sometime exclude some firms. Most of the financial conglomerates operating in Mexico are structured as authorized financial groups. However, at the time of this assessment, there were 7 domestic financial conglomerates that have not requested being authorized by SHCP to operate as such. Accordingly, these groups are not regulated and thus, as a whole, not subject to the –although limited– current consolidated supervisory regime. Some of these <i>de-facto</i> financial conglomerates not only are very active in the domestic financial market, but also are actively operating in a number of Latin American countries through banking subsidiaries and under the same brand.</p> <p>In order to effectively implement a comprehensive consolidated supervision framework, the authorities should consider amending the legal and regulatory framework, as necessary, to ensure CNBV has the powers to:</p> <ul style="list-style-type: none"> (a) apply a comprehensive set of prudential requirements to the financial group as a whole, (b) enforce consolidated supervision to all <i>de-facto</i> Mexican financial conglomerates, while applying discretionary powers to include as part of the group all relevant entities, including those operating abroad and those not declared as part of the financial group.
Principle 13	Home-host relationships. Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.
Essential criteria	
EC1	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.
Description and findings of EC1	At present, there are no Mexican banking institutions with a material cross-border presence that might justify the establishment of supervisory colleges with CNBV acting as home supervisor.
EC2	Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and risk management practices of the

	banking group ³⁹ and on the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential information.
Description and findings of EC2	<p>The law (Art. 147 of the LIC) empowers CNBV to exchange information with foreign counterparts based on bilateral MOUs. These MOUs cover not only banking but also securities market activities and provide, among other things, for the exchange of public and nonpublic information, surveillance visits, and the provision of technical assistance. CNBV also participates in the supervisory colleges of large cross-border financial firms that have a significant presence in Mexico.</p> <p>The abovementioned law also allows for reciprocal inspection visits by CNBV and overseas supervisors. Such visits shall be subject to Mexican legal provisions and to terms and conditions specified in the MOU. During such visits, foreign authorities may have access to all the information needed to perform their supervisory powers, including all information and documents related to AML/CFT.</p> <p>CNBV has entered into bilateral MoUs with financial authority counterparts in many countries, including all relevant jurisdictions. MoUs have been signed with the authorities of Argentina, Canada, Guatemala, Panama, Peru, Spain, The Netherlands, United States of America, and Venezuela. With respect to the United States, it has MoUs with counterpart supervisors including the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, and the New York State Banking Department.</p> <p>The interaction of CNBV with its foreign counterparts takes place through different channels. The MOUs allow the exchange of relevant information in the context of, for example, (i) an application for a banking license, or (ii) oversight activities (e.g., an on-site cross-border inspection). Conference calls are also frequently used to update one another in respect of any event or trend that could represent a risk for a cross-border entity or for the sound development of the financial system.</p> <p>In particular, CNBV has implemented a bilateral mechanism to follow up on the financial condition of the foreign financial institutions that have investments in Mexican affiliates. Through conference calls or more formal communication channels, the main discussion items include liquidity, capital, and corporate structure. In case of serious concerns regarding a specific bank, supervisors on both sides will discuss (i) the causes of the problem and measures to be taken; (ii) details of the government's support mechanism; and (iii) the potential impact on the Mexican subsidiaries.</p>
EC3	Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups.
Description and findings of EC3	As host supervisor, the Mexican regulation permits overseas supervisors to make on-site visits to local operations. When the home supervisor wishes to conduct an on-site

³⁹ See Illustrative example of information exchange in colleges of the October 2010 BCBS Good practice principles on supervisory colleges for further information on the extent of information sharing expected.

	inspection in Mexico, it should make the request to CNBV. Such cross-border inspection visit can be carried out jointly with CNBV or by the home supervisor on its own. At the request of CNBV the foreign supervisor will share the main findings of the visit. In practice, CNBV always participates in the on-site visits led by foreign supervisors. CNBV usually coordinates visits by foreign supervisors related to onsite inspections and outsourced-related services, particularly with The Federal Reserve Board (FED) of the United States and the European Central Bank (ECB).
EC4	The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.
Description and findings of EC4	At present, there are no Mexican banking institutions with a material cross-border presence that require the Mexican authorities to act as home supervisor.
EC5	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.
Description and findings of EC5	At present, there are no Mexican banking institutions with a material cross-border presence that require the Mexican authorities to act as home supervisor.
EC6	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings of EC6	At present, there are no Mexican banking institutions with a material cross-border presence that require the Mexican authorities to act as home supervisor.
EC7	The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings of EC7	Foreign banks are subject to the same prudential requirements, such as capital requirements, liquidity ratios, large exposure limits, loan loss provisioning, reporting requirements, etc., as domestic banks.
EC8	The home supervisor is given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.

Description and findings of EC8	CNBV reports not to have any impediments to the access to local offices and subsidiaries relative to home supervisors' visits and examinations. Documents made available to the assessors confirmed that home supervisors have visited Mexico and coordinated with CNBV under the scope of signed MOUs.
EC9	The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
Description and findings of EC9	There are no shell banks and booking offices in Mexico.
EC10	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.
Description and findings of EC10	This case has not materialized.
Assessment of Principle 13	Compliant
Comments	The law empowers CNBV to exchange information with foreign counterparts based on bilateral MOUs. These MOUs provide, among other things, for the exchange of public and nonpublic information, surveillance visits, and the provision of technical assistance. CNBV also participates in the supervisory colleges of large cross-border financial firms that have a significant presence in Mexico. In recent years, CNBV has been very active on the international cooperation front.
Principle 14	Corporate governance. The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks' Boards and senior management, ⁴⁰ and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.
Essential criteria	
EC1	Laws, regulations or the supervisor establish the responsibilities of a bank's Board and senior management with respect to corporate governance to ensure there is effective control over the bank's entire business. The supervisor provides guidance to banks and banking groups on expectations for sound corporate governance.
Description and findings of EC1	The laws and regulations relating to corporate governance, as reflected in the LIC (Art. 21) and CUB (Chapter VI) mainly, are quite extensive. The responsibilities of the Board and senior management deal with the effective management and control of the bank's entire business. Specifically, the Board is charged with the approval of the objectives of the internal control system and guidelines for their implementation. The objectives deal with the establishment and monitoring of risk, establishing an internal audit function, developing and updating information systems, minimizing conflicts of interest and clearly defining the responsibilities of all functions in the bank.

⁴⁰ Please refer to footnote 27 under Principle 5.

EC2	The supervisor regularly assesses a bank's corporate governance policies and practices, and their implementation, and determines that the bank has robust corporate governance policies and processes commensurate with its risk profile and systemic importance. The supervisor requires banks and banking groups to correct deficiencies in a timely manner.
Description and findings of EC2	The supervisory requirements and supervision practices in relation to the oversight of corporate governance in banks are extensive. They are set down in both the Institutional Supervisory Handbook (MIS), and the CEFER. In the area of corporate governance, these requirements include an evaluation of the members of the Board and senior management, with particular reference to a performance review of the bank's internal control system, to ensure that the bank's Board members and senior management properly perform the corporate governance duties in all the institution's activities. In seeking to ensure this, CNBV verifies that the Board pays particular attention to the fact that senior management, including heads of the control functions (risk management, internal control and internal audit), have properly trained staff resources.
EC3	The supervisor determines that governance structures and processes for nominating and appointing Board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members
Description and findings of EC3	Corporate structures and processes are dealt with in a number of pieces of legislation (Art. 10, 22, 23, and 24 of the LIC). They set out the requirements for Board structure and appointments to the Board. The Board must have a minimum membership of 5 and a maximum of 15 of which at least 25 percent must be independent. The majority of members must be Mexicans or foreign residents in the country. Potential Board members must meet certain criteria including appropriate technical knowledge, honesty, a satisfactory credit history and an extensive knowledge and experience in financial, legal and administrative matters. Those who are ineligible to be directors are also listed, for example, employees or officials of the bank (except the CEO), people with pending litigation with the bank, people convicted for financial crime, undischarged bankrupts, or bank supervisors. The regulation mandates that all banking entities should have an audit, risk, and human resources committees. The performance of these committees is regularly assessed as part of CNBV supervisory examinations.
EC4	Board members are suitably qualified, effective and exercise their "duty of care" and "duty of loyalty". ⁴¹

⁴¹ The OECD (OECD glossary of corporate governance-related terms in "Experiences from the Regional Corporate Governance Roundtables", 2003, www.oecd.org/dataoecd/19/26/23742340.pdf.) defines "duty of care" as "The duty of a board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the board member to approach the affairs of the company in the same way that a 'prudent man' would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgment rule." The OECD defines "duty of loyalty" as "The duty of the board member to act in the interest of the

(continued)

Description and findings of EC 4	As mentioned, the LIC set out the fit and proper criteria board members must meet, including appropriate technical knowledge, honesty, a satisfactory credit history and an extensive knowledge and experience in financial, legal, or administrative matters. Supervisory examinations include the assessment of the activities carried out by the Board, as well as its decisions, so as to ensure the adequate functioning of the Board.
EC5	The supervisor determines that the bank's Board approves and oversees implementation of the bank's strategic direction, risk appetite ⁴² and strategy, and related policies, establishes and communicates corporate culture and values (e.g., through a code of conduct), and establishes conflicts of interest policies and a strong control environment.
Description and findings of EC5	Art. 68 of the CUB (Chapter IV Title 2) establishes that the Board is responsible for approving the bank's risk appetite, strategic plans, as well as the general framework for a comprehensive risk management process, and risk exposure limits. It is also established that the Board will have the responsibility of supervising the implementation of a comprehensive risk management strategy. Additionally, the CUB establishes that the Board is responsible for approving the code of conduct of the institution, as well as promoting its dissemination and application. The regulation requires that the code of conduct and its amendments be sent to CNBV within ten working days of its approval by the Board. (CUB- Article 142 Chapter VI).
EC6	The supervisor determines that the bank's Board, except where required otherwise by laws or regulations, has established fit and proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management's execution of Board strategies, including monitoring senior management's performance against standards established for them.
Description and findings of EC6	The law sets down the responsibilities of the CEO. These entail the oversight of the implementation of board decisions particularly in the area of internal control. Article 24 of the LIC establishes that the appointments of the general director of commercial banks and the officers who hold positions immediately below, shall fall on individuals who are eligible due to their credit history and honorability and, among others, have served for at least five years in high decision-making positions requiring knowledge and expertise in financial and administrative fields. CNBV does not pre-approve the appointment of the CEO on an ongoing basis. It does so as part of the bank authorization process, which entails the approval of the appointment of board members, the CEO as well as any other senior management positions (e.g., financial controller, chief risk officer). After these initial appointments, CNBV must still approve the appointment of new board members but not subsequent CEOs or senior management, although it does have the power to remove CEOs and senior management.

company and shareholders. The duty of loyalty should prevent individual board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders."

⁴² "Risk appetite" reflects the level of aggregate risk that the bank's Board is willing to assume and manage in the pursuit of the bank's business objectives. Risk appetite may include both quantitative and qualitative elements, as appropriate, and encompass a range of measures. For the purposes of this document, the terms "risk appetite" and "risk tolerance" are treated synonymously.

	As part of CNBV supervisory routines, it is verified that the Board of Directors ensures that senior management, including those responsible for the control functions (risk management, internal control and internal audit), have the knowledge, abilities and the necessary resources to properly performs their functions.
EC7	The supervisor determines that the bank's Board actively oversees the design and operation of the bank's and banking group's compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies.
Description and findings of EC7	The regulatory compensation regime for banks incorporates the Principles and Implementation Standards of the Financial Stability Board. The bank's Board is responsible for the approval of the remuneration system including the policies and procedures that regulate it. Inter alia, the remuneration system can use mechanisms to align compensation with risk-taking incentives, considering quantitative and qualitative risk measures, as well as adjusting variable remuneration accordingly or deferring its pay until all results and risks have been materialized (CUB Section 8, Chapter VI).
EC8	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (e.g., special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings of EC8	CNBV makes this assessment by periodically examining the Board minutes and those of the Board Committees (Audit, Risk, Capital, etc.) and by forming a view of how the bank is managed through the interaction between the supervisors and the bank in general.
EC9	The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.
Description and findings of EC9	Art. 25 of the LIC empowers CNBV to order the suspension, removal or destitution of any directors or officers of banking organizations, as well as to impose the suspension from three months and up to five years, to the aforementioned individuals should they incur in serious or reiterated violations to the LIC and to the general provisions derived thereof.
Assessment of Principle 14	Largely Compliant
Comments	The laws and regulations relating to corporate governance, as reflected in the LIC and CUB mainly, are quite extensive and cover all relevant issues included in this BCP. However, the assessment of the quality and effectiveness of corporate governance and management –performed through the CEFER and meetings with board members and senior managers– could be enhanced further by giving a more prominent role to expert judgement. For instance, on the timeliness and quality of data available to the board, the time that directors are able to devote to the role, and the collective suitability and patterns of board discussions.

Principle 15	Risk management process. The supervisor determines that banks ⁴³ have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate ⁴⁴ all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including robust and credible recovery plans where warranted) that take into account the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank. ⁴⁵
Essential criteria	
EC1	The supervisor determines that banks have appropriate risk management strategies that have been approved by the banks' Boards and that the Boards set a suitable risk appetite to define the level of risk the banks are willing to assume or tolerate. The supervisor also determines that the Board ensures that: <ul style="list-style-type: none"> (a) a sound risk management culture is established throughout the bank. (b) policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite. (c) uncertainties attached to risk measurement are recognized. (d) appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff. (e) senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.
Description and findings of EC1	Article 65 of the LIC empowers CNBV to issue regulations on credit and overall risk management. This mandate has been completed in the CUB, articles 68 et seq, that set out the risk management regulatory framework for banks, which hinges around the risk committee, required by article 70. In short, the board approves the objectives, guidelines, policies, and limits; the risk committee ensures that they are observed; the risk management unit identifies, measure, monitor, and report risks; and the CEO ensures independence between the risk management unit and the business units. Articles 68 and 69 of the CUB stipulate the role and responsibilities of the board and senior management regarding risk governance and risk management.

⁴³ For the purposes of assessing risk management by banks in the context of Principles 15 to 25, a bank's risk management framework should take an integrated "bank-wide" perspective of the bank's risk exposure, encompassing the bank's individual business lines and business units. Where a bank is a member of a group of companies, the risk management framework should in addition cover the risk exposure across and within the "banking group" (see footnote 19 under Principle 1) and should also take account of risks posed to the bank or members of the banking group through other entities in the wider group.

⁴⁴ To some extent the precise requirements may vary from risk type to risk type (Principles 15 to 25) as reflected by the underlying reference documents.

⁴⁵ It should be noted that while, in this and other Principles, the supervisor is required to determine that banks' risk management policies and processes are being adhered to, the responsibility for ensuring adherence remains with a bank's Board and senior management.

	<p>The board is responsible for approving –and annually reviewing– the objectives, guidelines and policies for a comprehensive risk management framework, as well as for setting exposure limits (which could be delegated in the risk committee), and procedures for corrective actions. The board can exceptionally approve exceeding the risk limits. The CEO is responsible for ensuring appropriate independence between the risk management unit and the business units, as well as implementing:</p> <ul style="list-style-type: none"> • Biannual review programs by the risk management and the business units on compliance of objectives, processes, and controls. • Adequate systems to store, process, and manage information. • Advise and implement contingency plans for surpassing risk limits and risk tolerance due to force majeure. • Training programs for staff involved in risk taking. • Procedures for information flows between business units and the risk management unit. • Endorse the biennial technical evaluation on comprehensive risk management prepared by the risk committee. <p>The risk committee is made up of at least two directors, the CEO, and the heads of risk management and internal audit; the latter, as well as other individuals who may be invited, attend the meetings only in an advisory capacity with no voting rights (Article 70 LIC). Its functions include (articles 71 and 72):</p> <ul style="list-style-type: none"> • Propose to the board the objectives, guidelines and policies; global and specific limits; procedures for corrective actions; circumstances when limits can be exceeded; and exceptionally approve exceeding limits. • Approve risk methodologies and models, including for new products and operations; corrective actions proposed by the risk management unit; technical evaluation report of the comprehensive risk management; and risk management manuals. • Appoint and remove the chief risk officer. • Quarterly report to the board the risk exposure. • Report to the board corrective measures adopted. • Ensure knowledge of risk limits and risk tolerance levels by staff involved in risk taking. <p>The risk management unit, independent from the business units and reporting to the risk committee, is established by article 73, with the objective to identify, measure, monitor, and report quantifiable risks. Its functions (article 74) include:</p> <ul style="list-style-type: none"> • Ensure that all risks incurred by the bank are measured, controlled and managed. • Propose to the risk committee the methodologies, models, and parameters used for risk management. • Monitor observance with quantifiable risk limits and risk tolerance, broken down by business unit and risk driver; gather information to assess possible impact of unquantifiable risks. • Provide to the risk committee, the CEO, and business unit managers information on risk exposures, including sensitivity analysis; deviations from limits, including possible corrective measures.
--	--

	<p>CNBV carries out the assessment of the risk management function through the CEFER reviews and on-site inspections. The CEFER methodology describes 10 so-called 'principles' to review, detailed further in a few 'hints', for each principle. The principles refer to the following matters: capital planning, model validation, capital distribution by business lines, excess capital that banks are willing to maintain, stress testing, capital contingency plan; as well as particularities for credit, interest rate, operational, and liquidity risks. On-site reviews are focused on the review of the minutes of the board meetings, including the accompanying documentation.</p> <p>CNBV also checks that banks perform a yearly internal audit review and a technical evaluation by management of the overall risk management function (Articles 76 and 77, CUB), which are submitted to CNBV for supervisory purposes. The technical evaluation should discuss the quality of data and models used for risk management purposes. CNBV has introduced some level of proportionality by reducing the frequency of the review for less significant institutions.</p> <p>The principles and hints concerning risk management analyzed in the CEFER, together with the ones related to corporate management, consider the issues mentioned in the criteria. However, as described in other principles, the assessment of banks' overall risk management framework, as described in the CEFER methodology tends to rely on a formalistic approach rather than on expert judgement.</p>
EC2	<p>The supervisor requires banks to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate:</p> <ol style="list-style-type: none"> to provide a comprehensive "bank-wide" view of risk across all material risk types. for the risk profile and systemic importance of the bank. to assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank's risk management process.
Description and findings of EC2	<p>Article 67 mandates banks to develop policies and procedures to:</p> <ul style="list-style-type: none"> • Manage of the different risks assumed, either quantifiable or non-quantifiable. • Delimitate the different roles, activities and responsibilities of the different governance bodies, managing units, and staff. • Identify, measure, monitor, control, and report the different quantifiable risks. • Group, including financial subsidiaries, the different risks by business unit or risk driver. <p>Articles 79 to 86 set out the detailed requirements for each of the main risks (credit, liquidity, market, and operational risk), as discussed in each relevant CP in this document. Article 87 mandates appropriate risk management information and systems, and Article 88 sets out the adequate scope of related public disclosures.</p> <p>Risk management policies and procedures are reviewed by CNBV through the CEFER and on-site inspections, as described in EC1.</p>
EC3	<p>The supervisor determines that risk management strategies, policies, processes and limits are:</p> <ol style="list-style-type: none"> properly documented.

	<p>(b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions.</p> <p>(c) communicated within the bank.</p> <p>The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank's Board where necessary.</p>
Description and findings of EC3	<p>Article 78 of the CUB requires proper documentation of risk management policies and procedures, including risk profile; organizational structure that ensures independence of the risk management unit from the business units; manner and frequency of reporting to the board, risk committees and CEO; functions and responsibilities of risk-taking staff; general and specific risk limits; internal measures to correct deviations; procedures to approve new products; and procedures to approve excess to the different limits.</p> <p>Risk management policies and procedures are reviewed by CNBV focusing on the quality of the policies and procedures and that they are fit for purposes and updated, communicated across the organization, the level of involvement of the governance bodies, the independence of the internal reviewers (including internal audit), that due consideration is given to market and systemic conditions, and the suitability of the checks to spot excessive risk taking.</p>
EC4	<p>The supervisor determines that the bank's Board and senior management obtain sufficient information on, and understand, the nature and level of risk being taken by the bank and how this risk relates to adequate levels of capital and liquidity. The supervisor also determines that the Board and senior management regularly review and understand the implications and limitations (including the risk measurement uncertainties) of the risk management information that they receive.</p>
Description and findings of EC4	<p>Per Article 74 of the CUB, the risk management unit must report monthly to the risk committee, the CEO, and the business units, and quarterly to the board, the risk exposures of quantitative risks and the impact of qualitative risks (current and evolution), possible breach of limits, and proposal of corrective actions. The risk committee must meet at least monthly to review these reports, documenting its sessions.</p> <p>The board must review at least annually the limits for each risk, the overall risk management framework, and the coherence of the ICAAP with the bank's risk appetite, as well as the capital and liquidity levels vis-à-vis the strategic plans.</p> <p>CNBV checks that the information prepared by the risk management unit is of good quality, covers all the relevant risks, and is reported timely.</p>
EC5	<p>The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.</p>
Description and findings of EC5	<p>Article 50 Bis of the LIC requires commercial banks to evaluate, at least once a year, if the capital that they have is sufficient to cover possible losses arising from the risks in which said banks may incur in different scenarios, including adverse scenarios. If, according to this exercise (Evaluation of the Sufficiency of Capital), capital is not sufficient to cover the</p>

	<p>estimated losses, the bank must prepare an action plan (PAP, or Preventive Action Plan) to cover the estimated</p> <p>Losses. The ESC must consider qualitative and quantitative internal and supervisory scenarios and estimate capital and liquidity projections.</p> <p>The implementing regulation issued by CNBV (Chapter VI Bis and Annex 12-D) details the requirements of the ESC, including scenarios and shocks with a negative impact in capital and liquidity (adverse movements in asset prices, including foreign currency denominated; financing stress, including deposit withdrawals; rating downgrades; increase in volatility; etc.). Additionally, CNBV publishes a manual, including FAQs, with the particular features of the upcoming ESC.</p> <p>Additionally, Article 81 of the CUB requires banks to estimate potential losses stemming from forced sales of financial assets or inability to renew liabilities and prepare a plan to cope with unexpected financing needs.</p> <p>CNBV review of banks' capital and liquidity adequacy in relation to their risk appetite and risk profile focus on assessing the risks to what they are exposed and their internal control system and management performance, and compliance with internal regulations and good practices.</p>
EC6	<p>Where banks use models to measure components of risk, the supervisor determines that:</p> <ul style="list-style-type: none"> (a) banks comply with supervisory standards on their use; (b) the banks' Boards and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and (c) banks perform regular and independent validation and testing of the models. <p>The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.</p>
Description and findings of EC6	<p>Per Article 75b of the CUB, banks' risk management units must yearly assess the suitability of internal models and risk measurement systems and report the outcome of the assessment to the risk committee; and monthly check that the observed exposure match the estimates—and correct the model as warranted.</p> <p>The internal audit must yearly review the overall risk management (Article 76 CUB) to validate that the model reviews are well documented and approved by the risk committee, as well as the IT systems used.</p> <p>CNBV (Technical Vice Presidency modelling experts) reviews and validates the banks' internal models, including performing parallel calculations. Internal models used for the assessment of credit risk and the stability of deposits for market risk purposes must comply with the requirements of the CUB and be approved by CNBV.</p> <p>All internal models used for risk management purposes must be approved by the banks' risk committee and annually updated by the risk management unit. The Board has to know the functioning of the models, additionally the head of risk control yearly reports to the risk committee and, in turn to the board, their performance.</p>
EC7	<p>The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing and reporting on the size, composition and quality of exposures on a bank-wide basis across all</p>

	risk types, products and counterparties. The supervisor also determines that these reports reflect the bank's risk profile and capital and liquidity needs, and are provided on a timely basis to the bank's Board and senior management in a form suitable for their use.
Description and findings of EC7	The adequacy of banks' information systems is done by means of the annual off-site review of the internal reports submitted to the board, risk committee and CEO; risk focused inspections; and specialized on-site inspections. CNBV has carried a good number of inspections that have reviewed risk management information systems, where remedial measures have been adopted to address deficiencies, such as the quality of data, the use of spreadsheets not directly fed from the data repositories, and failure to consider all the relevant data.
EC8	The supervisor determines that banks have adequate policies and processes to ensure that the banks' Boards and senior management understand the risks inherent in new products, ⁴⁶ material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model and major acquisitions). The supervisor determines that the Boards and senior management are able to monitor and manage these risks on an ongoing basis. The supervisor also determines that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by their Board or a specific committee of the Board.
Description and findings of EC8	Banks' comprehensive risk management frameworks, approved by boards, must include—from a risk management perspective—the procedures to approve new products or business lines, as well as risk strategies. The proposal must include a description of the new operation, its risk analysis, cost/benefit assessment, and the methodology and procedure that will be used to identify, measure, monitor, control and report such risks, together with a legal feasibility assessment. These methodology and procedure are approved by the risk committee. Through on- and off-site reviews, CNBV checks that this approval procedure exists and reviews its implementation when warranted.
EC9	The supervisor determines that banks have risk management functions covering all material risks with sufficient resources, independence, authority and access to the banks' Boards to perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the Board and senior management. The supervisor also determines that the risk management function is subject to regular review by the internal audit function.
Description and findings of EC9	Per Article 78 of the CUB, the comprehensive risk management framework must consider the organizational structure that supports risk management, with a clear job description for all positions. The risk management unit must be independent from the business and risk-taking units and report directly to the risk committee and the board. As described above, internal audit yearly reviews risk management framework.

⁴⁶ New products include those developed by the bank or by a third party and purchased or distributed by the bank.

	Through the review of internal manuals and policies, minutes and documentation provided to the board and risk committee, organizational structure, remuneration system, reports to the board and risk committee, correction plans, and meetings with relevant staff, CNBV ensures that the risk management function have the resources to cover all material risks reports directly to the board; that their duties are clearly segregated from risk-taking, and that internal audit annually reviews risk management.
EC10	The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a Chief Risk Officer (CRO) or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the Board and generally should be disclosed publicly. The bank should also discuss the reasons for such removal with its supervisor.
Description and findings of EC10	All banks, regardless of their size and complexity, are subject to the same risk management requirements, which require a risk management framework, and a dedicated risk management unit headed by the CRO (See EC9). The appointment and removal of the CRO are decided by boards. Banks must report to CNBV the appointment of the CRO (within five days of the decision) and their removal (within ten days), explaining the reasons for such removal.
EC11	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings of EC11	Together with overall risk management standards, the CUB includes standards for credit risk, market risk, liquidity risk, interest rate risk, and operational risk. Additionally, the CUB also regulates separately legal and technological risks. In addition, the LCR and NSFR liquidity requirements are regulated separately in the Liquidity requirements regulation (<i>Disposiciones de carácter general sobre los requerimientos de liquidez para las Instituciones de banca múltiple</i>).
EC12	The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their risk management process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.
Description and findings of EC12	The CUB establishes that banks have to prepare funding contingency plans (PFC), for fortuitous events, centered on liquidity, and recovery plans (Planes de Contingencia). CNBV approve these plans, on occasion after banks' modifications observed by the assessors in the supervisory reports reviewed, as required by supervisors. Article 69 of the CUB mandates, among other duties of CEOs, to disseminate and, if needed, to implement contingency plans when, attributable to fortuitous events or <i>force majeure</i> , risk tolerance levels and risk limits are exceeded. Such plans are approved by the

	<p>risk committee. When the CEO considers that the deviation requires immediate attention because it puts the Institution's operation at risk, he/she may implement corrective actions and report to the risk committee.</p> <p>Banks must prepare liquidity contingency plans (PFC) for situations of unexpected liquidity needs. Such plans must consider the outcome of the stress test (Article 71 CUB) carried out under severe scenarios and assumptions concerning macroeconomic and market conditions, possible financing sources, deterioration in the credit portfolio, and developments in the financial system or individual institutions. The liquidity contingency plan must be documented and approved by the risk committee. It should include coordination arrangements, nomination of the individual responsible to activate the plan, the individual or committee responsible to coordinate implementation of the plan, the risk indicators, and the detailed operational tasks and responsibilities.</p> <p>Banks must prepare recovery plans (Article 119 LIC, Articles 172 Bis 37 et seq CUB) which are updated annually or as needed if the bank has undergone material changes. Recovery plans are approved by the board of each bank. Recovery plans describe what banks would do in case of severe stress of solvency or liquidity that could jeopardize their continuity as a going concern. They should describe their governance (including board approval), core business lines and critical functions, main counterparties, trigger events, and recovery measures—including their actionability. They are approved by CNBV, with the non-binding opinion of IPAB, Banxico, and SHCP. D-DIBs must submit their recovery plan every year for approval, while the rest of the banks submit their plan for approval every two years.</p> <p>The funding contingency plans and recovery plans are complementary and banks are required to explain their integration and coordinated implementation.</p> <p>Additionally, banks should prepare Business continuity plans (Planes de continuidad del negocio, Article 164 Bis, CUB) describing possible strategies, procedures, and measures to deal with operational contingencies ensuring critical procedures and minimizing possible damage.</p>
EC13	<p>The supervisor requires banks to have forward-looking stress testing programs, commensurate with their risk profile and systemic importance, as an integral part of their risk management process. The supervisor regularly assesses a bank's stress testing program and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision-making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing program:</p> <ul style="list-style-type: none"> (a) promotes risk identification and control, on a bank-wide basis (b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks; (c) benefits from the active involvement of the Board and senior management; and (d) is appropriately documented and regularly maintained and updated. <p>The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing program or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process</p>

Description and findings of EC13	<p>Stress testing, as required yearly by CNBV, is used by Mexican banks to assess their capital adequacy, as well as to improve planning processes, define the desired risk profile, and determine the risk exposure limits and risk tolerance levels. Their capital assessment policy considers the criteria under which each institution defines the exercise, considering scenarios with adverse economic conditions and stress that may compromise the adequacy of capital, liquidity, or viability. The exercise considers the total capital necessary for all the significant risks to which the institution is exposed, as well as the criteria, indicators and limits that will determine the activation of the necessary actions to maintain the level of capital according to its desired risk profile and the economic cycle. If needed, corrective measures are decided by banks' boards and reported to CNBV.</p> <p>Prior to carrying out the stress test, banks must inform CNBV of its main elements (including risks considered, scenarios and assumptions), which may require modifications to the design of the stress test. Also, CNBV may mandate more frequent testing when the desired risk profile is modified or when they do not alert about possible adverse outcomes. Stress tests must comply with the requirements of the CUB (Annex 12-B), approved by the risk committee, properly documented, and the methodology reviewed every year. CNBV checks compliance with these requirements through on-site inspection and the prior assessment of the design of the stress tests.</p>
EC14	<p>The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement and new product approval process for all significant business activities.</p>
Description and findings of EC14	<p>To assess the effects of risks in setting prices, the CUB establishes different obligations for credit risk, liquidity risk and market risk. Concerning liquidity risk management, banks must have methodologies to allocate liquidity costs to the different business units (CUB, Article 81).</p> <p>For the approval of new products Article 71 of the CUB establishes that the risk committee must approve methodologies for the identification, evaluation, measurement and control of the risks of the new operations, products and services that the bank intends to offer to the market. It is the responsibility of the risk management unit (UAIR) to prepare and present to the risk committee methodologies for the assessment, measurement and control of the risks inherent in new operations, products and services, as well as the identification of the risks they represent (Article 74 CUB).</p> <p>The technical areas of CNBV are in charge of reviewing these issues, through on-site inspections and CEFER analysis.</p>
Assessment of Principle 15	Largely Compliant.
Comments	<p>The regulations on overall risk management have been greatly enhanced since the last BCP assessment and are comprehensive and require that banks put in place overall risk management frameworks.</p> <p>Compliance with this principle could be reinforced by increasing the focus on assessing the quality of risk management rather than on formal compliance with regulatory requirements. Additionally, CNBV could consider applying proportionality to differentiate between large and complex banks and smaller banks with simpler business models</p>

Principle 16	Capital adequacy. ⁴⁷ The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
Essential criteria	
EC 1	Laws, regulations or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and findings of EC1	<p>Articles 50 of the LIC mandates banking institutions to operate at all times with a minimum net CAR and empowers CNBV to issue implementing regulation. Articles 2 Bis to 2 Bis 120 of the CUB require a minimum 8 percent of the sum of their equivalent risk-weighted assets for credit risk, market risk, and operational risk. It also grants CNBV the powers to define the components of the definition of capital and to require the conservation, systemic, and countercyclical buffers.⁴⁸ When modifying the components of capital, CNBV must hear the opinion of Banxico.</p> <p>The different components of capital and minimum levels are aligned with Basel definitions:</p> <ul style="list-style-type: none"> • 4.5 percent CET1 (Capital Fundamental) • 6.0 percent AT1 (Capital Básico No Fundamental) • 8.0 percent T2 (Capital Complementario) • 2.5 percent Capital Conservation Buffer • 0–2.5 percent Countercyclical Buffer • 0.6 percent–2.25 percent Systemic buffer for Mexican D-SIBs <p>The components of capital are aligned with the current Basel framework. The Capital Neto (Básico plus Complementario, i.e. T1 and T2) will be made up of capital contributions, as well as retained earnings and capital reserves, adding (e.g. convertible shares, eligible subordinated debt up to a 15 percent CET1 limit) or deducting (e.g. investments in banks' equity, investments in subordinated debt, shares of related companies, 50 percent of investments in DBs, shares in companies that are shareholders of the bank, loans granted to buy own shares, credit to related parties beyond the 25 percent limit, intangible assets) other elements. T2 includes eligible capital instruments, as defined in the CUB, which include subordinated debt beyond the 15 percent limit established for CET1, and 0.6 percent (banks using IRB models) or 1.25 percent (standardized approach) of the general</p>

⁴⁷ The Core Principles do not require a jurisdiction to comply with the capital adequacy regimes of Basel I, Basel II and/or Basel III. The Committee does not consider implementation of the Basel-based framework a prerequisite for compliance with the Core Principles, and compliance with one of the regimes is only required of those jurisdictions that have declared that they have voluntarily implemented it.

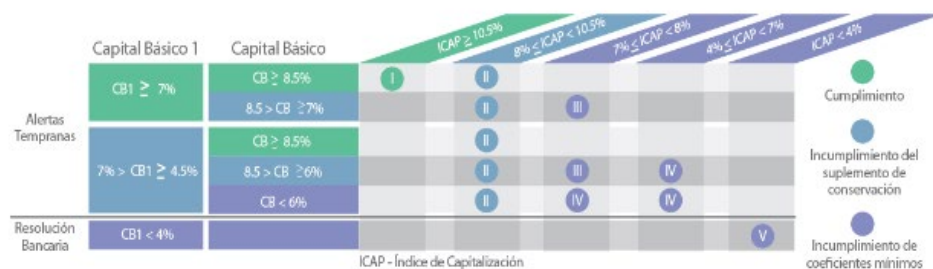
⁴⁸ On March 2015, Mexico underwent an Assessment of Basel III risk-based capital regulations (RCAP). The country was assessed by the BCBS compliant with the Basel capital standards, flagging a few items for follow-up.

credit risk provisions. Subordinated debt will be converted to capital when CET1 reach certain thresholds (5.125 percent, for instruments computed in AT1 or 4.5 percent, in T2). Including the conservation buffer and considering that the countercyclical buffer is currently 0 percent, all Mexican banks are subject to a 10.5 percent capital requirement. Additionally, D-SIBs must comply with a systemic requirement, which ranges from 0.6 percent to 2.25 percent, according to the banks' systemic impact in case of failure. At present, the six systemic banks are grouped into four categories, and the required buffers vary from 0.6 percent to 1.5 percent, growing in 0.3 pp tranches; category V, empty at present, would have a 2.25 percent buffer.

Calculation of capital requirements for each risk is detailed in the CUB, Articles 2 Bis 10 to 2 Bis 117. Banxico does this calculation with information submitted by banks and sends monthly the CARs to CNBV, that publishes it on its web page.

CNBV classifies banks according to their capital situation in 5 categories, to each of which a set of preventive and corrective measures are applied in a timely fashion (Articles 222 to 237, CUB) to restore their capital to adequate levels.

The graph below, from CNBV's web portal, shows the different categories⁴⁹.



Possible measures range from (Category II) requiring a detailed report analyzing the causes of the financial situation and a Capital conservation plan, restricting operations with related parties, or partial restrictions to pay dividends or bonuses; to (Category III) requiring a Capital restoration plan, suspension of dividends and purchase of own shares, suspension of bonuses, deferral of payment of interest and principal or early conversion of subordinated bonds; to (Categories IV and V) ban to make new investments in non-financial assets or new activities, removal of managers and directors, or limit interest paid to depositors.

Additionally, CNBV must inform IPAB of any breach of the CAR; i.e., banks in Categories III, IV and V.

Currently, all banks are in Category I. The banking system has a median CAR of 18.65 percent. The five biggest banks, holding 67 percent of the system assets, operate with CARs that range from 13.68 percent to 24.44 percent; and CET1, from 11.23 percent to 16.35 percent.

⁴⁹ Where Capital Básico 1 is CET1, Capital Básico is T1, ICAP is CAR. Blue means breach of the capital conservation buffer and purple, breach of CAR. Source: CNBV.

	<p>Total risk weighted assets amounted in June 2022 to MXN7.75 Trillion, of which 70 percent corresponded to credit risk, 20 percent to market risk (which is calculated for both the banking book and the trading book), and 10 percent to operational risk.</p> <p>Most banks in Mexico apply standardized methods for credit, market and operational risks, although the use internal methods could be authorized by CNBV for credit and market risks. Currently, no bank has applied for advanced measurement approach for market risk, and CNBV has only approved the use of 28 IRB credit risk models to six banks, for a few portfolios (corporates, mortgages, consumer, credit cards, banks, SMEs).</p> <p>The market risk capital charge under the standardized approach incorporates a charge for market risk in the full banking book, which is calculated applying standard VaR based coefficients to that broader book. This charge approximates an interest rate risk in the banking book (IRRBB) charge, which on average, according to CNBV, amounts to about what would be required for market risk in the trading book.</p> <p>Banks are to monthly publish their leverage ratio. Article 172 Bis 39 CUB establishes a 3% soft minimum leverage requirement, by defining this level of the ratio as 'sound banking practice'. Computation of the CAR and the disclosure templates are aligned with the Basel framework.</p>
EC2	At least for internationally active banks, ⁵⁰ the definition of capital, the risk coverage, the method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.
Description and findings of EC2	As described, capital requirements (definition of capital, risk coverage, method of calculation, and thresholds) in Mexico are aligned with Basel standards. They apply to all banking institutions.
EC3	The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not to have been adequately transferred or mitigated through transactions (e.g., securitization transactions) ⁵¹ entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.
Description and findings of EC3	All banks operating in Mexico are required by Article 50 of the LIC to maintain capital for credit risk, market risk, and operational risk. This article also empowers CNBV to impose specific capital requirements on all risks (both on and off balance) in which banks may be involved in their operation. Also CNBV may impose a specific capital requirement (Pillar 2) when it considers that the risk has not been adequately transferred or mitigated through other operations, as long as this situation potentially generates a deficit in the capital requirements.

⁵⁰ The Basel Capital Accord was designed to apply to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the Basel II and Basel III capital adequacy frameworks would apply such ratios on a fully consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalized on a stand-alone basis.

⁵¹ Reference documents: Enhancements to the Basel II framework, July 2009 and: International convergence of capital measurement and capital standards: a revised framework, comprehensive version, June 2006.

	<p>Article 2 Bis 117, CUB, establishes that CNBV, hearing the opinion of Banxico, may require an additional capital charge to any bank, based on the composition of assets, the efficiency of internal control systems, the risk exposure and risk management, or if deficiencies exist in policy implementation and risk recognition.</p> <p>Per Article 2 Bis 54, CUB, CNBV may assess the process and methodologies used to identify banks' securitization positions and determine whether they should be subject to capital requirements or adjustments.</p> <p>CNBV has not yet imposed Pillar 2 requirements to any bank.</p>
EC4	<p>The prescribed capital requirements reflect the risk profile and systemic importance of banks⁵² in the context of the markets and macroeconomic conditions in which they operate and constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.</p>
Description and findings of EC4	<p>The capital adequacy requirements and the leverage ratio disclosure are extended to all licensed banks. Additionally, as discussed above, CNBV, hearing Banxico, may require additional capital requirements to any bank. The modulation of the capital requirements according to the bank's risk profile and systemic relevance is achieved through the D-SIB buffer.</p> <p>Whitin the ICAAP process, capital adequacy is also assessed in the annual stress test under supervisory scenarios, through which CNBV verifies that banks have sufficient regulatory capital to continue operating in the short and medium terms in an adverse but feasible scenario. Although the exercise is mandatory for all banks, they are grouped in three levels of systemic importance, with different levels of complexity applied to each level.</p> <p>As discussed above, prior to the stress test exercise, banks submit CNBV its main elements (including risks, scenarios, and assumptions considered), which may require modifications to the design of the stress test. CNBV analyzes the projections sent by each bank and discusses any concerns they may have regarding capital adequacy or any other issue. If warranted, CNBV may make observations. The supervisory reports reviewed by the assessors included observations to banks concerning the scope and emphasis on the different risks given by banks.</p> <p>During the COVID pandemic CNBV permitted banks to use up to 50 percent of the capital conservation buffer, explaining the reasons to make use of the facility, as well as the strategy for the reestablishment of the levels of regulatory capital.</p>
EC5	<p>The use of banks' internal assessments of risk as inputs to the calculation of regulatory capital is approved by the supervisor. If the supervisor approves such use:</p> <p>(a) such assessments adhere to rigorous qualifying standards;</p>

⁵² In assessing the adequacy of a bank's capital levels in light of its risk profile, the supervisor critically focuses, among other things, on (a) the potential loss absorbency of the instruments included in the bank's capital base, (b) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (c) the adequacy of provisions and reserves to cover loss expected on its exposures and (d) the quality of its risk management and controls. Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support the risks it is running and the risks it poses.

	<p>(b) any cessation of such use, or any material modification of the bank's processes and models for producing such internal assessments, are subject to the approval of the supervisor;</p> <p>(c) the supervisor has the capacity to evaluate a bank's internal assessment process in order to determine that the relevant qualifying standards are met and that the bank's internal assessments can be relied upon as a reasonable reflection of the risks undertaken;</p> <p>(d) the supervisor has the power to impose conditions on its approvals if the supervisor considers it prudent to do so; and</p> <p>(e) if a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.</p>
Description and findings of EC5	<p>Articles 2 Bis 65, et seq, and a number of Annexes, of the CUB set forth the requirements to obtain authorization from CNBV for the use of IRB models to calculate the capital requirement for credit risk. Both foundation and advanced approaches are allowed. The requirements, which are aligned with the Basel regime, also include the bank's self-assessment, approved by the CEO, on the status of compliance with the CUB. The approval procedure requires that the applicant bank runs the model, in parallel with the standard approach, the prior three years before applying, and submits both results to CNBV. After approval the bank must continue the parallel run for another three-year period, which can be extended by CNBV. CNBV may as well order amendments, or suspend the use of IRB models, or revoke the authorization.</p> <p>Banks that choose to use IRB models must comply with the following:</p> <ul style="list-style-type: none"> • The internal rating systems must provide a statistically significant assessment of the characteristics of the borrower and a relevant segmentation of risk. • Have a comprehensive risk parameter estimation process that generates accurate, timely, and reliable estimators. • Have systems that validate the accuracy and consistency of the rating processes, as well as the estimation of all relevant risk components. They must also ensure that the internal validation process is carried out by an area independent from the one that developed the IRB model. • Annual review by the internal audit of the performance and operation of the rating system, and the estimation of the risk parameters. • Development and implementation of the must be approved by the corresponding collegiate bodies, designated by the board. <p>CNBV assesses performance of the banks' internal rating systems and may request any information from the institutions to verify compliance with current regulations, including the minimum requirements of Annex 15 of the CUB. If a bank fails to meet the minimum requirements a correction plan, which must be approved by CNBV, has to be prepared to remedy the failure. If not satisfied, CNBV may require more capital or mandate to return to the standard method in the corresponding portfolio.</p>

	Capital requirements for market risk are calculated using a standardized method; requirements for operational risk will transition from the current Basel II standardized approach to the Basel III method starting in January 2023.
EC6	The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing). ⁵³ The supervisor has the power to require banks: <ul style="list-style-type: none"> (a) to set capital levels and manage available capital in anticipation of possible events or changes in market conditions that could have an adverse effect; and (b) to have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.
Description and findings of EC6	Banks are required to assess their capital adequacy at least annually to determine if their capital will be sufficient to cover possible losses arising from the risks that these banks may incur under different scenarios, including stressed scenarios (Article 50 Bis, CUB). Banks must evaluate their general capital and liquidity adequacy, in relation to their risk appetite and business strategy, and submit their assessment to CNBV, which must include the estimation of capital for the next 10 quarters, in each scenario considered, and possible deviations from risk limits and risk appetite. In case of capital shortfalls, banks must submit to CNBV a capitalization plan considering corrective actions, as well as the estimated financial projections of the implementation of the measures—and submit periodic reports of progress. In the on- and off-site supervisory review CNBV check banks' policies and processes to monitor and follow-up on the implementation CAR and discuss deviations with senior management. The review includes the quality of information, including internal controls to ensure appropriate quality; the flow of information to the board and to the relevant managers and staff; the role of the risk management unit in calculating the capital requirements for credit, market and operational risk; the policies and governance of plans to correct deviations or, where appropriate, the monitoring of additional supervisory corrective measures imposed by CNBV.
Assessment of Principle 16	Largely Compliant
Comments	Mexico has a capital framework broadly consistent with the Basel framework. Although the capital framework is applied to all credit institutions on a solo basis, Mexican banks must deduct all investments and possible capital shortages in financial subsidiaries, from CET1, which is probably more demanding than the consolidated calculation. CNBV seems to have adequate powers provided by the law to apply Pillar 2 charges to banks. However, these powers have never been exercised hitherto. The assessment team encourages CNBV to sharpen the CEFER tool prior to applying Pillar 2, capital expectations, or other corrective actions.

⁵³ "Stress testing" comprises a range of activities from simple sensitivity analysis to more complex scenario analyses and reverses stress testing.

Principle 17	Credit risk. ⁵⁴ The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk ⁵⁵ (including counterparty credit risk) ⁵⁶ on a timely basis. The full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.
Description and findings of EC1	<p>Article 65 of the LIC provides the grounds to CNBV to issue prudential regulations on risk management. Additionally, Article 76 empowers CNBV to issue detailed rules on credit risk; namely, classification and provisioning and documentation needed in credit origination and renewal.</p> <p>Based on the LIC, CNBV has issued detailed rules on credit risk covering all the credit cycle: underwriting and evaluation (Articles 14 to 21, CUB), management and monitoring (Articles 22 to 29, CUB), and internal audit and control standards (Articles 30 to 32, CUB).</p> <p>Additionally, CNBV is the accounting regulator for Mexican supervised institutions (CUB, Annex 33 Accounting Standard B-6 "Loan Portfolio").</p> <p>Per Articles 66, 68 and 78, CUB, banks' boards are required to annually approve the banks' risk appetite, which must consider exposure to credit risk. In addition, Articles 7 and 25, CUB, require that banks' boards of directors approve the objectives, guidelines and policies for credit origination and management, which must be consistent with, and complementary to, those detailed in the comprehensive risk management framework. The board appoints the committees or employees responsible for developing these guidelines and policies and is responsible for effectively reviewing and approving each year the objectives, guidelines and policies related to credit risk.</p> <p>At a minimum, the policies and procedures must address limits on total credit exposures, limits for exposures to a single party or group of connected parties, and adequate monitoring of the nature, characteristics, diversification and quality of the credit portfolio. Banks must quantify, assess and monitor credit risk concentration by type of product, rating, economic sector, geographic location, and debtor. Additionally, banks must</p>

⁵⁴ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁵⁵ Credit risk may result from the following: on-balance sheet and off-balance sheet exposures, including loans and advances, investments, inter-bank lending, derivative transactions, securities financing transactions and trading activities.

⁵⁶ Counterparty credit risk includes credit risk exposures arising from OTC derivative and other financial instruments.

	<p>monitor the evolution and potential deterioration of the loan portfolio, assess the probability of default of each debtor and the expected losses of the entire loan portfolio. Banks must also forecast unexpected losses for the entire credit portfolio and compare them with observed losses (Article 80, CUB).</p> <p>The information described has to be disclosed either through regulatory templates or through periodic forms posted on the official websites of banks.</p> <p>CNBV assesses credit risk management processes and policies through specialized on-site inspections of banks' activities and the evaluation of the annual reports issued by the risk management and internal audit units, which are reviewed periodically by supervisors with the adequate expertise. Working papers are reviewed ex-post by supervisors during on-site inspections.</p> <p>CNBV carries out a review of some aspects of credit risk of every bank every year, including risk classification and provisioning. In this review normally all credit segments are evaluated, including the associated credit risk processes, from strategy to policies and systems. After the review, CNBV initiates formal or informal actions, as warranted, and follows up—through on- and off-site work—to ensure that the deficiencies are addressed.</p>
EC2	<p>The supervisor determines that a bank's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming,⁵⁷ identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.</p>
Description and findings of EC2	<p>Banks' boards are responsible for approving and annually reviewing the objectives, guidelines and policies for credit underwriting and management, which must be consistent, compatible and complementary to those established for comprehensive risk management, in accordance with Article 7 CUB. Banks must develop and have policies and processes to identify, assess, monitor, disclose, control and mitigate credit risk.</p> <p>Per Article 6 CUB, the CEO is responsible for ensuring coherence between objectives, policies, support infrastructure, origination, and ongoing management. The CEO must report annually to the board of directors any threat from deviations from the credit strategy and the measures adopted to address them, as well as the human, material and financial resources that are allocated to ensure proper management of the credit portfolio. In addition to monitoring compliance with the above provisions, CNBV performs the following activities during the supervisory review:</p> <ul style="list-style-type: none"> • Verify that the policies and procedures to be submitted board's approval are consistent with the bank's risk profile and appetite. • Verify that senior management is effectively implementing the credit risk strategy approved by the board.

⁵⁷ "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.

	<ul style="list-style-type: none"> • Review the evidence of the actions carried out by the risk committee and the audit committee for the fulfillment of their functions. • Review the reports and opinions of the internal audit. • Assess compliance of credit risk management procedures with the applicable rules. • Verify the proper implementation of regulatory changes regarding credit risk rating, such as e.g., IFRS9. • Review of the minutes of the committees and boards to validate the correct identification and monitoring of credit risks. And • Validation of compliance with regulatory risk limits: operations with related parties and credit risk concentration.
EC3	<p>The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including:</p> <ul style="list-style-type: none"> (a) a well-documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments; (b) well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing exposures, and identifying the appropriate approval authority for the size and complexity of the exposures; (c) effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification system; (d) effective information systems for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank's Board and senior management on an ongoing basis; (e) prudent and appropriate credit limits, consistent with the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff; (f) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board where necessary; and (g) effective controls (including in respect of the quality, reliability and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.
Description and findings of EC3	<p>The CUB contains CNBV's guidelines to ensure that banks have documented policies, methodologies and procedures for each of the stages of the credit process conducive to adequate credit risk management systems.</p> <p>Article 9 CUB instructs banks to have credit manuals, with policies, procedures, information, and methodologies for risk origination and risk management, which have to be coherent with the comprehensive risk management framework. CEOs are responsible for ensuring that the credit manual is properly implemented and applied.</p>

	<p>Articles 3–13 CUB describes the minimum guidelines that banks must comply regarding their credit risk activities, with a view to promote sound banking practices and prevent conflicts of interest: organization, phases, policies, delegations and committees for credit approval, infrastructure and controls, credit origination and analysis, loan administration, internal functions, responsibilities and delegations, loan recovery, and detailed internal audit review. Tasks and responsibilities of each committee and staff involved in credit risk management should be clearly defined.</p> <p>To assess compliance with the rules, supervisors review the reports submitted by the CEO to the board and during credit risk inspection visits.</p> <p>Articles 14 to 21 pertain credit origination. Banks must carry out the evaluation and analysis of credit proposals differentiating among the different portfolio type and their risk, considering, inter alia, payment experience, payment capacity, and solvency of the borrowers. All credits must be approved by the board, which can delegate to committees, business units, or individuals. Refinancing operations must follow the same steps that new ones.</p> <p>CNBV checks compliance with these rules through the review of the reports submitted by the CEO and the credit committee to the board, as well as during credit risk inspection visits.</p> <p>The CUB, Articles 22 to 32, contain the requirements concerning credit management and monitoring, including internal control and internal audit. Banks are obliged to permanently monitor relevant information, such as the status of guarantees, documentation, borrower's capacity and willingness to pay; flagging problem exposures and developing specific and strict policies to deal with these credits based on the type, amount and days in arrears. CNBV assesses whether the processes and methodologies in place are consistent with the objectives and guidelines approved by the board, and aligned with the risk appetite of the bank.</p> <p>Article 12 CUB instructs banks to have credit management information systems for the different steps of the credit process. At a minimum, they must generate reliable reports, avoid multiple entries and data manipulation, provide automatic, timely and transparent accounting reconciliation. Additionally, the information systems must provide the necessary information for decision-making to the board, the CEO, and the business areas in charge of the credit operation.</p> <p>CNBV determines the effectiveness of the banks' information systems, in order to assess the adequacy and timeliness of the identification, aggregation and reporting of exposures to credit risk, through the reviews carried out in the inspection visits. Supervisors validate that the information contained in the information systems, is consistent with the operational information, and that the information presented to the different collegiate and managerial bodies is adequate, timely and accurate. The supervisory reports reviewed by the assessors included observations on risk classification and provisioning, as well as reporting, and management practices.</p> <p>Article 68 CUB establishes that the banks' boards are responsible for approving the desired risk profile, the comprehensive framework for risk management, the risk exposure limits,</p>
--	--

	<p>the risk tolerance levels, and the mechanisms to apply corrective actions and contingency plans.</p> <p>Supervisors review and verify compliance with prudential and internal limits of capital consumption for credit risk approved by each bank, through inspection visits and review of the minutes of the board, and the credit and risk committees.</p> <p>Banks are required to develop credit policies and procedures to facilitate the implementation of control measures to identify, assess and limit, in a timely manner, risk taking in credit origination.</p> <p>Risk committees, with prior authorization from the board, may adjust or approve exceptions to the risk limits. The risk function, independently from business units, is required to report any deviation from the approved limits to the bank's CEO and the risk committee, explaining the causes and impact, to apply corrective actions. The correct and timely application of corrective actions will depend on the efficiency and effectiveness of each bank's internal controls, as well as on the strength of corporate governance.</p> <p>Banks must adhere to the credit portfolio rating processes and capital requirements for credit risk, established in the CUB. Banks that wish to apply internal methodologies to classify certain portfolios and determine capital requirements for credit risk, must request authorization from CNBV and comply with the minimum model requirements detailed in Annex 15 CUB. The CUB restricts the use of internal rating models to consumer loans and corporate loans up to UDI 2 million (equivalent to MXN270,000).</p> <p>As part of the authorization process, and during the use of these models, CNBV evaluates that the banks have effective controls that allow an adequate identification and measurement of credit risks.</p>
EC4	The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged foreign exchange risk.
Description and findings of EC4	<p>CNBV makes this determination in accordance with the requirements of Article 15 CUB, which establishes the minimum elements that must be considered by the intermediaries to assess and, where appropriate, approve the different types of credits. In particular, Section III, Subparagraph a), Numbers 1 and 3, instructs banks to take into account the total indebtedness of debtors, using reports prepared by the credit bureaus no older than three months. Additionally, banks must analyze financial information of the potential borrowers, assess creditworthiness, verify the credit history available in the credit bureaus, and assess collateral and creditworthiness of possible guarantors, among others.</p> <p>Through supervision activities (on- or off-site according to the annual supervision plan), CNBV evaluates the methodologies and practices used by banks in the credit origination, monitoring and recovery of the portfolio. This includes the validation of all the criteria defined by regulation to analyze borrower's payment ability.</p>
EC5	The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm's length basis.
Description and findings of EC5	Articles 3, 4, 8, 14, 17 and 19 CUB specify that banks must conduct lending activities free of conflicts of interest. Article 73 LIC requires that all operations with related parties are agreed under terms and conditions no more favorable than similar operations with the

	<p>general public. And Article 128 LIC empowers CNBV to order banks to suspend or partially limit operations (asset, liabilities or services) if they entail a conflict of interest to the detriment of its clients.</p> <p>The PIN describes specific tasks for the revision of banks' monitoring and follow-up of conflicts of interest that may arise from their credit operations. Supervisors review reports on related party loans, which are cross-checked against the documentation provided by the credit risk committee or the board. This work is performed off-site, using certifications requested from boards and credit committees. Additionally, during on-site inspections supervisors review working papers to assess effective implementation.</p>
EC6	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's Board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings of EC6	Articles 15 and 17 CUB require that loans to groups of connected clients exceeding 10 percent of banks' Tier 1 capital or UDI30 million (around USD11 million equivalent) and having a maturity of more than one year be approved by officers not lower than the second hierarchy level within the credit function. In practice, most banks refer such level of exposure to the board for approval. Other than that, the Mexican regulatory framework does not make such a requirement for major or especially risky exposures.
EC7	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Description and findings of EC7	Article 19 of the LCNBV provides the above authority. CNBV confirms unrestricted access to information or bank officials, and no cases of CNBV being denied full access to information or staff were reported to the assessors. For financial institutions incorporated abroad that are subsidiaries of Mexican parents, CNBV performs on-site inspections together with local supervisors about every other year.
EC8	The supervisor requires banks to include their credit risk exposures into their stress testing programs for risk management purposes.
Description and findings of EC8	<p>Stress tests are tools aimed at warning the different banks' management bodies and staff on the possible adverse impacts considering the possible evolution of the risks to which banks are exposed, as well as to assess its capacity to absorb potential losses, and timely identify possible actions to maintain the risk profile and preserve capital and liquidity. They also help to set risk exposure limits and risk tolerance levels.</p> <p>The scope and assumptions of stress tests must be approved by the risk committee and be clearly documented in the manuals for comprehensive risk management. At least once a year, the institutions must review the suitability of the stress tests and their correct use by the risk measurement and analysis systems.</p> <p>The CUB Annex 12-B details the minimum requirements for each risk that must be considered for stress testing purposes. In addition, the assessment of all material risks (including credit risk), in relation to the strategy, risk appetite and capital planning, taking into account a three-year horizon are part of CNBV annual supervisory stress test.</p>

Assessment of Principle 17	Compliant
Comment	CNBV has an adequate regulatory and supervisory framework for credit risk and places significant emphasis on credit risk and performs on-site verification of credit files and bank analysis of borrowers' creditworthiness. Through off-site supervisory tasks CNBV evaluates credit risk policies and procedures, as well as the methodologies and practices used by banks in the credit origination, monitoring and recovery. A threshold is not established for large or especially risky loans that must be approved by the board.
Principle 18	Problem assets, provisions and reserves. ⁵⁸ The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves. ⁵⁹
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings of EC1	<p>The Mexican regulatory framework, including all relevant accounting aspects, for financial instruments involving credit risk, such as loans and investment in securities, is fully placed under the authority of CNBV. The regulatory framework for underwriting and managing credit activities, and for classifying loan quality and provisioning for loan losses, is sound and very complete. CNBV continuously updates and improves its rules, adapting them to the Mexican market.</p> <p>Per Article 65 LIC banks must adopt and observe policies and procedures to manage credit risk, including problem loans. Article 76 LIC empowers CNBV to regulate the classification and provisioning of credits—seeking the opinion on Banxico.</p> <p>Banks are required by articles 8, 22 and 23 of the CUB to have objectives, guidelines and credit management policies, considering at least general strategies and policies, regarding:</p> <p>a) monitoring and control, refinancing of each type of loan; and b) cancellation, settlements, foreclosures and recovery.</p> <p>The CUB devotes 6 chapters concerning prudential requirements of credit risk portfolios:</p> <ul style="list-style-type: none"> • Articles 3 to 44, establish that banks are obliged to organize and control their active operations, including the reserve for problem loans; • Articles 45 to 51 Bis 14 mandate to properly maintain credit files, including minimum information of debtors identification; • Articles 52 to 61 and Articles 63 and 64 concern risk diversification and identification of groups of connected parties that should be considered as 'common risk':

⁵⁸ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁵⁹ Reserves for the purposes of this Principle are "below the line" non-distributable appropriations of profit required by a supervisor in addition to provisions ("above the line" charges to profit).

	<ul style="list-style-type: none"> Articles 89 bis to 139 Bis 7 to 89 Bis refer to credit classification and provisioning, which should be based on the significant increase in credit risk (SICR). Credits should be classified in stages 1, 2 or 3 according to the SICR. <p>The CUB details a wide variety of approaches according to their asset class (revolving consumer and credit cards, non-revolving consumer, residential and commercial mortgages, farms and municipalities, corporations, financial institutions and SMEs) that consider supervision and internal approaches to provisioning based on an expected loss methodology. For classification and provisioning purposes, banks could use the standard methodology (Articles 91 to 138) or an internally developed methodology (Articles 139 Bis to 139 Bis 7), either basic (only the probability of default is estimated internally) or advanced (estimation of probability of default, loss given default, and exposure at default are estimated internally). Models have to be authorized by CNBV and cannot refer to credit to the public sector and project finance.</p> <p>Articles 90 to 139 of the CUB establish the prudential rules that institutions must follow for loan classification and provisioning purposes. Loans are classified in three categories, according to the significant deterioration of credit risk. Stage 1 groups credits with no past due amounts older than 30 days; Stage 2, credits up to 90 days past due or significant increase of credit risk; and Stage 3, more than 90 days or objective evidence of impairment. Provisions for credits in stages 2 and 3 must be calculated for the remaining term of maturity.</p> <p>Article 132 of the CUB requires quarterly provisioning of repossessed assets. It provides a dual schedule to phase in provisions, reaching full coverage in 30 months for moveable assets, and 5 years for real estate.</p> <p>In addition, Annexes 13 to 27 of the CUB promulgate additional guidelines and criteria for classification and debtor analysis, including the eligibility criteria for internal credit rating models and provisioning methods.</p> <p>Section B-6 of annex 33 on accounting criteria provides definitions on problem, pass and past-due loans, including loan restructuring and renewal. It also puts forward a test of effective payment, precluding indirect refinancing of arrears. It requires full payment of due interest and a 20 percent reduction of principal. Moreover, Section B-6 provides the criteria for transfer among accounting stages and interest suspension on stage 3.</p> <p>Restructured loans are deemed in stage 3 and kept as past-due if they fail to pass a test of sustained service payment of three consecutive monthly payments, or one for installments longer than 60 days.</p> <p>For the purpose of loan classification and provisioning, the regulations set by CUB divide the credit portfolio into three relevant asset classes: consumer (subdivided in revolving, such as credit cards, and nonrevolving), housing, and commercial loans.</p> <p>For each asset class, the regulations offer a choice of methodologies for loan classification and provisioning. The institutions can choose to use a general method based on algorithms estimated by CNBV or, alternatively, the institutions can choose to use their internal methods for loan classification and provisioning, if approved by CNBV.</p>
--	---

For retail loans (consumer revolving and nonrevolving, and household mortgages), the CUB allows three eligible methodologies: (1) a generalized parametric algorithm estimated by CNBV; (2) CNBV approved internal methods developed by an institution; and (3) risk parameters used as part of a CNBV approved IRB capital model developed by an institution.

Loan loss reserves (LLR) are calculated following the traditional formulation (Loss provisions = PD * LGD * EAD). Required provisions are expected loss (EL) provisions estimates to a twelve-month horizon (stage 1) or lifetime (stages 2 and 3); point in time probabilities of default (PD) for stages 1 and 2, and 100 percent for stage 3; and reasonable loss given default (LGD) estimates.

These LGD estimates for retail portfolios range from 60 to 75 percent considering the nature of the collateral available. After a number of mandated payments in arrears, consumer loans attract a 100 percent LGD. Household mortgage loans use a LGD algorithm that includes a loan-to-value factor for mortgages and differentiates among Mexican States considering the overall effectiveness of their judicial process and loan recovery activities.

Similarly, for commercial loans, the CUB allows three eligible methodologies: (1) a generalized parametric algorithm; (2) CNBV approved internal methods developed by institutions, or the use of risk parameters used as part of a CNBV approved IRB capital model; and (3) the application of a general methodology for individual corporate borrower analysis (Articles 112 to 122). In all cases the level of the loan loss reserve is calculated as per the traditional formulation (Loss provisions = PD * LGD * EAD) where the PDs and LGD are estimated following the methodologies indicated. The standard methodology provides probabilities of default and ratios of loss given default calibrated by CNBV for the different credit portfolios (mortgages, consumer revolving, consumer not revolving, microcredit) as well as the requirements of the collateral for provisioning purposes.

For exposures of UDI 2 million or higher (about USD0.6 million) institutions are required to undertake an individual classification process based on a dual dimension approach (borrower rating and rating of the transaction), rather than allowing the use of the generalized parametric or the use of internal models. Articles 115 to 123 of the CUB, including associated annexes 18 to 19 CUB, provide an exhaustive set of steps to: (1) analyze and assign a credit rating to the borrowers (annexes 20.1 to 23) for its country, financial and industry risks, including payment experience; (2) proceed to the rating of the transaction by splitting the loan between its unsecured and secured portions; (3) evaluate personal guarantees and eligible collateral subject to strict eligible conditionality (Annex 24); and (4) reach a final split rating classification (Article 112) to assign a level of provisioning for such rating for the standard methodology (Article 129).

Eligible personal guarantees (Article 119) and pre-determined haircuts for eligible collateral (Article 120) indicated in step (3) above are combined to determine one to three upgrades to the borrower rating grade reached in step (1) before mapping to the corporate borrower scale (Article 122).

Finally, all loans graded by any of the methods discussed above are mapped to a master scale adopted by CNBV (Article 129) made up of nine classes A-1 to E.

	<p>This is done for both retail and corporate segments, whether using a generalized algorithm estimated by CNBV, an internal model approved by CNBV, or the general methodology to grade individual corporate loans.</p> <p>The accounting standards (CUB, Annex 33 Accounting Standard B-6 “Loan Portfolio”, paragraphs 9 and 113, item b) require disclosures about the accounting policies and methods used to identify problem commercial loans, whether they are current or overdue. Therefore, the problem portfolio are loans for which it has been determined that there is a significant probability that their principal and interest will not be recovered in full, regardless of their classification as current or past due.</p> <p>If CNBV is not satisfied with the credit risk policies and procedures, it may require increased provisions or, if these policies and procedures have serious deficiencies, the suspension of new lending. Absent a proper client file, the bank should make a 100 percent provision of the risk.</p>
EC2	<p>The supervisor determines the adequacy of a bank’s policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor’s opinion may be conducted by external experts, with the supervisor reviewing the work of the external experts to determine the adequacy of the bank’s policies and processes</p>
Description and findings of EC2	<p>Per Article 107 LIC, CNBV may require additional loan loss reserves if they assess a shortfall in the reserves made by banks. Article 17, section III of the RICNBV, establishes the power of supervisors to assess the quality of the assets of the supervised entities and establish adequate and robust levels of provisions based on sound banking and financial market practices.</p> <p>CNBV determines the suitability of the policies and procedures used to implement the provisions for classifying loans and estimating appropriate expected loss provisions. It does this through off-site monitoring of the periodic relevant reports indicated in EC1 above; evaluation of the reports of the risk management and internal audit units submitted to CNBV; and on-site reviews of the institutions’ activities conducted by the supervisors according to the risk focus of the annual program of inspections.</p> <p>On-site reviews and individual loan reviews are carried out as per mandated procedures adopted by CNBV as part of its Institutional Manual for Supervision, which identifies control points and the expected depth and details of reviews, including individual loans. As a consequence of its review, CNBV initiates formal or informal action, as the case might require, requiring institutions to remedy deficiencies noted, including reclassification of problem loans and additional provisions. Follow-up of progress by the institutions in remedying the deficiencies noted is carried out both on- and off-site.</p>
EC3	<p>The supervisor determines that the bank’s system for classification and provisioning takes into account off-balance sheet exposures.⁶⁰</p>

⁶⁰ It is recognized that there are two different types of off-balance sheet exposures: those that can be unilaterally cancelled by the bank (based on contractual arrangements and therefore may not be subject to provisioning), and those that cannot be unilaterally cancelled.

Description and findings of EC3	This is explicitly mandated by Article 76 LIC and the relevant articles of the CUB. The credit risk from off balance-sheet exposures is calculated as the replacement value of the position and its changes throughout the remaining maturity.
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.
Description and findings of EC4	Banks must periodically assess whether credits in stage 3 must be written off, according to their internal policies established in the credit manual. See discussion in EC1 and EC2 above.
EC5	The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g., 30, 60, 90 days). The supervisor tests banks' treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards (e.g., rescheduling, refinancing or reclassification of loans).
Description and findings of EC5	Interests of credits in stage 3 are not recognized in the income statement but through off-balance sheet. See discussion in EC1 and EC2 above.
EC6	The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.
Description and findings of EC6	According to article 207 of the CUB, in particular the regulatory report R04, banks must submit information on credit risk parameters on a regular basis (monthly). In accordance with articles 48 and 49 of the CUB, all credit information is supported by a credit file that is required by regulation and must include the documents in accordance with the provisions of Annexes 2 to 10 of the CUB, which detail the requirement of credit files for each asset class. Articles 110 to 115 of the CUB establish that the information on the portfolio of regulated entities will include information with the necessary detail to determine the amount of the reserves for losses. Reporting to CNBV is sufficient, in terms of amount and quality of the information filed, to properly carry out prudential oversight. CNBV frequently updates the templates and information required, such as, for instance, requiring specific reports to monitor COVID-19 related refinancing.
EC7	The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g. if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the

	bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.
Description and findings of EC7	<p>Article 102 LIC permits CNBV to require provisions when it identifies an inadequate valuation of assets. Article 136 CUB gives the power to CNBV to reclassify among risk categories and require additional provisions. Additionally, Articles 39 and 51 of the CUB, establish that CNBV may require additional provisions when the loan granted was originated through a defective credit process or if it is not properly documented, or represents conflicts of interest.</p> <p>Through frequent on-site inspections CNBV assesses that asset classification and provisioning are appropriate, including the value of existing collateral, compared to CNBV's benchmarks, and checks that credits are properly documented.</p> <p>If warranted, CNBV may also impose additional measures.</p>
EC8	<p>The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.</p>
Description and findings of EC8	<p>Pursuant to articles 15 and 22 CUB banks must have a mechanism to assess the value of credit risk mitigants and the hedged portion of credit exposures. In the case of impaired or higher risk loans, banks must establish stricter procedures to monitor these loans and their credit risk mitigants.</p> <p>In particular, the value of mortgage guarantees has to be assessed at least every 3 years, or annually when there are adverse conditions in the areas where the guarantees are placed or when prices drop by 10 percent per year.</p> <p>Credit risk mitigants such as guarantees, credit derivatives and collateral are eligible for the reduction of provisions and capital requirements if they meet the requirements established in Annexes 24 and 25 CUB, which are fully aligned with Basel standards.</p> <p>For consumer and mortgage loans, collateral is valued according to a parametric method, which must take into account the market value of that collateral. For commercial loans, the valuation of the collateral must be in accordance with the valuation policies established by the bank.</p> <p>Through periodic on-site inspections, CNBV evaluates the bank's procedures to assess risk mitigators, including guarantees, credit derivatives and collateral. Verify that the valuation of the guarantees reflects the net realizable value, taking into account market conditions, as described in the MIS, "rating of the commercial portfolio and off-balance sheet exposures."</p> <p>Repossessed assets must be fully covered with provisions in five (real estate) or 2.5 years (movable collateral).</p>
EC9	<p>Laws, regulations or the supervisor establish criteria for assets to be:</p> <ol style="list-style-type: none"> (a) identified as a problem asset (e.g., a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and (b) reclassified as performing (e.g., a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have

	been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).
Description and findings of EC9	<p>Annex 33 of the CUB, Accounting Standards B-6 "Loan Portfolio", paragraphs 9, 11 and 105, defines "problem loans" as commercial loans with significant chance, based on current facts and information, to not fully recover capital or interest, as agreed in the original terms and conditions.</p> <p>. In this sense, overdue loans are defined as those whose principal, interest or both have not been paid as originally agreed, as well as those granted to borrowers declared insolvent, except in cases in which, in accordance with the bankruptcy law, it is more likely than not that the bank will continue to receive the payment of those loans. Overdue loans whose balances pending payment (principal and interest, among others) are paid in full, and those restructured or renewed that, together with the assessment of the ability of the debtor to repay, meet the sustained payment condition of the loan can be reclassified as performing loans. (See EC1).</p>
EC10	The supervisor determines that the bank's Board obtains timely and appropriate information on the condition of the bank's asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.
Description and findings of EC10	<p>As established in articles 26 and 74 of the CUB, at least monthly, the Comprehensive Risk Management Unit must report to the risk committee and senior management about the quality, risk evolution and profitability of the portfolio, considering all operations with credit risk, the results of their analysis and projections, as well as reserves. Risk exposure reports are supplemented by sensitivity analysis and tests under different scenarios, the evolution of risks, deviations from the risk appetite level and analysis of its drivers and persistence, and the impact on capital.</p> <p>And, at least quarterly, it must report to the board. In the event of any deviation from the exposure limits, senior management and the risk committee will be immediately informed. Additionally, through off-site supervision, in particular through the review of the minutes of the governing bodies, supervisors verify quarterly how the risk committee sends the information (time and content) to the board, including on problematic assets, and monitoring the corrective actions taken by the banks.</p>
EC11	The supervisor requires that valuation, classification and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.
Description and findings of EC11	Article 15 establishes that for during the evaluation methods for commercial credits whose amounts are equal to or greater than 2 million UDIS (around USD 685,000), banks must consider a number of aspects of quantitative and qualitative evaluation; review of the payment date before the term (own source of payment credits), review of the limits for

	<p>operations under the concept of common risk and other specific conditions that must be reviewed by the Board.</p> <p>Additionally, in origination, Article 15 CUB mandates to perform sensitivity tests for loans that represent 10 percent or more of the bank's Tier 1 capital.</p> <p>Through periodic on-site inspections, CNBV evaluates that the valuation, classification and provisioning, at least for significant exposures, by sampling procedure, are carried out individually.</p>
EC12	<p>The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment.</p>
Description and findings of EC12	<p>CNBV reviews and assesses the quality of credit risk portfolios of individual banks. In such reviews, based on off-site and on-site inputs, the supervisors are able to compare the asset quality of any bank with that of its peer group and the banking system. Also at individual counterparty levels, the supervisors are able to compare the classification of one counterparty in any bank with the classification of the same counterparty in the other banks.</p> <p>Additionally, CNBV reviews trends and state of the risks, including credit risk, for the system. This analysis, which is made available in its portal, includes credit growth (volume and number of creditors), broken down by portfolios: risk concentration, including an analysis of the system's 25 biggest debtors, and of each bank, including the impact in the CAR of the default of the 5 biggest; exposures to vulnerable or weak economic sectors; vintage and cluster analysis, and default rates and expected losses.</p> <p>Additionally, there is a specialized unit in CNBV that produces monthly information on portfolio risk, including information on the increase or decrease in loan amounts, trends and concentrations of risk, and the evolution of expected losses, which help the supervisor to be aware of any concentration on risk.</p>
Assessment of Principle 18	Compliant
Comments	<p>Mexican laws and CNBV's regulations provide a detailed framework for the identification and management of problem assets, asset classification, provisioning and write-offs. When CNBV observes deficiencies or weaknesses, in credit risk classification and provisioning, or its reporting to CNBV, supervisory action is undertaken as described above.</p>
Principle 19	<p>Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential</p>

	limits to restrict bank exposures to single counterparties or groups of connected counterparties. ⁶¹
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk. ⁶² Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Description and findings of EC1	<p>Concentration, defined in Article 66 CUB as high and disproportionate exposure to particular risk factors within the same category or between different risk categories, is included among the risks considered in Article 65 CUB on comprehensive risk management framework and, therefore, banks are required to have management processes that take into account concentration risk. At a minimum, banks must measure, assess and monitor their concentration by financing type, rating, economic sector, geographical area and debtor.</p> <p>Article 86 Bis CUB requires banks to meet the following minimum requirements in relation to concentration risk:</p> <ul style="list-style-type: none"> • Consider the concentration of risk by debtors, counterparty or group of related counterparties, by economic sector, currency, geographic region, economic activity and reliance on raw materials. • Set up a process to identify the correlation between the solvency of the debtor, the guarantee or collateral, and the counterparties of the exposures, as well as the linkages between the exposures and the correlations between the different types of risk. • Establish a process for the identification of risk factors to ensure that all relevant positions exposed to concentration risk are covered, including on- and off-balance positions, as well as revocable and irrevocable positions. • Measure, assess, control and monitor concentration by the different risk types, by financing type, rating, economic sector, geographic area, debtor, borrower and counterparty. • Establish information systems that allow periodic and timely reports on the total risk of debtors, borrowers or connected counterparties that denote a 'common risk', and on the concentration of risks by geographic region, economic sector, market segment and funding sources. <p>Article 53 CUB allows certain risks among connected parties to be excluded from the aggregation to determine the lending limits when the repayment sources of a principal</p>

⁶¹ Connected counterparties may include natural persons as well as a group of companies related financially or by common ownership, management or any combination thereof.

⁶² This includes credit concentrations through exposure to: single counterparties and groups of connected counterparties both direct and indirect (such as through exposure to collateral or to credit protection provided by a single counterparty), counterparties in the same industry, economic sector or geographic region and counterparties whose financial performance is dependent on the same activity or commodity as well as off-balance sheet exposures (including guarantees and other commitments) and also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

	<p>party are not dependent on those of a connected party. Conditions for excluding such risks include the absence of cross-obligations among parties in a corporate group, as well as inter-company debts when contracted at market rates. Exclusion is left to the discretion of an institution without further guidance and interpretation from CNBV. There is neither ex-ante, nor ex-post notification requirements from an institution to CNBV regarding exclusions, including the requirement to keep records and reports which allow the tagging and tracking of such situations to be reported by bank Boards to CNBV.</p> <p>Article 56 excludes from the lending limits exposures to the Government of Mexico, Banxico, and IPAB, as well as loans to sub-national governments in compliance with eligible conditions.</p> <p>Article 52 requires institutions to adopt procedures for implementing the risk aggregation requirements, which procedures must be approved by CNBV.</p> <p>Finally, regulation on risk concentration is currently under revision, in order to update it in accordance with the Basel standard for Large Exposures.</p>												
EC2	<p>The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure⁶³ to single counterparties or groups of connected counterparties.</p>												
Description and findings of EC2	<p>Article 54 CUB establishes maximum permissible financing limits to a single counterparty or group of connected counterparties that vary according to the level of capital adequacy of a bank:</p> <table border="1" data-bbox="581 989 1273 1318"> <thead> <tr> <th>Capital ratio</th> <th>Exposure limit (Percent of Tier 1 Capital)</th> </tr> </thead> <tbody> <tr> <td>Bigger than 8% up to 9%</td> <td>12</td> </tr> <tr> <td>Bigger than 9% up to 10%</td> <td>15</td> </tr> <tr> <td>Bigger than 10% up to 12%</td> <td>25</td> </tr> <tr> <td>Bigger than 12% up to 15%</td> <td>30</td> </tr> <tr> <td>Above 15%</td> <td>40</td> </tr> </tbody> </table> <p>Article 54 CUB also mandates that the three largest exposures of a bank cannot exceed 100 percent of its Tier Capital 1.</p> <p>The maximum lending limit for institutions with a CAR of more than 12 percent exceeds the standard 25 percent international standard. The incremental concentration allowed so as to reach the 40 percent level with a 15 percent CAR appears excessive and will consume about 56 percent of the increase in capital required to operate at such a concentration level.</p>	Capital ratio	Exposure limit (Percent of Tier 1 Capital)	Bigger than 8% up to 9%	12	Bigger than 9% up to 10%	15	Bigger than 10% up to 12%	25	Bigger than 12% up to 15%	30	Above 15%	40
Capital ratio	Exposure limit (Percent of Tier 1 Capital)												
Bigger than 8% up to 9%	12												
Bigger than 9% up to 10%	15												
Bigger than 10% up to 12%	25												
Bigger than 12% up to 15%	30												
Above 15%	40												

⁶³ The measure of credit exposure, in the context of large exposures to single counterparties and groups of connected counterparties, should reflect the maximum possible loss from their failure (i.e., it should encompass actual claims and potential claims as well as contingent liabilities). The risk weighting concept adopted in the Basel capital standards should not be used in measuring credit exposure for this purpose as the relevant risk weights were devised as a measure of credit risk on a basket basis and their use for measuring credit concentrations could significantly underestimate potential losses (see *"Measuring and controlling large credit exposures"*, January 1991).

	<p>Current regulations do not provide an explicit definition of large exposures at the generally accepted 10 percent level, and there is no maximum aggregated lending limit for all large exposures. However, Article 58 of the CUB requires institutions to track and report to business units, to the Board and committees, and to the general public those exposures that equal or exceed 10 percent of basic capital.</p> <p>Article 57 of the CUB mandates the use of the same credit conversion factors applicable for calculating credit capital charges for off-balance sheet exposures in order to calculate equivalent risks for credit concentration purposes.</p> <p>The above limits are not applicable on a fully consolidated basis up to the highest level of the regulated parent in Mexico (the financial holding company regulated by SHCP).</p> <p>CNBV monitors banks to ensure that they have mechanisms in place that allow them to carry out their activities with risk levels in accordance with their respective Tier 1, liquid assets and operating capacity, in normal, adverse and extreme conditions, which must be consistent with the business model and strategies of the bank.</p> <p>Additionally, banks must have automated systems that allow obtaining periodic and timely reports that show the concentration of risks by geographic region, sector or market segment, so that in favor of maximum publicity, they must disclose to the public the number and amount of the Financing granted that exceed 10 percent of its basic capital, as well as the maximum amount of financing that they have with the debtors that represent a greater risk.</p> <p>CNBV monitors through regulatory reports the quality and timeliness of the information on concentrations of risk and large exposures. The quality of these reports is verified in inspection visits and the review of the internal audit reports. Among other procedures, the internal audit must verify that the IT infrastructure is capable of preserving the integrity, confidentiality and availability of the information and that prevents its alteration.</p>
EC3	<p>The supervisor determines that a bank's risk management policies and processes establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the bank's policies and processes require all material concentrations to be regularly reviewed and reported to the bank's Board.</p>
Description and findings of EC3	<p>Article 80 CUB directs institutions to adopt appropriate risk limits at levels at least as stringent as those established in the CUB, including concentration by type of credit facility, economic sector, geographic location, and single and group exposures of borrowers.</p> <p>The systems and risk limits are subject to review and monitoring by the risk management unit (Article 74 CUB), the internal audit unit (Article 76 CUB), as well as by a bank compliance officer (Article 143 CUB). These control functions report to the audit and risk committees, which inform the bank's Board with different frequencies (monthly to annual basis).</p> <p>In addition, Article 15 III c) CUB requires testing of the sensitivity of the projected cash flow of credit exposures to variation of the risk factors (interest rate, exchange rates) grouped as common risk if credits are granted with maturities exceeding 12 months.</p>

	During on-site inspections supervisors review the reports generated by the audit and risk management units, and the relevant committees, to confirm that the Board is well informed to make effective decisions.
EC4	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.
Description and findings of EC4	<p>CNBV receives monthly a comprehensive inventory of all banks' exposures in their credit portfolio, thus allowing it to monitor credit risk concentrations (Articles 207 and 208 CUB). These reports feed the repository of CNBV, allowing supervisors to monitor off-site concentrations including sectoral, geographical and currency exposures.</p> <p>Monthly CNBV prepares and publishes in its portal a uniform report providing a set of concentration measures per the dimensions required in this EC. This analysis includes credit risk concentration, including of the system's 25 biggest debtors, and of each bank biggest debtors, including the impact in the CAR of the default of the 5 biggest.</p> <p>Supervised institutions are required by Article 61 CUB to report excesses over exposure limits to CNBV, including a remediation plan subject to approval by the Commission. Based on this Article CNBV has the power to require remedial action. In addition, Article 59 of the CUB empowers CNBV to impose more stringent risk exposure limits than those stipulated in Article 54, based on its assessment of deficiencies in risk management and control systems at supervised institutions.</p> <p>Measures imposed by CNBV include economic penalties for breaches of the maximum lending limits, and requirements to strengthen their IT systems and concentration risk procedures.</p>
EC5	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case-by-case basis.
Description and findings of EC5	<p>Credit exposure to individual counterparties or groups of connected counterparties is a definition established by the LIC and is not an attribution granted to the supervisor. Articles 1 and 52 CUB define three types of relationship for presuming a common risk unless proven otherwise: (i) persons acting in concert due to specific family relationships; (ii) persons not having control but being able to exert management power upon a company, and (iii) persons exerting control by being able to impose decisions on the general assembly or to nominate the majority of the Board of a company. The criterion of "acting in concert" is restricted to parties connected by family relationships. There is no explicit regulatory guidance on its implementation.</p> <p>CNBV does not have explicit powers to exert discretion in regard to exposures among parties that are not connected in terms of the links established in Article 52 of the CUB. The CUB does not provide, either an explicit criterion to connect as a single common risk the exposures of two or more parties when there is mutual economic interdependence among them, and the problems of one of such parties could significantly affect the capacity of the other parties to repay their debts.</p>

EC6	Laws, regulations or the supervisor set prudent and appropriate ⁶⁴ requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. "Exposures" for this purpose include all claims and transactions (including those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.
Description and findings of EC6	See discussion in EC2 for limits to a single counterparty. These limits can be surpassed up to 100 percent of Tier 1 capital for exposures secured with unconditional and irrevocable guarantees granted by foreign financial institutions with investment grade from OECD or European Union member states and exposures guaranteed by the Mexican government. Article 57 CUB requires to use the capital framework conversion factors to off-balance sheet positions for credit concentration purposes.
EC7	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programs for risk management purposes.
Description and findings of EC7	Annex 12-B CUB requires that for stress testing purposes, banks consider the nature of their exposures and their degrees of concentration during different scenarios, including adverse ones and by types of risk. In particular, banks are required to consider at least: the impact on the value of the same type of collateral due to conditions that could significantly affect the bank's ability to realize their expected value; or the deterioration in the credit quality or the value of collaterals in a certain economic sector, currency, geographical region, economic activity or reliance on the raw material in which the Institution is concentrated; or take into account the abrupt deterioration of the credit quality of the main borrowers.
Assessment of Principle 19	Materially non-compliant
Comments	The Mexican regulation of large exposures sets different limits depending on the actual capital ratio of banks, departing from the Basel standard. Also, it lacks a formal definition of large exposure, which would be advisable to adopt. The framework for connected party lending does not empower CNBV to determine connected parties other than the links defined in the regulation, such as the exposures of two or more parties when there is mutual economic interdependence among them, hence the problems of one of such parties could significantly affect the capacity of the other parties to pay their debts or to discharge their obligation to the credit institution. CNBV could also monitor the exclusions allowed by Article 56, including requiring banks to put in place systems to tag, track, and notify them. The regulation on large exposures under preparation, whose implementation was delayed due to COVID-19, will align the Mexican rules with the Basel standard, thus likely achieving compliance with this CP.

⁶⁴ Such requirements should, at least for internationally active banks, reflect the applicable Basel standards. As of September 2012, a new Basel standard on large exposures is still under consideration.

Principle 20	Transactions with related parties. In order to prevent abuses arising in transactions with related parties ⁶⁵ and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties ⁶⁶ on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.
Essential criteria	
EC1	Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of "related parties". This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case-by-case basis.
Description and findings of EC1	<p>Article 73 LIC defines related party as (i) individuals or entities who directly or indirectly control two percent or more of the capital stock of the institution, the holding company or the other institutions of the financial group; (ii) members of the board of directors of the bank, the holding company, or other companies of the financial group; (iii) spouses and life partners of the above; (iv) any person, other the CEO and the managers directly reporting to the CEO⁶⁷ who may bind the institution with their signature; (v) firms and their directors and officers, in which the bank or the holding company directly or indirectly, control ten percent or more of the capital stock; (vi) legal entities in which the bank's officers are directors or managers; (vii) legal entities in which any of the entities mentioned above have direct or indirect control of ten percent or more of the capital stock or in which they have decision-making powers; and (viii) any operation through an unrelated third party or a trust, where the counterpart funds depend on any of the parties previously listed. For the definition of control, please see CP 6.</p> <p>Article 1, CXXXVII CUB defines a more delimited concept of 'relevant related party' as natural or legal persons who control 20 percent or more of the capital stock of the bank. The shares of such persons shall be added to the shares owned by their relatives and by trusts whose cash flow for repayment depend on relevant parties and their relatives. In addition, all the legal persons and members of a corporate group under the control of the above natural or legal persons shall be considered as relevant related parties. Credit to relevant related parties are subject to further specific requirements, such as more stringent</p>

⁶⁵ Related parties can include, among other things, the bank's subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, Board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

⁶⁶ Related party transactions include on-balance sheet and off-balance sheet credit exposures and claims, as well as dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs. The term transaction should be interpreted broadly to incorporate not only transactions that are entered into with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

⁶⁷ Article 73 IV has to be read in conjunction with Article 73 Bis 1, where the funcionarios are defined as the general director (CEO) and the second lines of command.

	<p>limits, which could be further reduced in application of early corrective measures, or the assessment by the external auditors of compliance with relevant prudential regulations. Whereas the scope and conditions of the 'related party' definition, including the associated lending limit, cannot be modified by CNBV as it would require an amendment of the LIC through parliament, the scope and the conditions of the 'relevant related party' definition are under the regulatory powers of CNBV and determine the risk excess to be deducted from capital adequacy.</p> <p>These provisions set out the scope for imposing two types of applicable lending limits (see EC5 below) with related parties, including: (i) a general lending limit; and (ii) a lending limit with relevant related parties. The scope of parties connected to a 'relevant related party' is more restrictive than the scope of parties connected to a 'standard related party' (LIC 73). The applicable definition of control of the CUB (Article 52 III) requires the power to impose decisions at the general assembly, or to nominate or replace the majority of the Board. Accordingly, companies where a relevant related party controls 50 percent or less of the shares (e.g., associate companies under IAS 38) might be excluded from the scope of aggregation. Individual companies, where a relevant related party has joint control, has an interest that gives it significant influence, or is an associate, will also be excluded from the scope of parties connected to the relevant related party.</p> <p>CNBV does not have explicit powers to (i) exert discretion in determining related parties not formally related as per the above conditions, or (ii) expand the scope of related party transactions for computing aggregated risk exposures. However, through the review of supervisory reports, the assessors verified that in practice the CNBV does exert discretion—to determine that both, parties and operations, are related-party; for instance, up front rental payments done by a bank to a related company were considered as a related-party credit operation for prudential purposes.</p> <p>There are no comparable standards for regulated holding companies similar to those required of banks acting as parents in a banking group.</p>
EC2	<p>Laws, regulations, or the supervisor require that transactions with related parties are not undertaken on more favorable terms (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties.⁶⁸</p>
Description and findings of EC2	<p>Article 73 VII LIC requires that all operations with related parties be entered into on terms and conditions no more favorable than similar operations entered into by an institution with the general public.</p> <p>In addition, banks that intend to enter into contracts for the assignment of rights or debts with persons with whom they maintain relevant links whose amount exceeds 25 percent of the Tier 1 capital, must request authorization from Banxico, including an analysis of the transfer price, to verify that it will be carried out under market conditions (see Circular 15-2012 of Banxico).</p>

⁶⁸ An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g., staff receiving credit at favorable rates).

EC3	The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.
Description and findings of EC3	<p>Article 73 LIC requires that the approval of related party transactions be made by at least three-fourths of the directors present at a Board meeting. Article 22 XI LIC requires a minimum quorum of half plus one of the members of the Board to be present.</p> <p>Transactions include deposits or other forms of disposition or loan, credit or discount transactions, granted in a revocable or irrevocable manner and documented through credit instruments or any agreement, restructuring, renewal or amendment, including the net positions in favor of the institution for derivatives and investments in securities other than shares, where they result or may result as debtors of commercial banks; CNBV construes this definition as inclusive of other dealings (on- and off-balance sheet credit exposures and claims, dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs) as defined in the BCPs.</p> <p>Article 73 also requires that directors and officers be absent from meetings and abstain from voting in those cases where they have a direct interest at stake.</p> <p>Article 73 Bis requires all operations with related parties to be submitted to the Board for approval.</p>
EC4	The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.
Description and findings of EC4	<p>Article 73 of the LIC requires that transactions with related parties are approved by 3/4 of the Board. The proposal is submitted to the board with the favorable opinion of the Risk Committee. Transactions up to UDI2 million (US\$280,000) are notified to the Board, along with the supporting information. The CUB mandates banks to have a credit manual describing, among others, policies, procedures and methodologies for credit risk origination and management.</p> <p>As a precautionary measure, CNBV may suspend bonus payment to the CEO, managers two levels below in the reporting line, and staff directly involved in the operation with related parties, if the bank is subject to corrective measures due to problems of capitalization or liquidity, resolution, business reorganization, government support for liquidity or insolvency, or any other equivalent procedure.</p>
EC5	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.
Description and findings of EC5	Standard related parties, whether integrating or not a "common risk," are individually subject to the same general lending limits applicable to "connected parties." This follows a

	<p>scale going from 12 to 40 percent of the bank's Tier 1 capital for each standard related party, after aggregation with its connected persons. In addition, related party lending is subject to the maximum aggregated limits for standard related and relevant related parties described below.</p> <p>Standard related parties are subject per Article 73 Bis of the LIC to an aggregated 35 percent of Tier 1 maximum lending limit as a whole set of parties related to an institution. Collateralized exposures with related parties are not subject to the limit mentioned above. Further reducing this aggregated lending limit to more prudent levels, however, would require an amendment of the LIC for which there might not be the necessary political consensus.</p> <p>Banks are required to deduct from their Tier 1 capital the aggregated risk exposures with their relevant related parties which exceed 25 percent of their adjusted Tier 1 capital (adjusted for mandated capital deductions).</p> <p>Exposures with associated and joint venture companies related to a relevant related party will not be included in the scope of the above deduction. Further, loans granted to entities controlled by a director or senior officer of an institution, or where such parties may exert significant influence, will also be outside the scope of this deduction. Except for the above deduction, any other instance of lending limits with related parties being exceeded is not mandated to be deducted from capital under the LIC. The above limits for related party exposures do not apply on a full consolidated basis up to the highest regulated parent company located in Mexico and are different from the related party exposure limits applicable to other nonbank financial intermediaries.</p> <p>If during on-site inspections CNBV determines that a credit operation with a related person was granted in non-market conditions, it may instruct its correction, modify the amount of required reserves, capital requirement to guarantee it or even its settlement (article 38 and 39 Bis of the CUB).</p>
EC6	<p>The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with related parties as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the Board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.</p>
Description and findings of EC6	<p>Article 80 I a) 2 CUB requires institutions to operate with policies and procedures with parties who present a "common risk." There are further explicit provisions requiring specific policies and procedures to govern lending activities with related parties. Reviewing on-site reports, the assessors verified that through on-site inspections, CNBV reviews transactions with related parties, and check, among other things, that they follow internal policies, do not exceed limits, and are properly monitored and reported accurately.</p> <p>CNBV confirms compliance with the above through onsite inspections as well as through offsite procedures that include reviews of the summaries of the minutes of the meetings of the Board of Directors and credit committees, as necessary.</p>

EC7	The supervisor obtains and reviews information on aggregate exposures to related parties.
Description and findings of EC7	Supervisors obtain information on related parties through regulatory reports of the "R04C" series, which contain information on commercial credits, with the possibility of identifying common risk operations. Likewise, through the regulatory report R24 C-2431 "Information on operations with related parties" CNBV collects disaggregated information on those operations in which they result or may become debtors of banks. Banks monthly submit this information to CNBV, which is monitored by line supervisors. CNBV also reviews the information on derivatives and securities, as well as interbank transactions, which include those between a Mexican bank and its foreign parent company, submitted to Banxico. According to the procedures of the Institutional Supervision Portal (PIN), one of the main tasks for on-site and off-site surveillance, in order to verify the compliance of operations with related parties, is to identify and quantify the financing granted in order to validate that their report covers the full scope of parties and transactions –as determined by regulation or internal criteria– and banks do not exceed limits , through the regulatory reports of operations with related parties.
Assessment of Principle 20	Largely compliant
Comments	Assessors have reviewed current practices and have evidenced the adequacy of the current framework to cope with transactions with related parties, including evidence regarding the exercise of discretionary powers to include all relevant definitions of transactions included in this principle. Full compliance with this CP would require the following actions: <ul style="list-style-type: none"> • Amend Article 73 of the LIC to reduce the 35 percent of capital aggregated maximum limit with standard 'related parties' to a level consistent with international practice. • Reinforce the powers of CNBV by providing explicit powers to exert discretion on a case-by-case basis. • Amend the LAF to require observance of lending limits on a full consolidated basis at the holding company level and extend requirements to unregulated mixed activity holdings (EC5).
Principle 21	Country and transfer risks. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk ⁶⁹ and transfer risk ⁷⁰ in their international lending and investment activities on a timely basis.
Essential criteria	

⁶⁹ Country risk is the risk of exposure to loss caused by events in a foreign country. The concept is broader than sovereign risk as all forms of lending or investment activity whether to/with individuals, corporates, banks or governments are covered.

⁷⁰ Transfer risk is the risk that a borrower will not be able to convert local currency into foreign exchange and so will be unable to make debt service payments in foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower's country. Reference document: *IMF paper on External Debt Statistics – Guide for compilers and users*, 2003.

EC1	The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance and risk appetite of the bank, take into account market and macroeconomic conditions and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored and managed on a regional and an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings of EC1	Through analyses of exposures abroad, which CNBV carries out when warranted (such as, for instance the war in Ukraine) CNBV believes that country risk and transfer risk are not significant risks to which Mexican institutions are exposed. Accordingly, these risks have not been explicitly included in the provisions of the CUB governing risks and risk management with the same depth as other financial risks. Article 114 of the CUB requires the analysis of country risk as part of credit analysis under the general methodology for single borrowers with exposures above UDI 4 million (USD1.4 million equivalent). Annexes 20 and 21 of the CUB mandate the use of the sovereign ratings of three international rating agencies to map the country risk of a borrower to the nine categories contained in the master scale utilized by CNBV for loan classification and provisioning purposes. Transfer risk is not yet explicitly treated in CNBV's regulations. Through prudential reports (R04) CNBV obtains monthly information on risk exposures to non-resident borrowers or counterparties.
EC2	The supervisor determines that banks' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings of EC2	The Mexican current prudential regulation does not specifically mandate that banks must have separate strategy, policies and processes for the management of country and transfer risks, which should include the analysis of country and transfer risk, as warranted.
EC3	The supervisor determines that banks have information systems, risk management systems and internal control systems that accurately aggregate, monitor and report country exposures on a timely basis; and ensure adherence to established country exposure limits.
Description and findings of EC3	There are no specific requirements set by CNBV regulation regarding the manner in which information, risk management and control systems are expected to identify and report country risk and transfer risk. However, in practice CNBV requires institutions to report all credit exposures with nonresidents with a specified code identifying the country of residence of the borrower.

	In the course of its onsite inspection work, as well as through the routine work of the internal audit function, CNBV confirms periodically the accuracy with which nonresident borrowers are tagged for the purposes of prudential reporting.
EC4	<p>There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include:</p> <p>(a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate.</p> <p>(b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate.</p> <p>(c) The bank itself (or some other body such as the national bankers association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.</p>
Description and findings of EC4	The new IFRS 9 methodology takes into consideration country risk, as part of the credit analysis under the general methodology for individual debtors with exposures greater than UDI 4 million (annex 22 CUB). The measurement of the probability of default includes a new quantitative variable for the evaluation of country risk based on the evolution of gross GDP over the last 18 months.
EC5	The supervisor requires banks to include appropriate scenarios into their stress testing programs to reflect country and transfer risk analysis for risk management purposes.
Description and findings of EC5	<p>For the evaluation of capital adequacy according to supervisory scenarios, CNBV provides banks with the macroeconomic scenarios, both expected and adverse but possible, including interest rates from other countries.</p> <p>In order for banks to consider transfer and country risks in their stress tests, the following minimum points are required:</p> <ul style="list-style-type: none"> • Significant reductions in the market price and liquidity of assets, • Adverse movements in currency prices, whose impact affects its financial position, • Reduced availability of contingent credit lines • Increased market volatility, which would affect the quality of the guarantees granted and the derivatives exposure due to changes in valuation, implying an increase in the position of the guarantees granted or other liquidity needs, • Affectation of the cash flow derived from the breach of obligations agreed by its counterparties, correspondents or custodians, and • Losses in value due to the forced liquidation of assets necessary to meet liabilities or positions not covered in the short term.

EC6	The supervisor regularly obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g., in crisis situations).
Description and findings of EC6	<p>There is no dedicated prudential report to obtain information on country and transfer risks. However, in practice CNBV requires institutions to report all credit exposures with nonresidents with a specified code identifying the country of residence of the borrower, which could be considered a proxy for country risk.</p> <p>CNBV has tagged as such only the largest known local corporate entities whose parent is located in Spain. A similar procedure is not followed for other relevant countries, such as those where the parents and actual end-borrower/end-counterparty are residents of NAFTA countries, or elsewhere.</p> <p>In the course of its onsite inspection work, as well as through the routine work of the internal audit function, CNBV confirms periodically the accuracy with which nonresident borrowers are tagged for the purposes of prudential reporting, as described above.</p> <p>The economic analysis unit of CNBV periodically distributes within CNBV economic monitoring, including information on country risk.</p>
Assessment of Principle 21	Largely compliant
Comments	<p>Country risk is non-material in Mexico, in part because the main banking institutions belong to global banking groups that do not carry out material cross-border activities from Mexico. This has resulted in the absence of an explicit prudential framework to cope with this risk. However, current regulatory reports allow CNBV to determine banks' country risk exposures, which in turns gives rise to supervisory actions if deemed necessary.</p> <p>Recently CNBV carried out a review of Mexican banks foreign exposures determining that country and transfer risks was not material (1.9 percent, including exposures to USA bonds, as of December 2021).</p> <p>In this context, compliance with the conditions of this CP can be strengthened by adopting a more proactive approach to the supervision of this risk. This is particularly important as exposure of banks to country risk may change in the near future, considering the rapid digitalization of financial services; hence the Mexican authorities should be ready to implement the following actions:</p> <ul style="list-style-type: none"> • Require that institutions, whose parents are located in the EU and NAFTA countries, undertake ad-hoc periodic reporting of both country and transfer risks, based on the management information system that is utilized to report to their parent institutions. • Require that all other institutions review the codification of the prudential reports to ensure that appropriate tagging of the end-borrower/end-counterparty, rather than only of nonresident borrowers, takes place for the reporting of both types of exposure by country. • Consider the publication of further guidance on the risk management practices expected from institutions, after compilation of the practices observed in leading local institutions.
Principle 22	Market risk. The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market

	and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate market risk management processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank; take into account market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.
Description and findings of EC1	<p>The regulation describes the minimum requirements for bank risk management (Title 2 Chapter IV CUB), which includes the responsibilities of the Board of Directors and senior management; definition of risk profile and risk appetite for each relevant risk, including market risk; internal policies and committees (roles, decision making and reporting); functions and characteristics of the comprehensive risk management unit (UAIR); policies and procedures to identify, measure, monitor, report and mitigate risks. The requirements extend to the establishment, control and notification of limits and rules to follow when these limits are exceeded (articles 66 to 78 of the CUB).</p> <p>Among the requirements that institutions must meet in managing market risk for the trading book (positions marked to market), the regulation mandates banks to:</p> <ul style="list-style-type: none"> • Analyze, assess and monitor all positions subject to market risk (by means of VaR models that measure the potential loss in the trading book, associated with movements in prices, interest rates or exchange rates, with a given level of probability over a specified period. • Seek consistency between the valuation models for positions in financial instruments, including derivatives, used by the unit for comprehensive risk management and those applied by the business units. • Assess concentration of positions exposed to market risk. • Compare the estimated market risk exposures with the results actually observed. When they differ significantly, corrections must be made. • Maintain the historical information of the Risk Factors necessary for the calculation of the market risk. • Calculate potential losses under different scenarios, including extreme scenarios (Annex 12-B CUB, on Stress test requisites). <p>Article 82 CUB establishes specific minimum requirements for the capital markets and trading activities generating market risk, including the use of models, valuation of positions and instruments, validation of models and concentration of market risk. The requirements also extend to data collection, back testing, stress testing, as well as comparison of actual vs. projected results and risk measures. Macroeconomic conditions in the risk management processes are taken into consideration more explicitly in the yearly stress testing exercises required by CNBV.</p>

	<p>CNBV determines periodically the suitability of market risk management processes and applicable policies by means of: (i) the evaluation of the annual reports of the comprehensive risk management and internal audit units; (ii) risk focused and annual on-site reviews of institutions' activities.</p> <p>The annual reports from internal auditors are reviewed off-site and changes to the focus or extension of their audit program requested as necessary. This includes in certain cases a request for ad-hoc internal audit work to provide specific opinions ('certifications') to CNBV, at their request, on particular issues.</p> <p>Following the level of risk assessed as per the risk matrix of each institution (CEFER) regarding its trading and capital market activities, the Supervisory Group of CNBV decides each year whether to inspect these activities and the scope of the inspection. CNBV's normal practice is to conduct an on-site inspection that covers market risk every two years. For large institutions, nearly every year there is a target review in the area of market risk. Transaction testing on-site is performed to (i) verify positions and transactions in financial instruments, with a focus on valuation, data entry and the calculation of and compliance with trading and market risk limits; and (ii) assess the effectiveness and reliability of management and control systems.</p> <p>On-site reviews are performed both by line inspectors and, if requested, by the risk specialists. Market risk models and risk measurement techniques are normally reviewed by the latter. Both groups of supervisors utilize specific procedures, which focus respectively on: (a) establishing compliance with policies and procedures as required by the CUB; and (b) evaluating the effective implementation and reliability of management and control systems. Both sets of procedures can be made more consistent in practice, including by integrating them more effectively for the purposes of rating the risk profile of trading and capital market activities.</p> <p>Consequent upon the review work performed, CNBV initiates formal or informal actions to remedy the deficiencies identified. Follow-up on the progress made by the institutions in remedying these deficiencies is performed by means of both off-site and on-site work.</p> <p>There are no standards for market risk management for regulated holding companies similar to those required of banks acting as parents in a banking group.</p>
EC2	<p>The supervisor determines that banks' strategies, policies and processes for the management of market risk have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.</p>
Description and findings of EC2	<p>Article 68 CUB states that banks' boards or risk committees are responsible for approving the risk appetite of the institutions; the framework for comprehensive risk management; the limits for each risk; the risk tolerance; the ways for carrying out corrective actions; as well as the contingency plan and the financing contingency plan. Furthermore, senior management is responsible for the implementation of the bank's risk strategy and capital adequacy, to cover the exposure of all the risks to which it is exposed, above the minimum regulatory requirements.</p>

	Supervisors review the consistency of internal policies and processes (as well as liquidity and capitalization) considering the objectives and strategic plans of the bank. In this sense, CNBV supervisory teams verify, through the review of regulatory reports and the minutes of the relevant committees, and accompanying documentation, that boards are effectively involved in the design, implementation and execution of the comprehensive risk management framework, which includes management of market risk. In addition, supervisors check that boards review risk exposure limits at least once a year and that it is working closely with senior management the risk committee.
EC3	<p>The supervisor determines that the bank's policies and processes establish an appropriate and properly controlled market risk environment including:</p> <ul style="list-style-type: none"> (a) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk exposure to the bank's Board and senior management; (b) appropriate market risk limits consistent with the bank's risk appetite, risk profile and capital strength, and with the management's ability to manage market risk and which are understood by, and regularly communicated to, relevant staff; (c) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board, where necessary; (d) effective controls around the use of models to identify and measure market risk, and set limits; and (e) sound policies and processes for allocation of exposures to the trading book.
Description and findings of EC3	<p>Article 78 of the CUB sets the general requirements for all risk management activities, including the organization, roles and responsibilities of the board and management, as well as those of the risk committee and the comprehensive risk management unit. The requirements extend to the assessment, monitoring, control and reporting of limits and to when these limits are exceeded.</p> <p>In addition, Article 82 of the CUB sets specific minimum requirements for capital market and trading activities that give rise to market risk, including use of models, valuation of positions and instruments, model validation, and market risk concentration. The requirements extend also to data gathering, back-testing, stress testing, as well as comparing actual versus projected results and risk measures.</p> <p>Institutions inform CNBV of their market risk and capital market activities by means of a suite of prudential reports. CNBV has access to the information system warehoused by Banxico, which permits CNBV to have a full inventory of all the financial instruments, including off-balance sheet contracts and OTC derivatives, which integrate the different portfolios (trading, available for sale, and held-to-maturity).</p> <p>For large institutions and for institutions that present a higher risk contribution from trading and capital market activities, the units in charge of their supervision require in excel format more frequent (weekly) reports and granular analysis.</p> <p>The information stored by CNBV is utilized to elaborate a series of analytical reports and indicators which allow weekly and monthly analysis. The standardized monthly report on market risk for each institution, prepared by the technical vice-presidency, is well</p>

structured and comprehensive, and provides a suite of indicators on market risk, both at notional and marked-to-market values, including:

- A summary reconciliation of portfolios-at-risk to balance sheet and marked-to-market values.
- Relative positions in fixed income, derivatives, equity, and foreign exchange portfolios.
- Long, short and net positions by risk factor (interest rate by currency, equity, and FX rate).
- VaR by the same risk factors at the 99 percent level (1 and 10 days), and expected shortfall.
- Potential loss under stress: (a) 99 percent, 1 day VaR and split VaR; and (b) VaR per market (99 percent, 1 day and 10 day).
- Composition of the trading portfolio (gross and net) by market (cash, derivatives, currency and equity) and major instrument type.
- Capital adequacy ratio estimated under stressed VaR (above) and past scenarios.

These standardized market risk metrics extracted from the system should as soon as possible be used for rating the risk profile of the institutions, as proxy 'entry note' for the market risk position.

CNBV determines adherence by the institutions to their internal market risk limits, and the performance by the Board and senior management on their respective roles and responsibilities by means of the supervisory activities discussed in EC1. Moreover, off-site supervisors follow up on the risk limits communicated to the Commission against the above set of metrics.

CNBV has powers to request modification of the market risk limits adopted by the institutions, as well as to require specific capital charges and limits on exposures to those institutions that present deficiencies in their risk management or control processes.

During inspection visits, supervisors review the overall performance of market risk management and compliance with the regulatory framework, including the following:

- Having effective information systems to guarantee the accurate and timely identification and measurement of risks, including market risk. In this respect, the comprehensive risk management unit must report it daily to the CEO, the head of internal audit, and the heads of the relevant business units; during episodes of high volatility, either internal or due to market conditions, this information may be distributed intraday.
- Market risk limits (Articles 69, 74 and 75 CUB) should be consistent with the bank's risk appetite, risk profile, and capital strength, as well as the management's ability to manage market risk. In addition, article 71 of the CUB requires that personnel involved in risk-taking decisions know the bank's risk limits, risk profile, risk tolerance, and capital strength.
- Immediate reporting by the comprehensive risk management unit to the risk committee on deviations from the defined risk appetite, risk limits or risk tolerance (Articles 69, 70 and 74). The CEO is responsible for implementing the corresponding corrective action plans.

	<ul style="list-style-type: none"> • Risk committees must approve all risk assessment models, including market risk models, proposed by the comprehensive risk management unit (Article 71 CUB). Additionally, per Article 75 CUB the comprehensive risk management unit must ensure the correct measurement, monitoring and control of the various types of risks, including market risk.
EC4	The supervisor determines that there are systems and controls to ensure that banks' marked-to-market positions are revalued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.
Description and findings of EC4	<p>The requirements for the valuation of financial instruments are set out according to accounting criteria in Article 174 of CUB and compiled in Annex 33. The accounting criteria include rules to adjust values, make provisions, and establish investment loss reserves, as well as to value less liquid securities including provisions for marking-to-model.</p> <p>Article 175 Bis 6 CUB, mandates banks to daily mark to market all positions using the information and market prices provided by price providers authorized by CNBV. Banks must carry out, at least once a month, a verification of the accuracy of these prices through a valuation carried out by a unit independent from the business units. Reviews on the timeliness and completeness of these valuations are made through on-site inspections. CNBV also evaluates the adequacy and reliability of the systems and controls in place by monitoring the annual work programs and reports of the risk management and internal audit units discussed above in EC1, including target reviews following the procedures established in the supervision manual, as well as the biannual reports of the management technical evaluation of risks (Article 77 CUB).</p> <p>CNBV requires institutions to remedy deficiencies noted. Follow-up on progress in resolving deficiencies is performed by means of both on-site target visits and off-site work. The latter involves ad-hoc reports from the internal audit or risk management unit.</p> <p>Banks are allowed to use internal valuation models, provided that they comply with the provisions of articles 175 Bis 3 and 175 Bis 8 CUB, which establish that:</p> <ul style="list-style-type: none"> • Internal models are reviewed and validated by a unit independent of the business units that take risks, which could be the internal audit. • Banks have appropriate policies and processes in place to use internal valuation models. <p>Internal valuation models must include adjustments considering, at least, the costs of cancellation and closing of positions, the operational risks, the financing costs of the operations, future administrative expenses, unrecognized credit spreads, model risk,</p>

	<p>(including that associated with the use of an incorrect valuation methodology and with the calibration of unobservable parameters), and the illiquidity of positions.</p> <p>The Institutional Supervision Portal of CNBV defines the following criteria for the processes and activities related to the valuation of financial instruments of money market institutions, stock market and derivatives operations, during on-site inspections:</p> <ul style="list-style-type: none"> • Money market portfolios. CNBV verifies that the valuation of investments in securities is recorded in accordance with the regulation, using prices from authorized price providers; accounting guidelines, policies and procedures. • Capital markets. CNBV verifies initial accounting record, transfers between accounts, sales, maturity of investments in securities, profit recognition due to valuation (increase/decrease), interest and sale of these investments. • Derivative operations. CNBV verifies the valuation models of derivative products, risk measures, internal controls implemented, the security and integrity of information systems, data processing, risk management and models valuation.
EC5	The supervisor determines that banks hold appropriate levels of capital against unexpected losses and make appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities.
Description and findings of EC5	<p>According to article 2 Bis 2 of the CUB, banks may use internal valuation models provided that the positions valued according to models are adjusted for capital requirement purposes by including, at least, the costs of cancellation and closure of positions, operational risks, transaction financing costs, future administration expenses, unrecognized spreads, model risk, including the risk associated with the use of an incorrect valuation methodology, and the calibration of unobservable parameters, as well as, where appropriate, the lack of liquidity of the positions.</p> <p>Banks must establish and follow procedures to identify illiquid positions, as well as continuously verify that the corresponding adjustment remains valid, for which they must consider factors such as the time needed to hedge the position, the volatility of the purchase and sale price differentials, the availability of market prices, the average and volatility of the amounts traded under normal and stress conditions, market concentrations and the time elapsed since the transaction agreement.</p> <p>In the annual capital adequacy assessment banks must assess whether their capital is sufficient to cover possible losses arising from exposures to market risks in different scenarios, which are defined by supervisors. When the outcome of this assessment, show that a bank has insufficient capital, it shall submit a capitalization plan, which CNBV may challenge and require more capital.</p>
EC6	The supervisor requires banks to include market risk exposure into their stress testing programs for risk management purposes.
Description and findings of EC6	<p>Annex 12-B CUB, details the general and risk specific requirements for stress tests, including market risk. Stress tests must be carried out at least once a year as a comprehensive risk management tool.</p> <p>Banks must contemplate short and long term specific and systemic scenarios, as well as combined scenarios, as well as their impact on the structure and financial profits of the bank, without ruling out scenarios of low-probability high-impact. The design of the</p>

	<p>scenarios must observe the type of operations and exposures to which the Institution is subject, in such a way that it reflects its degree of complexity and is in accordance with the guidelines defined by boards, considering most recent stress events and events with the greatest volatility that the Institution may face.</p> <p>For market risk, banks must consider the following assumptions to define their scenarios: (i) illiquidity events and price increase; (ii) concentration of positions relative to the total placement amount; (iii) markets with only buying or selling positions; (iv) existence of non-linear products and options out of the money; (v) significant changes in correlations; and (vi) any other risk that is not adequately captured by VaR methodologies.</p>
Assessment of Principle 22	Compliant
Comments	<p>Market risk risk-weighted assets, in December 2021, amounted to MXN1.57 trillion (USD78.5 billion equivalent), or 20 percent of total RWAs, including both trading and banking books. As of October 2021, the system foreign exposures totaled USD20 billion (short) and USD20.5 billion (large); thus, the net open position (large) _to USD409 million, which would produce a 63 basic point reduction of capital if the MXN experienced a 25 percent depreciation against the USD. In turn, the net short position in the trading book MXN 33 billion together with the net short position in interest rate swaps, would produce a 44 basic point reduction in capital to the 250 basic point increase in the interest rate curve. Additionally, Banxico’s restrictive regulations for foreign currency open exposures, together with the current level of sophistication of the Mexican capital market, determines that the risks associated with trading activities of Mexican banks are quite limited.</p> <p>In this context, the assessors’ review of supervisory practices towards market risk, including both off-site and on-site reports, concludes that compliance with the essential criteria of this CP is fully achieved, albeit it can be further enhanced by implementing the following actions:</p> <ul style="list-style-type: none"> • Use the concentration metrics already calculated as ‘entry note’ to rate the risk profile of institutions explicitly under the current risk rating methodology (EC2), also see CEFER in CP19. • Compile and publish observed risk practices among different types of institutions in managing market risk inherent in their trading and capital market activities. • Amend the LAF to require consistent market risk management standards at the group level, including local holding companies and significant nonbanking institutions within a group.
Principle 23	Interest rate risk in the banking book. The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk ⁷¹ in the banking book on a timely basis. These systems take into account the bank’s risk appetite, risk profile and market and macroeconomic conditions.
Essential criteria	

⁷¹ Wherever “interest rate risk” is used in this Principle the term refers to interest rate risk in the banking book. Interest rate risk in the trading book is covered under Principle 22.

EC1	Laws, regulations or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the risk appetite, risk profile and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank's changing risk profile and market developments.
Description and findings of EC1	<p>IRRBB is regulated by Article 83 of the CUB, which mandates banks to analyze, assess, and monitor the impact in financial income and economic value using risk models that have the ability to measure the potential loss in the banking book, associated with exchange rates and interest rates by currency, over a specific period. These valuation models must be consistent with the valuation models used by the different business units. Additionally, banks must compare the variations projected in financial income with the actual observations, and calibrate the model as warranted. To estimate potential losses, different scenarios, including extreme scenarios, must be used. Historical information of risk factors used for the calculation must be kept.</p> <p>The CUB also instructs institutions to formulate a comprehensive management framework for IRRBB.</p> <p>Article 67 of the CUB states that banks must define their objectives on risk exposure and develop policies and procedures for their management, which include the obligation to identify, measure, monitor, limit, control, report and disclose the risks to which they are exposed. Additionally, Article 68 of the CUB establishes that the Board of Directors is responsible for approving the risk appetite of the bank, as well as the risk tolerance levels and the mechanisms for carrying out corrective actions, as well as preparing contingency plans.</p> <p>Likewise, it is established in article 74 of the CUB that the information of market risks exposure must be provided daily to the General Director of the Institution, to the head of the internal audit function and to the heads of the respective business units and, when the bank is exposed to situations of high financial volatility derived from their internal circumstances or market conditions, or even on intra-day basis.</p> <p>Article 75 of the CUB establishes minimum conditions for the measurement, monitoring and control of risks, including:</p> <ul style="list-style-type: none"> • Consolidated exposure for all types of risk. • Impact on the value of capital and the income statement caused by the alterations of the different risk factors. • Risk concentrations that may affect the consolidated risk of the bank. <p>Finally, Article 88 of the CUB establishes that banks must disclose a brief description of the methodology for identifying, quantifying, managing, and controlling market risk, including interest rate risk in the banking book.</p> <p>In practice, although all banks are subject to the same requirements, management of the IRRBB is more sophisticated in large than in small banks. Therefore, the focus of</p>

	<p>supervisors is placed on the largest banks operating in the system (G-7), which have more elaborate information systems that already visualize interest rate as a significant inherent risk within their risk management activities. Smaller banks are required to conduct standard market risk stress scenarios periodically; this is being extended to their banking books and captures all interest earning assets and interest-bearing liabilities, including loans and deposits.</p> <p>Title One of the CUB regulates that banking institutions must determine capital charges for market risk in accordance with Basel III recommendations; the Mexican rules, however, include the IRRBB in Pillar 1 requirements.</p>
EC2	<p>The supervisor determines that a bank's strategy, policies and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank's Board. The supervisor also determines that senior management ensures that the strategy, policies and processes are developed and implemented effectively.</p>
Description and findings of EC2	<p>The strategies, policies and processes for the management of IRRBB, as for all risks, are approved and reviewed by the Board. Article 68 of the CUB establishes that Boards of Directors shall review, at least once a year, the adequacy of the risk exposure limits for each type of risk, as well as the suitability of the institutional framework for the comprehensive management of risks.</p> <p>Supervisory work takes place through a mixture of activities, including: (i) the assessment of the periodic regulatory reports received from banks and the annual reports of the risk management and internal audit units; (ii) the offsite evaluation of the sensitivity of the institutions to changes in interest rates to identify those institutions that present a more adverse/riskier profile; and (iii) targeted onsite reviews of the institutions' activities and risk control environment. The reports submitted to Banxico are available to CNBV that prepares of analytical reports and calculates monitoring and analysis indicators. In practice, supervisors focus on the largest banks (G-7), which have more elaborate information systems, which consider interest rate as a significant inherent risk within their risk management.</p> <p>The adequacy of interest rate risk management practices is assessed by the Directorate of Methodology and Risk analysis of the Technical Vice Presidency, staffed with 26 specialists in modelling and risk measurement, and banks implementation of risk management systems. These specialists assist the line supervisors to carry out their tasks. The activities to assess interest rate risk management policies and processes concentrate on the systems used to manage market risk in the trading and banking books, both of which are subject to Pillar 1 capital requirements following a standardized VaR approach for interest and exchange rate risks. However, as described above (EC1) banks are required to manage IRRBB separately from the trading book, although both banking and trading books are jointly measured for capital requirement purposes. Therefore, supervisors assess separately banks' management of the banking and the trading books.</p>
EC3	<p>The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including:</p> <p>(a) comprehensive and appropriate interest rate risk measurement systems;</p>

	<p>(b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions);</p> <p>(c) appropriate limits, approved by the banks' Boards and senior management, that reflect the banks' risk appetite, risk profile and capital strength, and are understood by, and regularly communicated to, relevant staff;</p> <p>(d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks' senior management or Boards where necessary; and</p> <p>(e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks' Boards and senior management.</p>
Description and findings of EC3	<p>The Institutional Supervisory Portal (PIN) considers various procedures that serve as a guide for supervisors to assess risk management practices, which generally include:</p> <ul style="list-style-type: none"> • Assess the methodologies and systems used to evaluate the behavior of the different risks to which the bank is exposed. • Assess the methodologies, models, parameters, scenarios and assumptions used to measure the different types of risks to which the bank is exposed. • Verify that the comprehensive risk management unit (UAIR) performs the functions of measuring, verifying, and analyzing the adequacy of capital and liquidity levels to cope with the risks the banks is exposed. • Verify that the UAIR monitors compliance with all relevant internal policies aimed at mitigating risks, including pertinent regulatory limits. • Verify if the bank identifies potential events, changes in the economic conditions, as well as the relationship between these events and their causes, which may affect the financial situation of the bank. • Assess whether the bank performs a sensitivity analysis and stress testing analysis under different scenarios. • Assess the role of the internal audit function as regards risk controls and compliance with internal and external regulations. <p>CNBV assesses interest rate risk environment as described in EC1 above. In addition to the positions in financial instruments in the trading and banking books, CNBV looks at other possible structural re-pricing mismatches among interest-earning assets and interest-bearing liabilities that would produce material interest rate risk exposures, which is considered by CNBV adequately covered by charging the banking book with market risk capital requirements.</p> <p>Through on-site reviews CNBV has established that most sources of interest rate risk in the banking industry are located in the "held to maturity" portfolio of securities, since most loan portfolios are short or medium term and long-term portfolios are mostly contracted at variable interest rates.</p> <p>CNBV periodically conducts interest rate sensitivity analysis under different scenarios on a case-by-case basis, projecting cash flows and financial statements on a monthly basis for a two-year horizon. CNBV simulates different scenarios with changes in the peso exchange</p>

	rate, inflation, GDP growth, and interest rate changes, including estimated changes in banks' deposits which impact the net interest margin and the CAR. Also, CNBV simulation model estimates the impact on financial performance and economic value to parallel shifts in the yield curve and changes in key rates to which the institution is vulnerable; (4) the monthly sensitivity and stress testing of the above measures.
EC4	The supervisor requires banks to include appropriate scenarios into their stress testing programs to measure their vulnerability to loss under adverse interest rate movements.
Description and findings of EC4	<p>As part of the capital adequacy exercise (ICAAP) banks should estimate the impact on its financial condition considering both baseline and adverse scenarios. The baseline scenario considers expected macroeconomic assumptions that include interest rates, among other macroeconomic indicators. CNBV, in order to determine these scenarios, makes its own projections and also considers those of Banxico, SHCP and experts from the private sector. For the adverse scenarios CNBV considers a set of unfavorable projections and risk variables with the aim of evaluating the financial strength of each banking institution in a scenario that is adverse but possible.</p> <p>The specific and detailed requirements and guidelines for stress tests exercises are found in Annex 12-B of the CUB. This annex states that banks must conduct stress tests that consider interest rate risk at least once a year in order to estimate the potential effects that changes in rates would have on income and the economic value of their positions.</p> <p>Article 71 of the CUB establishes the obligation of the approval, monitoring and participation of the Board of Directors in the generation of such stress testing exercises.</p>
Assessment of Principle 23	Compliant
Comments	Although the regulation does not differentiate between banking and trading books for capital purposes (Pillar 1), banks are required to manage both books separately. The review by the assessors of IRRBB management by banks and the supervisory review lead to the conclusion that compliance with the essential criteria of this CP is adequately achieved.
Principle 24	Liquidity risk. The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than, those prescribed in the applicable Basel standards.

Description and findings of EC1	<p>The liquidity requirements in Mexico have been established in joint regulations between CNBV and Banxico. The requirements are in line with the standards issued by the BCBS. All commercial banks, both internationally active and local banks, must comply with the LCR and the NSFR.</p> <p>Accordingly, regulatory provisions include the calculation of the LCR, regulatory minimums, thresholds that trigger supervisory actions or liquidity scenarios, corrective measures, and plans in case of falling to comply with the above, the definition of breaches of the standard and the guidelines for the disclosure of information to the public.</p> <p>LCR requirements are aligned with the Basel standard and was thus recognized in the consistency assessment conducted in 2015 by the Basel Committee (RCAP, 2015).</p> <p>In 2017 the authorities began to request information from institutions on the calculation of the NSFR indicator, which has been monitored since by CNBV and Banxico.</p> <p>In August 2021, the final rule on the LCR and NSFR was published and entered into force in March 2022.</p>
EC2	<p>The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.</p>
Description and findings of EC2	<p>Minimum quantitative liquidity requirements are fully based on the Basel standards for the measurement of this risk through the LCR and NSFR indicators, which consider market conditions and on-balance and off-balance sheet positions. In addition, as discussed elsewhere in this document, the CUB (Article 81 and Annex 12-B) mandates banks to conduct a stress testing exercise as part of their comprehensive risk management strategy; the technical design of the stress tests are shared and discussed with CNBV, which may require changes. The exercise includes the assessment of liquidity adequacy and the output is submitted annually, to be reviewed and approved by the supervisor.</p> <p>The CUB also requires banks to have a documented contingency funding plan, which establishes the strategies, policies and procedures to follow in case of unexpected liquidity requirements or problems to liquidate assets. This plan must meet the guidelines described in Annex 12-C of the CUB.</p> <p>Monthly CNBV prepares an individual and system risk analysis, that includes liquidity risk. The report discusses, among other issues, evolution of the LCR (daily average, median and minimum) flagging outliers in terms of volatility; liability concentration, including an analysis of the largest depositors and flagging sensible depositors, which are to be closely monitored; the evolution and volatility of the NSFR; interbank financing concentration; and level of debt funding.</p>
EC3	<p>The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events, and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks' Boards. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance.</p>

Description and findings of EC3	<p>Article 81 of the CUB establishes the principles banking entities should comply for the proper management of liquidity risk. They establish that in the processes of measuring and managing liquidity risk, institutions must consider:</p> <ul style="list-style-type: none"> • The risk profile of the bank and the liquidity needs of each financial subsidiary or any entity of the banking group that could affect its liquidity. • Restrictions access to markets' resources. • Interactions with other risks. • Forecasts of inflows and outflows from on- and off-balance sheets operations. • Concentration on funding sources. • Forecasts of mismatches between the timing of inflows and outflows. • The types and value of available collaterals. <p>The adequate compliance of this general principles is assessed during on-site examinations and corresponding results included in the CEFER methodology. CNBV carries out several supervisory activities to verify the soundness and depth of the liquidity management framework. Among other issues, the supervisor assesses liquidity risk management strategies, verify adequate documentation and information systems, revise policies and procedures on liquidity risk management, and verify the proper calculation of prudential regulatory liquidity ratios (CCL, CFEN).</p>
EC4	<p>The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including:</p> <ol style="list-style-type: none"> (a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks' Boards; (b) sound day-to-day, and where appropriate intraday, liquidity risk management practices; (c) effective information systems to enable active identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide; (d) adequate oversight by the banks' Boards in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite; and (e) regular review by the banks' Boards (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.
Description and findings of EC4	<p>Article 65 of the CUB establishes that banks must implement mechanisms to ensure that their operations are within risk levels according to their capital, amount of liquid assets and operating capacity, in normal, adverse and extreme conditions. Such mechanisms must be fitting to the nature and complexity of their operations, and must allow Institutions to identify their vulnerabilities. Risk management processes must ensure, in a systematic and prospective manner, that the risk level for the different relevant activities are kept within limits that maintain its solvency, liquidity and financial feasibility, and that fit its Desired Risk Profile. Article 68 of the CUB establishes that the Board of every Institution is</p>

responsible for approving the Desired Risk Profile of the Institution, the Comprehensive Risk Management Framework, the risk exposure limits, the risk tolerance levels, and mechanisms to implement corrective actions, as well as the Contingency Funding Plan. The Board may delegate the approval of Specific Risk Exposure Limits and Tolerance Levels for each business unit and risk type to which the Institution is exposed, to the risk committee. As required by the CUB (Article 74) adequacy of banks' liquidity levels is assessed by the UAIR, which allows to face liquidity needs, even intraday. In addition, Article 81 requires that banks manage their liquidity complying at all times with regulatory and internal requirements as well as with payment and settlement obligations in a timely fashion, both in normal and in stress conditions.

According to Article 69 CUB, the CEO must ensure the existence and proper operation of systems for data storage, processing and management, and establish procedures that ensure the proper flow, quality and timeliness of the information, between business units and the UAIR, for the latter to possess all the elements necessary to execute its functions. Article 81 CUB also establishes that banks must also consider the risk of each financial subsidiary, the consolidated risk, and the risk of any entity that is part of the business group affecting their liquidity, considering all transactions, including off-balance sheet items. For this purpose, they must execute the respective analysis by currency type, units of account and reference, by line of business and by business unit, both on an individual and a consolidated basis.

The Board must review the adequacy of Risk Exposure Limits for each type of risk and the Framework for Comprehensive Risk Management at least once a year, as well as liquidity and capital adequacy levels with respect to its objectives and strategic goals. Article 70 of the CUB establishes that the Board of every bank must constitute a Risk Committee focused on the management of the bank's risks, overseeing that the execution of transactions fits their risk appetite, the Comprehensive Risk Management Framework, and the limits approved by the Board. The risk committee must propose, for approval by the Board, the overall risk exposure limits and, if applicable, specific risk limits, on a consolidated basis and detailed by business unit or risk factor. The risk committee shall inform the Board, at least on a quarterly basis, about the bank's risk profile, as well as about the negative effects on the Institution's operation and breaches of the risk appetite and risk tolerance limits Article 71 CUB). Per Article 74 CUB, the Board receives at least quarterly reports on the risk profile, including the exposure of discretionary risks as well as the incidence and impact of non-discretionary risks and sensitivity analyses and tests under different scenarios, including extreme scenarios.

CNBV determines the suitability of the liquidity risk management strategy and processes, including the oversight of the role exercised by the banks' Boards, through a number of supervisory activities, including: (i) offsite monitoring of the liquidity indicators calculated on a daily and monthly basis; (ii) assessment of the reports prepared by the risk management unit, which are requested on a weekly or more frequent basis, if needed, for the most relevant institutions; and (iii) on-site reviews of the institutions' activities and risk management environment. Additionally, CNBV determines the suitability of the liquidity risk management strategy and processes, including the oversight role exercised by the

	banks' Boards, through a number of activities, including: off-site monitoring of the proxy liquidity indicators calculated on a daily and monthly basis; (evaluation of the reports of the risk management unit, which are requested on a weekly or more frequent basis; on-site reviews of the banks' activities. Following the review work performed, CNBV initiates formal or informal actions, as warranted.
EC5	<p>The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g., credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy, and include:</p> <ul style="list-style-type: none"> (a) an analysis of funding requirements under alternative scenarios; (b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress; (c) diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits; (d) regular efforts to establish and maintain relationships with liability holders; and (e) regular assessment of the capacity to sell assets.
Description and findings of EC5	<p>The CUB (articles 67, 74, 80, 81, 82 and 83) establishes that for liquidity risk management purposes, banks must diversify their sources of financing considering maturity and taking into account potential losses.</p> <p>Article 81 of the CUB states that banks must preserve an adequate level of liquid assets sufficient to cover outflows of resources, even in situations of stress, considering the desired risk profile and the duration and severity of financial stress, as well as value of assets' realization.</p> <p>Liquidity stress testing exercises should consider, among others, the institution's needs to buy back debt or meet non-contractual obligations in order to mitigate reputational risk.</p>
EC6	<p>The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the bank's contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.</p>
Description and findings of EC6	<p>Article 81 of the CUB establishes the obligation of banks to have a Contingency Funding Plan (PFC) that clearly establishes the strategies, policies, and procedures to be followed in case of unexpected liquidity requirements or problems to liquidate assets. This plan must meet the guidelines described in Annex 12-C of the CUB, which include:</p> <ul style="list-style-type: none"> • Identify the person in charge of activating the PFC and describe the process by which the personnel involved will be informed about its activation.

	<ul style="list-style-type: none"> • Identify the instances responsible for decision-making until the level of risk is restored. • Define the instances responsible for coordinating all required actions once the PFC has been activated. Responsible bodies must have sufficient hierarchy, autonomy, and capacity to properly manage the PFC. • Establish and describe the events and risk indicators, quantitative and qualitative, that will activate the PFC, considering the scenarios designed in the stress tests exercises referred to in Article 81 of the CUB. • Establish criteria that allow the bank to assess the severity of the situation it faces. <p>CNBV may, if deemed appropriate, require amendments to the PFC.</p>
EC7	<p>The supervisor requires banks to include a variety of short-term and protracted bank-specific and market-wide liquidity stress scenarios (individually and in combination), using conservative and regularly reviewed assumptions, into their stress testing programs for risk management purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity risk management strategies, policies, and positions and to develop effective contingency funding plans.</p>
Description and findings of EC7	<p>Article 81 of the CUB states that institutions must carry out stress testing exercises, which must follow the guidelines established in Annex 12-B of the CUB. These requirements include:</p> <ul style="list-style-type: none"> • The definition, scope and assumptions of stress tests must be approved by the bank's risk committee and formally documented. • At least once a year, banks shall verify the suitability of stress tests and verify that their results are properly included in risk measurement and risk analysis internal procedures. • Consider specific scenarios of the institution, systemic and combined, that consider short- and long-term perspectives, as well as their effects on the structure and financial results of the bank. The design of the scenarios must observe the type of activities and risks to which the bank is exposed. • Consider and evaluate different degrees of severity for each scenario, in order to better identify the vulnerabilities of the institution, including a scenario with extreme conditions that reflects both the most recent events and those of greater financial volatility. <p>Prior to implementation, banks must submit to CNBV the design of their stress tests. CNBV has the authority to order modifications to such design if deemed necessary. The results of stress tests, as well as their incorporation into the Contingency Funding Plan, are subject to the review and approval of CNBV.</p> <p>The review of stress tests by CNBV's supervisory teams includes, among others:</p> <ul style="list-style-type: none"> • Verify that banks contemplate realistic scenarios, including abrupt movements and/or decreases in the market prices of assets, as well as the impossibility of making them liquid in case of fire-selling strategies. • Verify that banks identify and include correlations between all sources of market financing, in accordance with their activities and risk to which they are exposed.

EC8	The supervisor identifies those banks carrying out significant foreign currency liquidity transformation. Where a bank's foreign currency business is significant, or the bank has significant exposure in a given currency, the supervisor requires the bank to undertake separate analysis of its strategy and monitor its liquidity needs separately for each such significant currency. This includes the use of stress testing to determine the appropriateness of mismatches in that currency and, where appropriate, the setting and regular review of limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant currency individually. In such cases, the supervisor also monitors the bank's liquidity needs in each significant currency, and evaluates the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal entities.
Description and findings of EC8	Due to restrictions imposed by the regulation of the Central Bank, currency position and corresponding mismatches are relatively low for banks operating in Mexico. Total liabilities in foreign currencies are limited to 1.83 percent of capital (Circular 3/2012 of the Central Bank). Banxico carries out daily surveillance of the foreign currency exposure of credit institutions. Article 81 of the CUB indicates obligations for institutions with respect to the exchange rate in the administration of liquidity risk, particularly the obligation to carry out liquidity analysis by type of currency. Additionally, the regulation establishes that stress testing exercises should consider adverse movements in the prices of the currencies the bank is exposed to.
Assessment of Principle 24	Largely Compliant
Comments	The authorities have a well-established regulatory and supervisory framework for liquidity risk. With the inclusion of the LCR and the NSFR prudential regulations the framework is fully aligned with the Basel III recommendations. However, it should be noted that deposit-taking development banks are not subject to the current liquidity prudential framework applicable to commercial banks. Accordingly, it is recommendable to amend this shortcoming through the obligation of development banks to adhere to prudential regulation addressing liquidity risk.
Principle 25	Operational risk. The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk ⁷² on a timely basis.
Essential criteria	
EC1	Law, regulations, or the supervisor require banks to have appropriate operational risk management strategies, policies, and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk. The supervisor determines that the bank's

⁷² The Committee has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

	<p>strategy, policies, and processes are consistent with the bank's risk profile, systemic importance, risk appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the bank on a bank-wide basis (including periods when operational risk could increase).</p>
Description and findings of EC1	<p>The Title II, chapter IV, of the CUB establishes the principles and requirements for risk management policies and processes. According to this regulation, risks are classified into two main categories: (i) the discretionary risks—riesgos discrecionales—that result from a risk-taking decision (e.g., credit, liquidity, and market risks); and (ii) the non-discretionary risks—riesgos no discrecionales—including, but not limited to, operational risks resulting from breakdowns in internal procedures, people, and systems. The regulation requires banks to have in place comprehensive risk management processes, including appropriate oversight by the Board of Directors and senior management. It also states that risk management processes should address, among others, operational, technological and legal risks. According to this regulation, the bank's Board of Directors must approve risk exposure limits submitted by the bank's Risk Committee.</p> <p>Art. 86 of the CUB specifically addresses operational risk (OR) issues and requires banks to identify operational risks and establish minimum measurement and monitoring practices. Banks are required to have a comprehensive risk management unit (Unidad para la Administración Integral de Riesgos) that is independent of the management and is responsible for ensuring that the bank has in place adequate internal controls, including information technology and legal risk.</p> <p>CNBV has designed specialized areas for the supervision and monitoring of operational risk (Dirección General de Supervisión de Riesgos Operacionales y Tecnológicos–DGSROT). Through the CEFER matrix, compliance with the regulations applicable to operational risk is assessed, which includes the assessment of the following areas: corporate governance, risk management practices, internal controls, and independent audit function.</p>
EC2	<p>The supervisor requires banks' strategies, policies, and processes for the management of operational risk (including the banks' risk appetite for operational risk) to be approved and regularly reviewed by the banks' Boards. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.</p>
Description and findings of EC2	<p>Article 68 of the CUB establishes that the Board of Directors is responsible of approving the desired risk profile of the institution, the framework for comprehensive risk management, the risk exposure limits, the risk tolerance levels and the mechanisms to control and implement corrective actions. The risk profile, risk management framework, exposure limits, tolerance levels, control mechanisms, and corrective actions are detailed by risk.</p> <p>Pursuant to the CUB, the Board oversees management and ensures that banks' strategies, policies and processes for the management of operational risk are implemented effectively through the Audit Committee which follows the activities of Internal Audit Unit.</p> <p>Specific policies and procedures for the management of operational risk include Article 86 (CUB) the identification, assessment, monitoring and control of the operational risks implicit</p>

	<p>in the Institution's processes by risk category; the criteria for collecting and managing losses from operational risk events. In addition, banks must at least perform the following functions:</p> <ul style="list-style-type: none"> • Describe and document the processes that tasks of each unit of the Institution. • Identify and document in an inventory, the operational risks implicit in the processes referred to in the previous number. The inventory must contain, at a minimum: the description of the operational risk identified; the type of operational risk involved; the business line, process and product; the quantification; the controls, and, if applicable, the mitigation plans and area responsible for their mitigation. • Evaluate and report, at least quarterly, the profile of exposure to operational risk, as well as the possible consequences that the materialization of the identified risks would generate for the business, and report the results to those responsible for the units involved, in order to evaluate the measures taken. • Establish risk tolerance levels for each type of risk identified, defining their causes, origins or risk factors. • Keep a historical database of loss events detailing the different types of loss and its cost, its accounting record, and the business unit or line. • Implement policies, procedures and criteria for the identification, prioritization, quantification, monitoring and control of operational risks, as well as for their assignment to the different business lines. • Establish operational risk indicators to monitor the evolution of each operational risks prioritized. • Generate information for decision-making, which must at least include the inventory of priority operational risks; risk profile maps; operational risk rating at the institution or business unit level; control and mitigation procedures; most relevant operational risk events and corrective actions implemented.
EC3	The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the bank's overall risk management process.
Description and findings of EC3	CNBV conducts onsite reviews focused on verifying that (i) the responsibility for managing this risk has been assigned at the proper level and with adequate segregation of functions and independence; (ii) bank Boards have approved policies to identify and manage operational risks; and (iii) these policies are adhered to by management.
EC4	The supervisor reviews the quality and comprehensiveness of the bank's disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.
Description and findings of EC4	The regulation requires banks to have a Disaster Recovery Plan (DRP) and a Business Continuity Plan (BCP). The regulation includes a detailed section and a technical appendix describing the requirements that should be included in both the BCP and the DRP.

	<p>CNBV verifies through on-site examinations the adequacy of these plans to ensure the bank is able to operate as a going concern and minimize losses. CNBV has given greater attention to these issues over the last years. The supervisory methodology includes detailed tasks and activities that should be performed primarily by IT supervisors. The DGSROT has developed a risk-based methodology in accordance with best practices and international standards such as:</p> <ul style="list-style-type: none"> • Control Objectives for Information and Technologies (COBIT). • Risk and Control Management System (COSO). • National Institute of Standards and Technology (NIST). • Information Technology Infrastructure Library (ITIL).
EC5	<p>The supervisor determines that banks have established appropriate information technology policies and processes to identify, assess, monitor and manage technology risks. The supervisor also determines that banks have appropriate and sound information technology infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security and availability and supports integrated and comprehensive risk management.</p>
Description and findings of EC5	<p>For IT risk management, banks are obliged to assess vulnerability in hardware, software, systems, applications, security, information retrieval systems and networks. The regulation requires banks to regularly submit reports on their IT systems, including any significant modification that might impact their operational risk profile. CNBV has a dedicated team of experts who conduct IT reviews.</p> <p>Article 168 bis 11 of the CUB establishes that banks must adopt policies and processes to identify, evaluate, monitor and manage information security risks. These requirements contemplate the protection of the confidentiality and the integrity and availability of information. Article 168 bis 12 of the CUB establishes obligations with respect to the technological infrastructure of banks. Article 168 bis 13 of the CUB establishes the obligation of banks to have a Chief Information Security Officer (CISO).</p> <p>CNBV supervises that banks have an adequate and solid technological infrastructure to guarantee the integrity, security and availability of their data and systems, according to the results of the cybersecurity risk assessment of each institution. In the last 3 years the supervisory effort has focused on supervising the formalization of the CISO and the adoption of a security master plan.</p> <p>Given the increase exposure to cyber risks brought about by the recent boom in the digitalization of financial services, the greater interconnectivity between agents, and the massive use of electronic channels, CNBV has made significant efforts to enhance its ability to supervise this particular risk. Currently, CNBV has regulation on cybersecurity only for banks, brokerage houses, and financial technology institutions. Given the broad range of financial entities within the scope of CNBV's supervision, there are significant entities in Mexico that are not currently subject to enforceable cyber regulation or guidelines.</p> <p>CNBV has only started to conduct cyber on-site inspections of its supervised entities in April 2022, largely due to limitations of resources.</p>

EC6	<p>The supervisor determines that banks have appropriate and effective information systems to:</p> <ul style="list-style-type: none"> (a) monitor operational risk; (b) compile and analyze operational risk data; and (c) facilitate appropriate reporting mechanisms at the banks' Boards, senior management and business line levels that support proactive management of operational risk.
Description and findings of EC6	<p>There is a general requirement for supervised entities to have information systems in place to ensure the adequate management and control of risks. Article 68 and 69 of the CUB specifies the role and responsibilities of the Board of Directors and senior management in matters of risk management. These articles provide for the obligation to constitute a Risk Committee (article 70 of the CUB), composed of at least two members of the Board, the general manager and the head of the Unit for Comprehensive Risk Management (UAIR). The Risk Committee is responsible for, among others, approving the methodologies and procedures to identify, measure, monitor, limit, control, report and disclose the different types of risk to which the institution is exposed (Article 71 of the CUB).</p> <p>Article 86 of the SCI establishes that banks must have a detailed historical database of the different types of incurred operational losses, which is regularly verified by supervisors during on-site examinations.</p> <p>The supervision carried out by CNBV is focused on verifying the understanding of Board member regarding the information they receive, as well as to assess the sufficiency and adequacy of such information for decision-making purposes.</p>
EC7	<p>The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.</p>
Description and findings of EC7	<p>Reporting templates R28 'Operational Risk Information' is intended to collect information regarding operational losses incurred by banks stemming from failures or deficiencies in internal controls; errors in processing and storing operations or transmitting information; adverse administrative and judicial resolutions; and fraud or theft. The information reported in these templates are classified by business line, process and product. Similarly, it seeks to collect information necessary to identify operational risks and their corresponding inherent banks' risk rating.</p>
EC8	<p>The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program covers:</p> <ul style="list-style-type: none"> (a) conducting appropriate due diligence for selecting potential service providers; (b) structuring the outsourcing arrangement; (c) managing and monitoring the risks associated with the outsourcing arrangement; (d) ensuring an effective control environment; and (e) establishing viable contingency planning. <p>Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.</p>

Description and findings of EC8	<p>Outsourcing is permitted by the CUB (Article 317 et seq.), but must comply with a number of requirements, which should be explicitly and unrestrictedly accepted by the service provider and included in the service agreement documentation:</p> <ul style="list-style-type: none"> • Explicit consent of the service provider in the contract to grant access to its dependencies and records to the external audit, the bank' and the individuals designated by CNBV to carry out supervisory tasks. • Keep confidentiality of the information managed and put systems in place to ensure confidentiality and security of the operations. • Restriction or qualification of possible further outsourcing by the services provider to a third party. <p>A report must be prepared by the bank's CEO director or another official designated by him, and approved by the Board at the proposal of the Risk Committee or the Audit Committee. The report must describe which operational processes or administration of databases and computer systems are the object of outsourcing; the policies and criteria to select service providers, focused on assessing their expertise, technical capacity and human resources to provide the service with adequate levels of performance, reliability and security, as well as the events that may occur. The Audit Committee will be responsible for verifying the implementation of these policies and criteria.</p> <p>Banks' CEOs are responsible for the implementation of the internal control system concerning information security to ensure its confidentiality, integrity and availability. Articles 317 and 318 of the CUB establish a comprehensive set of requirements for outsourcing activities of banks, which covers -among others- the following:</p> <ul style="list-style-type: none"> • Minimum conditions should be included in outsourcing services contracts. • Effective policy framework in place to identify and control outsourcing activities 'risks. • Ensure the possibility for the bank to access dependencies and internal/external control reports of the service provider company. • Elaborate internal reports to describe and justify outsourcing decision to be made. • Safeguard confidentiality of the information. • Include outsources activities/processes into contingency plans. • Clear dispute resolution framework. • Adequate information system to the Board. • Definition of the role of Audit and Risk Control areas. <p>CNBV executes rutinary on-site examinations to verify, among others, the compliance of aforementioned standards.</p>
Assessment of Principle 25	Largely Compliant
Comments	<p>CNBV has made significant efforts to improve its regulatory and supervisory framework for operational risk. Comprehensive regulations are in place and supervisory efforts include, among other, the creation of a specialized unit within CNBV (DGSROT), specialized in the supervision of operational and IT risks.</p> <p>However, the supervision of cybersecurity risks is still developing and needs to be properly staffed to ensure CNBV keep abreast of IT development and corresponding risks and, more importantly, in a good shape to perform effective supervision over IT risks.</p>

Principle 26	Internal control and audit. The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent ⁷³ internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank's Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these controls address: (a) organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g., clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g. business origination, payments, reconciliation, risk management, accounting, audit and compliance); (b) accounting policies and processes: reconciliation of accounts, control lists, information for management; (c) checks and balances (or "four eyes principle"): segregation of duties, cross-checking, dual control of assets, double signatures; and (d) safeguarding assets and investments: including physical control and computer access.
Description and findings of EC1	Article 141 and 142 of the CUB provide a comprehensive regulatory framework for internal controls as well as for internal auditing, with a system of checks and balances and segregation of duties among the Board of Directors, senior management, audit committee and internal and external auditors (Title II, Chapter VI). It is the responsibility of the Board to ensure the creation, maintenance, and oversight of an effective internal control mechanism aimed at safeguarding and securing the property and assets of the bank; ensuring greater accuracy in reporting; strengthening legal and regulatory compliance; minimizing financial irregularities; and improving efficiency. To achieve this, banks are required to develop internal control systems that should at least cover: (i) management oversight and a risk control culture; (ii) risk identification and measurement; (iii) control activities and segregation of duties; (iv) accounting, information, and communication systems; and (v) monitoring activities.

⁷³ In assessing independence, supervisors give due regard to the control systems designed to avoid conflicts of interest in the performance measurement of staff in the compliance, control and internal audit functions. For example, the remuneration of such staff should be determined independently of the business lines that they oversee.

	<p>Banks are also required to establish an independent internal audit unit. In the same vein, they should appoint an Audit Committee responsible for proposing for the Board's approval, the objectives of the internal control system and the guidelines for their implementation considering the following aspects: organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments.</p> <p>During on-site visits, CNBV's inspectors review compliance with these principles. On several occasions, CNBV instructed banks' Boards to pay further attention to internal control issue and ensure clear segregation of functions and the full independence of the internal auditors.</p>
EC2	<p>The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the bank's Board) to be an effective check and balance to the business origination units.</p>
Description and findings of EC2	<p>CNBV inspectors assess the adequacy and appropriate distribution of resources between the back and front offices. Particular attention is paid to the communication between the two units (e.g., daily reconciliation of positions) and to the appropriate segregation of duties between the back office and control functions relative to the front office/business origination.</p>
EC3	<p>The supervisor determines that banks have an adequately staffed, permanent and independent compliance function⁷⁴ that assists senior management in managing effectively the compliance risks faced by the bank. The supervisor determines that staff within the compliance function are suitably trained, have relevant experience and have sufficient authority within the bank to perform their role effectively. The supervisor determines that the bank's Board exercises oversight of the management of the compliance function.</p>
Description and findings of EC3	<p>Compliance officers, in charge of ensuring compliance with AML/CFT requirements are mandatory for financial institutions. CNBV provides a certification that empowers individuals to act as compliance officers.</p> <p>Boards should establish a committee (Comité de Riesgo) whose role is to assist senior management in managing the compliance risks faced by the institution (Art. 166 and 167). The risk committee should have at least two members of the Board, senior management, the head of the risk management unit and the internal auditor of the institution. This committee shall meet at least once a month and all meetings and agreements shall be recorded in the minutes. CNBV performs an evaluation of the effectiveness of the compliance function mainly during on-site examinations, based on banks' compliance with</p>

⁷⁴ The term "compliance function" does not necessarily denote an organizational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance who should be independent from business lines.

	prudential regulation. CNBV pays particular attention to the following: (i) the audit annual working plan, when applicable, and how it is being accomplished; (ii) the number and importance of the findings during previous CNBV examinations and internal audit reviews; (iii) the suitability of manuals and controls; and (iv) the content, quality and scope of reports issued by the person in charge of the compliance function to senior management and the Audit Committee.
EC4	The supervisor determines that banks have an independent, permanent and effective internal audit function ⁷⁵ charged with: <ul style="list-style-type: none"> (a) assessing whether existing policies, processes and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the bank's business; and (b) ensuring that policies and processes are complied with.
Description and findings of EC4	<p>It is the responsibility of the Board to ensure the creation, maintenance, and oversight of an effective internal control mechanism aimed at safeguarding and securing the property and assets of the bank; ensuring greater accuracy in reporting; strengthening legal and regulatory compliance; minimizing financial irregularities; and improving efficiency. To achieve this, banks are required to develop internal control systems that should at least cover: (i) management oversight and a risk control culture; (ii) risk identification and measurement; (iii) control activities and segregation of duties; (iv) accounting, information, and communication systems; and (v) monitoring activities.</p> <p>Banks are also required to establish an independent internal audit unit. In the same vein, they should appoint an Audit Committee responsible for proposing for the Board's approval, the objectives of the internal control system and the guidelines for their implementation considering the following aspects: organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments.</p> <p>The CUB requires banks to establish an internal audit function that is independent of the other operational units. The internal audit function is assigned responsibility for conducting the internal audit as well as preparing and updating the internal guidelines on the various aspects covered by Mexican regulations concerning banks' internal audit. The internal audit responsibilities include analysis and evaluation of financial, accounting, operational, and other activities through both on-site and off-site reporting. In practice, CNBV conducts examinations to verify whether the bank has an independent, permanent and effective audit function. For this purpose, CNBV has developed a detailed methodology (MIS and Bitácora) spelling out all the controls to be reviewed. The findings are used to update the Risk Matrix CEFER.</p>
EC5	The supervisor determines that the internal audit function: <ul style="list-style-type: none"> (a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing;

⁷⁵ The term "internal audit function" does not necessarily denote an organizational unit. Some countries allow small banks to implement a system of independent reviews, e.g. conducted by external experts, of key internal controls as an alternative.

	<p>(b) has appropriate independence with reporting lines to the bank's Board or to an audit committee of the Board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations;</p> <p>(c) is kept informed in a timely manner of any material changes made to the bank's risk management strategy, policies or processes;</p> <p>(d) has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties;</p> <p>(e) employs a methodology that identifies the material risks run by the bank;</p> <p>(f) prepares an audit plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly; and</p> <p>(g) has the authority to assess any outsourced functions.</p>
Description and findings of EC5	<p>To assess the adequacy, effectiveness and integrity of internal controls and audit, CNBV has different means: on-site and off-site supervision, review of audit reports, manuals and procedures, examination of external audit's reports, working papers, interviews, etc. This work allows CNBV staff to rate the quality of internal controls and internal audit in the Risk Matrix CEFER. Supervisory standards for the internal audit (IA) include:</p> <ul style="list-style-type: none"> • IA is independent of the business and administrative areas. • IA submit to the Audit Committee the reports of its management • IA submit for approval by the Audit Committee its annual audit work plan. • IA has documented procedures and methodologies to carry out its duties, including the adoption of corrective measures by audited areas. • IA has a good understanding of the institution's strategy, activities and risks.
Assessment of Principle 26	Compliant
Comments	CNBV has in place a suitable regulatory and supervisory framework that promotes best practices as regards the role of the internal control and auditing functions.
Principle 27	Financial reporting and external audit. The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.
Essential criteria	
EC1	The supervisor ⁷⁶ holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.

⁷⁶ In this Essential Criterion, the supervisor is not necessarily limited to the banking supervisor. The responsibility for ensuring that financial statements are prepared in accordance with accounting policies and practices may also be vested with securities and market supervisors.

Description and findings of EC1	<p>Under Mexican law, information provided by banks to their supervisors must be accurate and the Board of Directors is responsible for the accuracy of the financial statements. In this regard, banks must have adequate financial record-keeping systems to ensure information accuracy and reliability. According to the CUB, (Article 179), CNBV requires financial statements to be signed by the CEO, CPA, Comptroller, Internal Auditor, or their equivalents. Also, banks must obtain from these senior officers a declaration of truth concerning, inter alia, financial statements and disclosure, operational procedures and internal controls.</p> <p>The financial statements should be approved by the board, and signed by the CEO, Chief Accountant, and Head of Internal Audit.</p> <p>Banks have to observe the accounting rules for banks issued by CNBV, which are aligned with internationally accepted accounting standards.</p>
EC2	<p>The supervisor holds the bank's Board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor's opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.</p>
Description and findings of EC2	<p>According to the law, banks are subject to a series of obligations in terms of transparency and disclosure. They are required to disclose on their website the following information: (i) the audited financial statements; (ii) the opinion of the external auditor; (iii) comments from the institution's management on the results of its operations and on its financial condition (which shall contain all information that facilitates the analysis and understanding of any significant changes in regard to the results of its operations and its financial condition). These statements must be issued annually and updated quarterly (Article 180 and 212 of the CUB).</p> <p>Annual financial statements are reviewed by external auditors who, according to Article 14 of the CUAE, must adhere to the ISAs issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants, as well as the Reference Framework for Assurance Works, and the Standards to Attest, issued by the Audit and Assurance Standards Commission of the Mexican Institute of Public Accountants, A.C. Every year, boards must approve the designation, substitution, hiring, and fee agreed with the external auditor. The Audit Committee reviews the performance of the external audit and reports its findings to the board.</p>
EC3	<p>The supervisor determines that banks use valuation practices consistent with accounting standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that banks document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes.</p>
Description and findings of EC3	<p>According to the CUB, Annex 33, banks can recognize three categories: trading, available for sale, and held to maturity. The trading category is measured at fair value through profit and loss, available for sale is also measured at fair value through other comprehensive income. The held to maturity category is measured at amortized cost through profit and loss. According to the CUB, (Article 175 Bis), fair value is determined by price vendors.</p>

	<p>Banks must establish and maintain adequate systems and controls to demonstrate that their valuations are prudent and reliable, as well as document the policies and procedures, including the responsibilities of the areas involved, which has to be approved, and reviewed, by the Audit Committee.</p> <p>Valuation models must observe the requirements established by the CUB, including approval by the risk committee, periodic review by the internal audit or other independent party, filing of prices together with the information used for the calculations, to name a few. The policies and procedures should be documented, including the responsibilities of the areas involved. CNBV should approve, and may suspend, the use of the model.</p>
EC4	Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk and materiality-based approach in planning and performing the external audit.
Description and findings of EC4	CNBV cannot exercise its supervisory discretion to establish and extend the scope of external audits of individual banks. Current bank rules do not contain any aspects related to the scope of external auditors. However, the Commission can require the financial institutions and external auditors to provide additional specific information in relation to their functions.
EC5	Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting.
Description and findings of EC5	<p>The CUB sets the minimum elements for the external audit review. They cover loan classification and provisioning (with a view to ensuring compliance with CNBV regulation), loan portfolios, liquid assets, investments, deposits, off -balance sheet items, foreign currency transactions, revenues and expenses.</p> <p>Annually CNBV reviews the audit reports, which are to be submitted by the audit firms and discusses with them, and the banks, the shortcomings identified.</p>
EC6	The supervisor has the power to reject and rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards.
Description and findings of EC6	Article 25 of the LIC empowers CNBV to order the removal of external auditors, as well as to suspend or disqualify them for a period of time, when they seriously or repeatedly incur in violations of the LIC or provide reports containing false information. Article 43 empowers CNBV to request a new audit—to the financial statements or part of them—when not satisfied with the quality of the audit report.
EC7	The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.
Description and findings of EC7	Article 7 of the CUAE (Circular Unica de Auditores Externos), specifies the obligation of alternation of independent external auditors at least every five years.

EC8	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings of EC8	There is no provision in the CUB, or in any guidance from CNBV, contemplating regular meetings with external audit firms. However, contact is established through different channels (meetings, conference calls) when a particular issue warrants attention. Article 423 of the CUAE empowers CNBV to summon the external auditor to discuss the scope of the audit and share relevant information. Upon finalization of the audit, CNBV meets with the audit firm to discuss topics such as effectiveness of internal controls, possible breaches of regulations, or material transactions.
EC9	The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings of EC9	Article 40 of the CUAE provides that when the auditor detects irregularities or any other situation that, based on their professional judgment, could jeopardize the stability, liquidity or solvency of the audited entity, a detailed report on the situation observed should be submitted to the Chairman of the Board, to the Audit Committee and to CNBV. The following shall be considered as irregularities: non-compliance with applicable regulations; destruction, alteration or falsification of physical or electronic accounting records; and carrying out activities not permitted by the law. This communication in good faith does not constitute a breach of any contractual or legal restriction on the disclosure of information, in addition to being considered confidential information by CNBV.
Assessment of Principle 27	Compliant
Comments	The legal framework and practices related to financial reporting and external auditors follows best international best practices and meet the criteria set in this BCP.
Principle 28	Disclosure and transparency. The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.
Essential criteria	
EC1	Laws, regulations or the supervisor require periodic public disclosures ⁷⁷ of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.

⁷⁷ For the purposes of this Essential Criterion, the disclosure requirement may be found in applicable accounting, stock exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.

Description and findings of EC1	<p>The disclosure of financial information required by CNBV's Regulatory Accounting Standards is in line with accounting policies and practices that are widely accepted internationally. The CUB requires periodic public disclosure by banks that adequately reflects their financial condition. The information required to be disclosed includes qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, and corporate governance.</p> <p>Articles 176 to 186 provide a detailed description of the minimum disclosure requirements, which are generally in line with the BCBS standards.</p>
EC2	<p>The supervisor determines that the required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.</p>
Description and findings of EC2	<p>According to Articles 176 to 186 CUB and Annex 33, Accounting Standard A-3, paragraphs 30 to 33, and standards issued CINIF, the financial information disclosures required by CNBV are consistent with accounting policies and practices widely accepted internationally, as provided by IFRS.</p> <p>Banks are required to include on their website:</p> <ul style="list-style-type: none"> • The audited financial statements with their notes. • The opinion of the external auditor. • The information related to the analysis report and management comments on the profits of operations and financial situation of the institution (which must contain all the information that facilitates the analysis and understanding of any significant change in the results of operations and the situation of the financial institution). • The template of Annex 1-O CUB regarding the composition of the capital and the leverage ratio, the characteristics of the capital Instruments, the information regarding risk weighted assets, the assessment of the adequacy of its capital in relation to its risks; as well as the weights established for the calculation of its countercyclical capital buffer. • The Template of Exhibit 1-O Bis discloses the composition of the main sources of leverage, a comparison between total assets and its risk weighted assets, a reconciliation between the total assets and the exposure within its balance sheet, and an analysis of the main variations of the leverage ratio. • As notes to the quarterly and annual financial statements, the templates on Annex 5 and Annex 10 of the Liquidity requirements regulation (<i>Disposiciones de carácter general sobre los requerimientos de liquidez para las Instituciones de banca múltiple</i>) disclose the composition of liquid assets, inflows, outflows, available stable funding, and required stable funding to calculate the LCR and NSFR. <p>This information must be prepared annually and updated quarterly.</p>

	<p>Banks are also required to issue a report with comments and analysis on their financial situation, including information about relevant changes in income, financial position, liquidity, capital, and a brief description of their Internal Control System.</p> <p>CNBV also requires banks to provide specific disclosures on financial instruments, derivatives and hedge accounting, which include qualitative and quantitative information disaggregated by risk categories that includes exposure and management of credit risk, market risk and liquidity risk.</p> <p>Article 88 CUB describes the disclosure requirements concerning the risk management environment. Mandatory disclosures on risk management permit a good understanding of risks assumed by the bank and risk management practices. Disclosures include, the objectives and policies for each risk category; methodologies to identify, manage, and control credit, market, liquidity and operational risks; portfolios to which they are applied; a discussion on how to construe the quantitative information disclosed; organizational arrangements for risk management; risk mitigation policies; main features of the models used for risk classification and provisioning purposes; breakdown of credit portfolio by geography, economic sector, residual maturity; detail of stage three assets; among many others.</p> <p>Disclosures regarding the Remuneration System are described in article 168 Bis 3 CUB. It includes the description of the remuneration policies; the composition and responsibilities of the remunerations committee, as well as consultants hired to advice the committee; the linkages of remuneration policies with the risks considered for remuneration purposes; long-term adjustments of remuneration; number of meetings held by the committee; number of staff who received bonuses and total amount of bonuses paid; fixed and variable remunerations paid and retained; among others.</p>
EC3	Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.
Description and findings of EC3	Banking groups disclose the material entities in the group structure.
EC4	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Description and findings of EC4	<p>As part of its mandate, CNBV assesses banks' compliance with information disclosure requirements during its ongoing supervisory process. The LIC and the CUB provide that banks must comply with reporting and information disclosure requirements and that noncompliance will be subject to various enforcement actions depending on the severity of the violations.</p> <p>CNBV quarterly and annually reviews the notes to financial statements as well as the comments and explanations disclosed to validates the substance of the information, as well as the figures published, to check compliance with the provisions of Annex 33 CUB.</p> <p>In case of finding any omission or inconsistency of the information, further information will be requested and, where appropriate, observations may be issued and the corresponding corrective measures, in order to correctly comply the disclosure standards. CNBV may instruct banks to make relevant mandatory disclosures, when they do not properly apply the principle relative importance.</p>

EC5	The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).
Description and findings of EC5	As described in above, CNBV receives a huge quantity of information through financial returns and keeps a database containing all relevant information on origination and performance for every single credit. It is possible to identify newly originated loans, restructured loans, delinquent loans, etc. The database is processed and aggregates are published on CNBV website. CNBV also has information on the probability of default for each credit and can aggregate information to measure risk at any level (portfolio, institution, banking group or system level). CNBV publishes monthly on its website, the individual and grouped information on the financial situation of banks, including financial situation statement, income statement, ratios on delinquent loans and profitability, and capital adequacy. On a quarterly basis, CNBV publishes the quarterly average of the LCR and NSFR. Likewise, it disseminates information about the relevant events, such as the revocation of an entity's license, intermittence of digital services of an institution, incorporation of a new entity in operation and joint communications with other authorities (SHCP, Banxico, IPAB, CONDUSEF) when the matter in question concerns the banking sector.
Assessment of Principle 28	Compliant
Comments	Mexican banks disclosure requirements required by CNBV's is in line with practices that are widely accepted internationally.
Principle 29	Abuse of financial services. The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities. ⁷⁸
Essential criteria	
EC1	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings of EC1	The responsibilities, duties and powers of CNBV are clearly established. Under the Mexican system, SHCP is responsible for the implementation of the AML/CFT regime in the financial sector, with overall responsibility for the regulation and supervision of compliance with AML/CFT requirements. Its functions are performed through five administrative bodies and

⁷⁸ The Committee is aware that, in some jurisdictions, other authorities, such as a financial intelligence unit (FIU), rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and the financing of terrorism. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in Essential Criteria 7, 8 and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this Principle.

	<p>agencies. As far as banks (and the other entities regulated by CNBV) are concerned, the competent agency is CNBV.</p> <p>In contrast, the functions, powers and obligations of CNBV as the supervisory authority of the financial system, are established in several laws, in particular the LCNBV and the LIC. The latter entitles CNBV to carry out supervision of the credit institutions through on-site visits while the LCNBV defines the supervisory and regulatory mandate of CNBV. It is therefore clearly established that CNBV is responsible for overseeing the transactions, organization, operations, processes, internal control systems, risk management and information systems of banks. Moreover, CNBV has broad powers to obtain access to and inspect banks' operations and processes. It is also vested with enforcement powers to sanction any deviation from AML/CFT laws and regulations.</p> <p>The duties, responsibilities and powers concerning ML/TF of CNBV, as the supervisory authority of the financial system, are established in various laws and regulations:</p> <ul style="list-style-type: none"> • Federal Law for the Prevention and Identification of Operations with Resources of Illicit Origin (LFPIORPI). • Credit Institutions Law (LIC). • Law of the National Banking and Securities Commission (LCNBV). • Internal Regulations of the National Banking and Securities Commission (RICNBV). • Supervision Regulation of the National Banking and Securities Commission (RSCNBV). • General provisions referred to in article 115 of the Credit Institutions Law (DCG applicable to Banks). <p>Hence, CNBV performs comprehensive supervision of banks, covering both prudential issues focused on the risks to which they are subject, as well as their control systems, management quality and preventive processes, as well as AML/CFT issues. Additionally, per Article 16 LFPIORPI, CNBV will carry out the supervision, verification and monitoring of compliance with the obligations and the provisions of the laws that regulate the supervised entities in matters of AML/CFT. As such, CNBV is vested with the power to develop guidelines and policies on AML/CFT supervision.</p>
EC2	<p>The supervisor determines that banks have adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.</p>
Description and findings of EC2	<p>Supervisory expectations with regard to the existence of policies and processes to guard against financial abuse are contained in the credit institutions law and implementing regulations and guidelines. The AML law requires that banks adopt, develop and implement programs, procedures and internal controls to prevent and detect operations related to ML/TF. More precisely, financial institutions are required to (i) adopt an adequate KYC system; (ii) have procedures to ensure that their staff has a high level of integrity and adequate training; (iii) set up mechanisms to detect suspicious activities; (iv) establish procedures to report suspicious activity to the Financial Intelligence Unit (FIU) in a timely fashion; (v) appoint an officer in charge of communicating these transactions to the FIU; and (vi) have an internal audit system capable of verifying compliance with</p>

	<p>AML/CFT obligations. In addition, the units in charge of implementing and monitoring this framework are required to have sufficient human and material resources and authority to enable them carry out their functions.</p> <p>At CNBV level, there is an extensive supervisory program related to verification of internal controls at banks, and CNBV verifies compliance with reporting obligations during its on-site visits, paying special attention to the quality of the reports that are sent to the FIU. A sampling of significant operations is also conducted during on-site visits to test the effectiveness of banks' detection mechanisms. On several occasions, including for international active banks, measures have been requested to correct deficiencies in their reporting practices. Follow-up mechanisms for these corrective actions are part of the off-site process.</p> <p>CNBV, developed and issued in March 2018 (and amended in 2021) the Inspection Guidelines on AML/CFT matters for all supervised entities. The guidelines provide more tools for supervisors in line with international practices and a better understanding by banks of supervisory scope and the AML/CFT risks associated with their operation. Modified procedures and tasks included concerning politically exposed persons, due diligence measures and beneficial owners, which seek to strengthen the activities of inspectors to verify the implementation or effectiveness of the processes of the supervised entities.</p> <p>Provision 64th of the DCG applicable to Banks establishes the obligation to prepare a Compliance Manual, detailing the KYC policies, as well as the internal procedures to manage AML risks.</p> <p>In addition, according to Provision 37th of the DCG applicable to Banks, banks have the obligation to report unusual operations that they detect, to SHCP through CNBV.</p> <p>Provision 10th Ter of the DCG applicable to Banks, introduced the possibility to suspend the identification process, when they have reasons to believe that they could alert the customer of suspicion in the bank.</p> <p>To achieve higher professional standards for banks' staff with AML/CFT responsibilities CNBV developed in 2014 a certification program addressed at internal and external auditors, compliance officers, and other interested professionals. Individuals certified by CNBV are entitled to provide their services in supervised entities.</p> <p>Article 170 CUB instructs banks to prepare a code of conduct approved by the board, which should be known by directors, managers and staff. The code of conduct and the modifications to it, must be submitted to CNBV.</p> <p>The code of conduct must contain rules in accordance with current legislation and other applicable legal provisions, with healthy banking practices and uses.</p>
EC3	<p>In addition to reporting to the FIU or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when such activities/incidents are material to the safety, soundness or reputation of the bank.⁷⁹</p>

⁷⁹ Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and the financing of terrorism to the relevant national centre, established either as an independent governmental authority or within an existing authority or authorities that serves as an FIU.

Description and findings of EC3	<p>In accordance with Provision 37 of the DCG applicable to Banks, banks must submit to SHCP, through CNBV, all the reports of unusual operations carried out by their clients, within the following three business days counted from the conclusion of the session of the Committee that pronounces it as such. However, if banks have well-founded suspicions or indications that the funds or a transaction could come from illicit activities, banks must file a "24-hour" report.</p> <p>Banks must adopt and implement mechanisms that allow them to identify the clients or users included in the list of blocked persons (LPB).</p>
EC4	<p>If the supervisor becomes aware of any additional suspicious transactions, it informs the FIU and, if applicable, other designated authority of such transactions. In addition, the supervisor, directly or indirectly, shares information related to suspected or actual criminal activities with relevant authorities.</p>
Description and findings of EC4	<p>CNBV and the FIU meet periodically to discuss matters related to the AML/CFT regime, share experiences, actions and concerns, and check that the regulatory framework is updated and consistent with international standards.</p> <p>In the same way, as part of the collaboration agreement between the FIU and CNBV, there is the provision of feedback reports by the FIU, on supervised entities to which a supervision measure will be carried out, which is shared with supervision to feed the annual supervision program. In turn, CNBV shares with the FIU the information on observation and recommendations following on- or off-site activities.</p>
EC5	<p>The supervisor determines that banks establish CDD policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the bank's overall risk management and there are appropriate steps to identify, assess, monitor, manage and mitigate risks of AML/TF with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management program, on a group-wide basis, has as its essential elements:</p> <ul style="list-style-type: none"> (a) a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks; (b) a customer identification, verification and due diligence program on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant; (c) policies and processes to monitor and recognize unusual or potentially suspicious transactions; (d) enhanced due diligence on high-risk accounts (e.g., escalation to the bank's senior management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk); (e) enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank's senior management level of decisions on entering into business relationships with these persons); and

	(f) clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five-year retention period.
Description and findings of EC5	<p>The requirements for customer identification are laid out in Article 115 LIC and in the DCG 115. Customer Due Diligence and KYC requirements are comprehensive, and include a customers' identification and due diligence policy, assessment of their risk profile, including politically exposed persons, and policies and processes to identify, monitor and report unusual or suspicious transactions; AML/CFT records must be kept and available to the relevant authorities for 10 years. The DCG 115 also contains risk-sensitive approaches that permit enhanced and simplified CDD. Under certain regulations (Provisions 25a and 25a Bis of DCG 115), banks are required to classify customers and transactions in accordance with the degree of ML and TF risks. It is also suggested that banks understand the person who controls the customer and the actual beneficiary of the transaction. Banks are also required to have internal control mechanisms to monitor and identify unusual transactions. As observed by the IMF in 2008 and the FATF 2018 Report and recent updates, Mexico has a comprehensive legal and regulatory framework for the reporting of transactions to the FIU, which includes the filing of reports for any suspicion of ML and, more generally, for any unusual transaction that is not justified. Both actual and attempted transactions must be reported, and there are other types of reports based on objective monetary thresholds. There is also a clear obligation to report transactions suspected of being related to domestic terrorism or its financing. Compliance management arrangements and adequate training for staff are also mandatory. In particular, the AML-CFT banks' internal AML/CFT framework must cover:</p> <p><i>Compliance manual, Compliance officer, Communications and control committee</i></p> <ul style="list-style-type: none"> • Compliance manual, containing the policies, criteria, measures and internal procedures for the CDD and KYC purposes and the criteria, measurement and internal procedures to manage the client's risks according to the bank's, as well as the procedure and criteria for deciding whether to open, limit or terminate a business relationship, which must be consistent with the risk assessment (Provision 64th DCG). • Compliance officer, charged with preparing the compliance manual containing the CDD and KYC policies. • Communication and Control Committee (Provision 43rd DCG) with the following functions and obligations: (i) submitting the Compliance manual, and any modifications to it, for the approval of the audit committee; and (ii) receiving the reports from internal and external audits regarding the assessment of the effectiveness of policies, criteria, measures, and procedures (Provision 60th DCG) and adopt corrective actions, as warranted. <p><i>Customers' file</i></p> <p>Provision 4th DCG, establishes that banks must prepare and keep an identification file of each of their clients. For firms banks must know the shareholding and corporate structure of their clients, legal entities and trusts, establishing a series of minimum measures and criteria to identify and know the ultimate beneficial owner (UBO).</p> <p>At a minimum, the identification file, which has to be updated annually, must have:</p> <ul style="list-style-type: none"> • Information on the shareholding structure and the internal corporate structure.

- Identify UBO of legal entities. If no individual controls the firm, then the manager shall be deemed the UBO. If designated administrator is also a legal entity or trust, it will be understood that control is exercised by the individual appointed by the administrator of the legal entity or trust.
- Declaration of the legal representative of the firm stating the UBO.

For its part, SHCP prepared and published, together with CNBV, the Guidelines for the identification of the UBO in order to establish measures, guidelines and criteria to identify the UBO of the client's operations.

In response to FATF Recommendation 1, to perform a risk-based approach to AML/CFT supervision CNBV has reinforced the legal framework (now mandatory) modified DCC and KYC supervisory review, which is now mostly focused on thematic reviews by risk (such as UBO identification procedures).

Regarding the KYC policies, Provisions 23rd and 24th DCG establish that banks must collect information on the amount, number, type, nature, geographic area of operation and frequency of the operations that customers commonly carry out, as well as on the origin and destination of the resources involve to determine the transactional profile of each client.

Clients are to be classified attending to their risk level in two categories, at least: high- and low-level (Provision 25th Bis DCG); likewise, between the high and low risk levels, financial institutions can establish as many intermediate levels of risk as they deem necessary, according to their personal and transactional features. The risk evaluation model is approved by the risk committee. Clients have to be reassessed every six months, or more frequently if warranted by the risk level.

Banks are also required to have internal control mechanisms to monitor and identify unusual transactions, including internally originated. Mexico has a comprehensive legal and regulatory framework for the reporting of transactions to the FIU, which includes the filing of reports for any suspicion of ML and, more generally, for any unusual transaction that is not justified. Both actual and attempted transactions must be reported, and there are other types of reports based on objective monetary thresholds. There is also a clear obligation to report transactions suspected of being related to domestic terrorism or its financing (the obligation, however, does not extend to suspected financing of international acts of terrorism). The LIC and sectoral regulations also oblige banks and other FIs to have in place mechanisms to keep records for at least 10 years. Compliance management arrangements and adequate training for staff are also mandatory. As part of its on-site work, CNBV verifies compliance with CDD/KYC stipulations and other requirements as mentioned above. BCP assessors read a sample of on-site examination reports and noted that inspectors are giving attention to these topics. In all cases reviewed, there were observations or comments in relation to KYC/CDD (oficio de observaciones). The mechanisms for reporting suspicious activities to the FIU are also closely examined during on-site visits. In several instances, corrective measures were required at the end of the inspection (oficio de medidas correctivas). The AML Unit has also submitted several requests to the Legal department in order to process sanctions against banks that failed to comply with their reporting obligations.

	<p><i>Suspicious operations reporting</i></p> <p>Banks have the obligation to report unusual operations that they detect, to SHCP through CNBV within three days of the meeting of the CCC which determined the operations to be suspicious (Provision 37th DCG). The determination must be finalized within 60 days from the operation. Well-founded suspicions could be reported within 24 hours. The identification process could be suspended when the bank reasonably believes that it could prevent or alert the client.</p> <p>Provision 38th DCG sets forth the circumstances that Banks must consider to determine unusual operations. To mention a few, occupation, profession, activity, line of business; unusually high-amount or complex operations; failure to provide information; attempts to bribe, persuade or intimidate staff; extraordinary events with no clear explanation; involvement of jurisdictions with preferential tax regimes; concern about the UBO; etc.</p> <p>To facilitate the process of identifying Unusual Transactions, SHCP regularly advises banks and provide guides, information and typologies that allow the detection of Transactions that must be reported in accordance with these Provisions.</p> <p>Banks must have automated systems to manage clients' information and transactions, which should be able to classify transactions, detect suspicious operations, produce suspicious reports, generate alerts, and preserve records (10 years).</p> <p>In 2021, amendments were introduced in the regulations concerning politically exposed persons, due diligence measures, and beneficial owners.</p> <p>As part of its on-site work, CNBV verifies compliance with CDD/KYC stipulations and other requirements as mentioned above. Most of the times, CNBV instructs banks to or comments in relation to KYC/CDD (oficio de observaciones). The mechanisms for reporting suspicious activities to the FIU are also closely examined during on-site visits. In several instances, corrective measures were required at the end of the inspection (oficio de medidas correctivas). The AML Unit has also submitted several requests to the Legal department in order to process sanctions against banks that failed to comply with their reporting obligations.</p>
EC6	<p>The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes include:</p> <ul style="list-style-type: none"> (a) gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and (b) not establishing or continuing correspondent relationships with those that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.
Description and findings of EC6	<p>The DCGs (Provision 29th) establish that for the provision of correspondent banking to foreign counterparts, such activity has to be approved by management. In addition, procedures and measures that their counterparts carry out on AML/CFT must be documented. In this regard, banks and other FIs must obtain from their foreign counterparts the following:</p>

	<p>(a) A certification by an independent auditor or, in its absence, a certification by its counterpart, where it should be stated that it complies with similar obligations to the ones established for banks in the DCGs, with regard to CDD and KYC; and</p> <p>(b) Information that will enable the bank to:</p> <ul style="list-style-type: none"> • Know the counterpart's business. • Assess control mechanisms to determine that they comply with international standards on AML/CFT. • Understand if its counterpart is supervised by any authority on AML/CFT issues. an • Determine if the counterpart has a good reputation. <p>Additionally, the DCGs establish enhanced scrutiny for correspondent banks incorporated in countries or territories where, according to SHCP, AML/CFT policies are deficient or insufficiently applied.</p> <p>Engaging in a correspondent banking relationship with shell banks is also prohibited. In practice, CNBV has given particular attention to the issue of correspondent banking and considers this business to be particularly exposed to high ML risks, given the local context.</p>
EC7	<p>The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.</p>
Description and findings of EC7	<p>In order to confirm that banks have sufficient controls and systems in place for AML purposes, CNBV has built its supervisory arrangement similarly as for any other type of risk, there is a mix of on-site and off-site activities for ML. However, unlike the other risks AML is monitored through a dual system. There is a dedicated VP for AML (VPSPP) that can perform both on-site visits and ongoing surveillance. In addition, the other VPs in charge of prudential surveillance also carry out AML duties under the leadership of the VPSPP. The human resources available to the VPSPP include 72 AML/CFT specialists.</p> <p>Along with the horizontal reviews mentioned above, CNBV conducts three types of on-site visits: (i) ordinary (visitas ordinarias); (ii) special (visitas especiales); and (iii) targeted (visitas de investigación). They are carried out with the purpose of verifying and evaluating banks' adherence to AML requirements. Internal policies, procedures, and internal controls are examined, and the effectiveness of the reporting system and the quality of the IT systems is also tested. On-site visits include verifying that banks have adopted selection processes in order to ensure that their personnel has adequate technical quality and experience, as well as high ethical standards, to carry out their duties.</p> <p>CNBV uses a methodology to assess banks by degree ML/FT risk. To perform this assessment, the methodology takes into account the types of clients, areas or geographical zones, type of currency and monetary instruments in relation to the products or services with which the entities operate. Each of the items is assigned an inherent risk rating for both ML and FT, depending on their level of concentration of clients, operations and amount of high risk according to their characteristics. To determine the inherent ML and FT risk of each entity, the ratings assigned to the 3 items evaluated are averaged. The entity's final inherent risk will be given by the weighted average of the inherent risks calculated for ML (70 percent) and FT (30 percent). Then, it considers risk intensifiers and mitigators to increase or decrease inherent risk, and assigns a rating.</p>

	<p>The intensifiers are made up of information related to the reports of operations of the Financial Intelligence Unit, breach of regulatory obligations, operations considered high risk and the relevant facts detected by the internal or external auditor, in. In the case of mitigants, the result of the revisions to the preventive regime of the entities is considered. The ML/FT risk rating is a risk component in the CEFER, making up 70 percent of the legal and reputational risk, which in turn weights 10 percent of the Comprehensive risk in the CEFER.</p> <p>In terms of AML/CFT, CNBV has developed various dashboards on the SupTech platform for the analysis of quantitative information in order to detect risks associated with customers and users, products and services, countries or geographic areas and delivery or distribution channels with which the supervised institutions operate, thus feeding into supervision strategies and objectives, using the available resources on the entities and areas that present a greater risk.</p> <p>The AML/CFT Inspection Guidelines were developed for all supervised entities, published in March 2018 and modified in October 2021. These Guidelines are a useful instrument for supervised entities to understand the procedures and elements subject to supervision and the associated risks. As ascertained during the assessment, in on-site inspections CNBV reviews banks' AML/CFT procedures, including the customers' risk classification methodologies, the ability of the IT systems to identify, monitor and report unusual and suspicious transactions, among other issues, and require corrective actions.</p>
EC8	The supervisor has adequate powers to take action against a bank that does not comply with its obligations related to relevant laws and regulations regarding criminal activities.
Description and findings of EC8	<p>CNBV has a broad set of powers to take action against banks, as needed.</p> <p>Article 49 of the RSCNBV empowers CNBV to make observations and recommendations to supervised entities to correct shortcomings and promote the improvement of their control systems. Article 52 of the RSCNBV states that CNBV can order the supervised institutions to take actions aimed at correcting the irregularities or preventing them from occurring. These corrective actions can be carried out through the establishment of actions, corrective measures or mandatory compliance programs for the supervised institutions with the purpose of adjusting their activities and operations to the applicable laws, to the provisions of a general nature, to the appropriate mercantile, banking practices and securities, as well as the appropriate practices of the financial markets. Article 4 of the LCNBV empowers CNBV to discipline breaches of laws and regulations by imposing administrative penalties.</p> <p>Sanctions can be of various types: reprimands, vetoes, suspensions or disqualification of bank's officials, as well as the imposition of administrative fines. The amounts of the fines are established according to the seriousness of the infraction, among other factors that are taken into account for these purposes. The powers granted to CNBV in this context include the ability to revoke the authorization previously granted to carry out operations.</p> <p>Article 115 LIC establishes the sanctions that CNBV will apply to banks for the violation of the DCG applicable to Banks.</p>
EC9	The supervisor determines that banks have:

	<p>(a) requirements for internal audit and/or external experts⁸⁰ to independently evaluate the relevant risk management policies, processes and controls. The supervisor has access to their reports;</p> <p>(b) established policies and processes to designate compliance officers at the banks' management level, and appoint a relevant dedicated officer to whom potential abuses of the banks' financial services (including suspicious transactions) are reported;</p> <p>(c) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship; and</p> <p>(d) ongoing training programs for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities.</p>
Description and findings of EC9	<p>The risk management and internal audit requirements for banks are detailed DCG. For banks, the relevant DCG establishes that they must set up a Communications and Control Committee, which determines the related policies and procedures. The Committee must be composed of high-ranking employees and, in any case, the general director. Likewise, the Committee will appoint from its members an employee as Compliance Officer, who will carry out the duties and responsibilities of AML/CFT risk and to whom potential abuses of the bank's financial services shall be reported. Through on-site visits CNBV verifies that financial institutions adhere to these rules—which appears to be the case.</p> <p>The Mexican regime has established strict screening and fit and proper processes. The DCG also mandates that credit institutions must develop training and dissemination programs that contain, at least, the following: (i) courses at least once a year, directed especially to those officers and employees that are in the front line; (ii) the dissemination of the DCGs and their amendments; and (iii) information regarding techniques, methods, and trends to prevent, detect, and report ML/TF transactions. Banks must also issue certificates that prove the participation of their officials and employees in the training courses.</p> <p>Provision 60 DCG establishes the obligation to maintain control measures that include an annual review by internal audit or an independent external auditor, to evaluate and assess the effectiveness of the bank's compliance with the DCG. The outcome of these inspections must be presented to the CEO and the Communication and control committee for the purpose of evaluating the operational effectiveness of the measures implemented and following-up on the applicable corrective action programs. These reports must follow the "Guidelines for the preparation of the Audit Report to evaluate compliance with the general provisions regarding the prevention of operations with resources of illicit origin and financing of terrorism", be filed with CNBV within sixty calendar days of the end of the period under review, and kept for five years.</p> <p>Among the duties and functions of the Communication and Control Committee (Provision 43rd DCG) the following are highlighted: to (i) be aware of the contracts or account</p>

⁸⁰ These could be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	<p>opening of high risk for the bank; (ii) establish and disseminate the criteria for the classification of clients, according to their degree of risk; (iii) analyze whether the suspicious operations are to be reported; (iv) inform the competent area of the bank about acts carried out by its directors, officials, employees or representatives, which might be an infraction of the DCG or its internal policies; (v) approve training programs for staff; and ensure that the bank has the internal structures, in terms of organization, workforce, material and technological resources.</p> <p>Governance arrangements include the appointment of a Compliance officer, responsible for interaction with the authorities, reporting to the Communications committee, and overall management of AML/CFT matters. The Compliance Officer must be independent from the business units and must not have any internal audit mandate.</p>
EC10	<p>The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilize adequate management information systems to provide the banks' Boards, management and the dedicated officers with timely and appropriate information on such activities.</p>
Description and findings of EC10	<p>In the course of its supervision of AML, CNBV examines the policies and processes in place for reporting any abuse of financial services.</p> <p>Provision 57th of the DCG applicable to Banks states that each bank must establish mechanisms and systems that allow its officials and employees to send directly to compliance unit, warnings about actions be considered unusual or worrying internal operations. To report these operations banks must have (Provision 51st DCG) automated systems available to staff to inform to the responsible areas in a secure, confidential, and traceable manner.</p> <p>In the inspection visits, CNBV supervisors verify that banks have clear policies and procedures to report any possible abuse of financial services, as well as suitable management information systems.</p> <p>Codes of Conduct, which are prepared by the CEO, reviewed by the internal audit, and reviewed by CNBV during inspections, establish the obligation for staff to report misconducts and irregularities.</p>
EC11	<p>Laws provide that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.</p>
Description and findings of EC11	<p>The LIC states that compliance with the reporting obligations established in the law or in implementing regulations is not an infringement of confidentiality. Also, the DCG establishes that reports and all other information generated by banks shall not be considered an indication of the of a crime perpetration. Thus, bank officials and staff that report suspicious activities in good faith cannot be held responsible in any way for reporting unusual or suspicious transactions to the competent authorities.</p> <p>To ensure confidentiality, provision 57 DCG mandates that banks must ensure that neither the staff reported nor the hierarchical superior of the reporting employee are aware of the reporting.</p>

EC12	The supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities or shares with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings of EC12	<p>Unlike other countries where suspicious activities are directly reported by banks to the FIU, the Mexican regime requires banks to send their STRs to the FIU through the system of CNBV. The transmission is made automatically. There are no limitations that prevent CNBV from sharing information with other domestic authorities as long as the information requested is within its scope of competence. For example, Art. 97 of the LIC states that to facilitate the fulfillment of their functions, SHCP, Banxico, CNBV, CONDUSEF, and IPAB shall be able to request and share the information that they gather. Likewise, these institutions may provide assistance, if required, to the CNSF and CONSAR to perform their functions. For the purposes of the provisions of this article, the indicated authorities must enter into information exchange agreements (MOUs) in which they specify the information to be exchanged and determine the terms and conditions to which they must be subject for it. The MOUs define the degree of confidentiality of the information, as well as the respective control instances to which refer cases in which the information is denied.</p> <p>In this sense, CNBV and the FIU meet periodically to discuss matters related to the AML/CFT regime, share experiences, actions and concerns and review that the regulatory framework is updated and consistent with international standards.</p> <p>CNBV shares with the FIU the outcome of reviews (ordinary visit, remote review or a supervision program), allowing the identification of the main deficiencies presented by supervised entities. In turn, the FIU provides a non-compliance rating of supervised entities, which is used to prepare the annual supervision program.</p> <p>For legal and regulatory reforms, SHCP seeks the opinion of Banxico, the FIU, and CNBV. For this purpose, CNBV, SHCP, and the FIU meet periodically to discuss matters related to the AML/CFT regime, share experiences, actions and concerns and ensure that the regulatory framework is consistent with international standards.</p> <p>Article 117 Bis LIC allows CNBV to provide foreign financial authorities with information concerning operations and services under the AML provisions of Article 117 and under Article 46 (permissible activities for FIs covered by the LIC) CNBV is very active in developing international cooperation through MOUs with foreign supervisors. Foreign supervisors participate in on-site visits of Mexican-licensed entities and CNBV staff participates in similar visits abroad.</p> <p>Throughout 2021 CNBV continued to strengthen collaboration—domestic and international. In this regard, CNBV handled 34 requests for information from domestic authorities and 29 requests from foreign authorities, through some 250 official letters and memorandums.</p>
EC13	Unless done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities. In this case, the supervisor regularly provides information on risks of money laundering and the financing of terrorism to the banks.
Description and findings of EC13	In accordance with the provisions of Article 15 of the Internal Regulations of the Ministry of Finance and Public Credit, the FIU is responsible for approving the AML/CFT typologies, trends and indicators, as well as the guidelines and best practices for the preparation and

	<p>submission of AML/CFT reports matter. Through its official website the FIU, makes the different typologies and trends available to the public.</p> <p>For its part, CNBV is entitled to issue guidelines, best practices, criteria, directives, guides and other provisions to facilitate proper compliance with the general provisions regarding AML/CFT. In doing so, CNBV has shared the following Guidelines to the supervised entities, through the portal of the Inter-institutional Information Transfer System (SITI AML/CFT):</p> <ul style="list-style-type: none"> • Guide for the prevention and detection of operations with resources of illicit origin in the financial system, derived from acts of corruption. • Guide for the prevention and detection of operations related to the financing of terrorism. • Guide for the implementation of warning and monitoring scenarios for the prevention and detection of operations with resources of illicit origin and financing of terrorism. • Risks of money laundering and financing of terrorism detected at the international level due to the global health contingency of COVID-19. • Guide for the implementation of warning and monitoring scenarios for the prevention and detection of operations with resources of illicit origin and financing of terrorism, related to business email compromise (BEC) and trade-based money laundering. • Guide for the prevention and detection of operations with resources of illicit origin derived from international bribery. • Guide for the prevention of operations with resources of illicit origin during electoral processes. • Guide on financial flows related to human trafficking. <p>According to the LCNBV, CNBV has supervisory powers but does not deal directly with criminal activities. To fulfill its AML/CFT supervisory mandate CNBV set up the Vice Presidency of Supervision of Preventive Procedures (VSPP) to supervise AML/CFT compliance by financial institutions. The VSPP has 72 employees, with expertise in AML/CFT matters.</p>
Assessment of Principle 29	Largely compliant
Comments	<p>Supervision of AML/CFT has significantly improved since the last BCP assessment. CNBV has continued to update regulations and implement new supervisory tools and methodologies. The staff shortage noted in the prior assessment has been mostly solved by hiring staff with the right skills.</p> <p>Similar to the recommendations for other principles, we encourage CNBV to continue advancing towards an AML/CFT full-fledged risk-based supervision.</p>

SUMMARY COMPLIANCE WITH THE BASEL CORE PRINCIPLES

Core Principle	Grade	Comments
1. Responsibilities, objectives and powers	Largely Compliant	The opinion of the assessors is that compliance with the essential conditions of this CP has been achieved. However, compliance may be further enhanced by implementing an effective consolidated supervision framework.
2. Independence, accountability, resourcing and legal protection for supervisors	Materially Non-Compliant	<p>CNBV governance structure results in a direct and significant influence of SHCP on CNBV affairs. The president of CNBV, as well as 5 out of a total of 13 members of CNBV's board, is appointed by SHCP. The remaining members are appointed by Banxico (three), and one each by CONSAR (pensions regulator) and CNSF (insurance regulator). The president and two vice presidents of CNBV are also members of the board. There are no independent members—all members are ex-officio. Moreover, there are no term appointments for CNBV and board members, no legally established reasons for dismissal and no requirements to disclose reasons for dismissal. Historically, changes in Government have resulted in replacing the President and board members of CNBV. Turnover has also been significant among members of the governing board, especially after presidential elections.</p> <p>CNBV has no autonomy to establish/modify its own budget, although supervisory fees collected from institutions have systematically exceeded its budget. CNBV should be granted effective operational independence, with strengthened governance as well as budget autonomy, becoming a decentralized body, in order to allow them to pursue their objectives more effectively.</p> <p>The law does not grant statutory immunity to CNBV and its personnel for the bona fide discharge of their legal functions and powers; however, other operative protection is granted. Lawsuits against supervisors have been reported to be infrequent. Nonetheless, current legal protection provisions do not mitigate risks of frivolous actions by third parties—staff is not protected against lawsuits for actions taken while discharging their duties in good faith. The legal provisions established under the LCNBV and the LIC require CNBV to provide legal assistance for board members and officers that</p>

Core Principle	Grade	Comments
		<p>have discharged their duties according to the law. The assistance is extended to individuals nominated by CNBV to serve as special administrators in banks. Over the last five years there have been several lawsuits against CNBV but none against individuals. Since the establishment of the fund in 2005 there has been only one lawsuit against an individual (2006). Notwithstanding, nothing precludes the industry from filing lawsuits against CNBV supervisors related to actions taken in the course of discharging their duties.</p>
3. Cooperation and collaboration	Compliant	<p>CNBV has clear powers to exchange information with relevant authorities both domestically and abroad. Relevant MOUs are in place or are actively in use.</p>
4. Permissible activities	Compliant	<p>The Mexican regime for permissible activities of institutions that are licensed and subject to supervision is clearly defined in the law and the use of the word “bank” in names is properly controlled. The authorities pay particular attention to preventing illegal deposit-taking; there are several provisions in the LIC dealing with the prohibition of the unlicensed taking of deposits from the public.</p>
5. Licensing criteria	Compliant	<p>The organization and operation of a universal banking institution requires authorization by CNBV and the favorable opinion of Banxico. That is, the approval of the Central Bank is necessary to grant authorization. This has resulted in a positive double-checking scrutiny over new applicants, while it has not limited CNBV discretionary power to deny such authorization. Although the licensing authority for banking institutions is CNBV, the licensing authority for Development Banks and financial holding companies is SHCP. It should be mentioned, however, that development banks are authorized by law on case-by-case basis; furthermore, during the last 20 years no new development bank has been created.</p> <p>The operating plans, business strategy and projected financial statements are among the documents that are presented when requesting a bank license. These documents are examined by CNBV during the authorization process to determine the viability of the proposed institution. The fit-and-proper test of directors and managers includes skills, moral suitability, experience in relevant financial activities and no adverse regulatory determination or poor credit record.</p>

Core Principle	Grade	Comments
6. Transfer of significant ownership	Compliant	The legal framework in place, as well as CNBV's supervisory protocols, are adequate to prevent transfers of significant ownership without prior control and authorization of the authorities.
7. Major acquisitions	Compliant	CNBV has the power to approve or reject on major acquisitions or investments by a bank including establishment of cross-border operations. The limits established for investments in non-financial companies -individual and global- seem adequate to prevent banks having high stakes in these types of investments.
8. Supervisory approach	Largely Compliant	At the time of adoption, the CEFER was a major step forward towards risk-based supervision. However, the assessors recommend that the tool is enhanced to better asses the actual level of risks in banks.
9. Supervisory techniques and tools	Largely Compliant	<p>The assessors reviewed a sample of materials discussed above, such as on-site examination reports, supervisory plans, and banks' financial assessment reports, together with other inspection related documents (letters of observation and corrective measures). These supervisory reports were considered mostly rule-based oriented and concerning risk management practices and corporate governance issues lack the necessary deepness to truly reports meaningful findings.</p> <p>The deployment of supervisory resources has required to be adjusted in recent years as a consequence of budgetary restrictions (see BCP 2), which so far has been adequately coped with by CNBV without seriously affecting core supervisory activities.</p>
10. Supervisory reporting	Compliant	CNBV has developed a sophisticated system for collecting, reviewing and analyzing prudential reports and statistical returns from banks. The technological platform designed for regulatory reporting allows proper management of information comparable across institutions and sectors, and facilitates the analysis and development of aggregated statistical information.
11. Corrective and sanctioning powers of supervisors	Largely Compliant	Mexico has established a supervisory regime that can deliver timely corrective actions. Remedial measures range from informal instructions directing a particular response by management, to the severe action of intervention and, if needed, liquidation (through the suspension of the institution's

Core Principle	Grade	Comments
		<p>license). CNBV puts great emphasis on the early detection of problems. In this regard, CNBV has issued rules to classify banks in a particular category based on their CAR (Spanish acronym, ICAP) in order to perform early detection, intervention and resolution of troubled banks. As for sanctions more specifically, CNBV is the authorized enforcement agency. It can apply both fines and administrative penalties, including revocation of the license in the most severe cases. Sanctions against individuals are also permitted by law. CNBV can apply fines under the LIC to banks' directors, managers, officers, and staff more broadly. Under the current regime, CNBV is empowered to take corrective measures against banks while IPAB is the lead agency in case of liquidation.</p> <p>As mentioned in EC6, ring fencing options available for the authorities to effectively protect the bank from indirect risks steaming from the activities of non-regulated financial entities belonging to the same group are limited.</p>
12. Consolidated supervision	Materially Non-Compliant	<p>Even though the Financial Groups Law (LAF) was an important step taken in 2014 towards establishing a legal framework for consolidated supervision, it does not empower supervisors to impose prudential measures to financial conglomerates at group level. This legal shortfall prevents the LAF from allowing effective consolidated supervision.</p> <p>Additionally, several domestic financial conglomerates fall out of the scope of the authorities for consolidated supervisory purposes. Financial conglomerates can legally exist only if they request on voluntarily basis being authorized by SHCP to operate as such; this authorization is limited to the firms declared by the banking group, which might sometime exclude some firms. Most of the financial conglomerates operating in Mexico are structured as authorized financial groups. However, at the time of this assessment, there were 7 domestic financial conglomerates that have not requested being authorized by SHCP to operate as such. Accordingly, these groups are not regulated and thus, as a whole, not subject to the –although limited– current consolidated supervisory regime. Some of these <i>de-facto</i> financial conglomerates not only are very active in the domestic financial market, but also are actively operating in a number of Latin-American countries through banking subsidiaries and under the same brand.</p>

Core Principle	Grade	Comments
13. Home-host relationships	Compliant	<p>The law empowers CNBV to exchange information with foreign counterparts based on bilateral MOUs. These MOUs provide, among other things, for the exchange of public and nonpublic information, surveillance visits, and the provision of technical assistance. CNBV also participates in the supervisory colleges of large cross-border financial firms that have a significant presence in Mexico. In recent years, CNBV has been very active on the international cooperation front.</p>
14. Corporate governance	Largely compliant	<p>The laws and regulations relating to corporate governance, as reflected in the LIC and CUB mainly, are quite extensive and cover all relevant issues included in this BCP.</p> <p>However, the assessment of the quality and effectiveness of corporate governance and management –performed through the CEFER and meetings with board members and senior managers– could be enhanced further by giving a more prominent role to expert judgement.</p> <p>For instance, on the timeliness and quality of data available to the board, the time that directors are able to devote to the role, and the collective suitability and patterns of board discussions.</p>
15. Risk management process	Largely compliant	<p>The regulations on overall risk management have been greatly enhanced since the last BCP assessment and are comprehensive and require that banks put in place overall risk management frameworks.</p> <p>Compliance with this principle would be reinforced by increasing the focus on assessing the quality of risk management rather than on formal compliance with regulatory requirements.</p>
16. Capital adequacy	Largely compliant	<p>Mexico has a capital framework broadly consistent with the Basel framework. CNBV seems to have adequate powers provided by the law to apply Pillar 2 charges to banks. However, these powers have never been exercised hitherto. The assessment team encourages CNBV to sharpen the CEFER tool prior to applying Pillar 2 capital charges.</p>
17. Credit risk	Compliant	<p>CNBV has an adequate regulatory and supervisory framework for credit risk and places significant emphasis on credit risk and performs on-site verification of credit files and bank analysis of borrowers' creditworthiness. Through off-site</p>

Core Principle	Grade	Comments
		supervisory tasks CNBV evaluates credit risk policies and procedures, as well as the methodologies and practices used by banks in the credit origination, monitoring and recovery.
18. Problem assets, provisions, and reserves	Compliant	Mexican laws and CNBV's regulations provide a detailed framework for the identification and management of problem assets, asset classification, provisioning, and write-offs.
19. Concentration risk and large exposure limits	Materially non-compliant	<p>The Mexican regulation of large exposures set different limits depending on the actual capital ratio of banks, departing from the Basel standard. Also, it lacks a formal definition of large exposure, which would be advisable to adopt.</p> <p>The framework for connected party lending does not empower de CNBV to determine connected parties other than the links defined in the regulation.</p> <p>The Mexican authorities are currently working on a new regulation on large exposures which will enhance compliance with this CP.</p>
20. Transactions with related parties	Largely compliant	A number of gaps in the related party framework have been identified by the last FSAPs and remain unaddressed. Limits for RPTs are not aligned with international practice.
21. Country and transfer risks	Largely compliant	Compliance with the conditions of this CP has been largely achieved in practice and can be further strengthened by adopting a more proactive approach to the supervision of this risk
22. Market risk	Compliant	Compliance with the essential criteria of this CP is fully achieved.
23. Interest rate risk in the banking book	Compliant	Although the regulation does not differentiate between banking and trading books for capital purposes (Pillar 1), banks are required to manage both books separately. The review by the assessors of IRRBB management by banks and the supervisory review lead to the conclusion that compliance with the essential criteria of this CP is adequately achieved
24. Liquidity risk	Largely Compliant	The authorities have a well-established regulatory and supervisory framework for liquidity risk. With the inclusion of the LCR and the NSFR prudential regulations the framework is fully aligned with the Basel III recommendations.

Core Principle	Grade	Comments
		However, it should be noted that deposit-taking development banks are not subject to the current liquidity prudential framework applicable to private banks.
25. Operational risk	Largely Compliant	<p>CNBV has made significant efforts to improve its regulatory and supervisory framework operational risk. Comprehensive regulations are in place and supervisory efforts include, among other, the creation of a specialized unit within CNBV (DGSROT), specialized in the supervision of operational and IT risks.</p> <p>However, the supervision of cybersecurity risks is still developing and needs to be properly staffed to ensure CNBV keep abreast of IT development and corresponding risks and, more importantly, in a good shape to perform effective supervision over IT risks.</p>
26. Internal control and audit	Compliant	CNBV have in place a suitable regulatory and supervisory framework that promote best practices as regards the role of the internal control and auditing functions.
27. Financial reporting and external audit	Compliant	The legal framework and practices related to financial reporting and external auditors follows best international best practices and meet the criteria set in this BCP.
28. Disclosure and transparency	Compliant	Mexican banks disclosure requirements required by CNBV's is in line with practices that are widely accepted internationally
29. Abuse of financial services	Largely compliant	Supervision of AML/CFT has significantly improved since the last BCP assessment. CNBV has continued to update regulations and implement new supervisory tools and methodologies.

RECOMMENDED ACTIONS AND AUTHORITIES' COMMENTS

A. Recommended Actions

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks	
Reference Principle	Recommended Action
Principle 1	<p>To improve the prudential legal framework for consolidated supervision, the authorities are recommended to:</p> <ul style="list-style-type: none"> • Make the application of the consolidated supervision legal framework mandatory for those financial groups operating in Mexico. • Introduce legal amendments to grant the authorities the legal power to impose a set of prudential regulations at group level. • Amend the current legal framework so that the perimeter of the consolidated supervisory framework could be discretionally determined by the authorities.
Principle 2	<p>The authorities are recommended to enhance independence by:</p> <ul style="list-style-type: none"> • Changing the composition of the governing body of the CNBV, including terms of its members and reasons for removal, to make it more independent to government interference. • Granting CNBV greater levels of budgetary autonomy. • Strengthening current arrangement to ensure effective legal protection for supervisor.
Principle 5	<p>CNBV is recommended to issue internal guidelines detailing the criteria to assess the financial soundness of significant shareholders, as well as their ability to support the bank if needed.</p>
Principle 8	<p>To streamline the CEFER methodology, CNBV is recommended to:</p>

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks	
Reference Principle	Recommended Action
	<ul style="list-style-type: none"> • Reduce and simplify indicators and categories used to determine inherent risks. • Make it the assessment of mitigants more dependent on expert judgment rather than formal checks. • Introduce internal supervisory routines and decision-making arrangements to foster and unify expert judgment.
Principle 9	To Improve the quality of supervisory reports delivered to banking institutions, CNBV is recommended to set up a quality assurance procedure, including supervisory peer review process, aimed at ensuring the effectiveness of on-site examinations to assess risk management.
Principle 11	The authorities are recommended to enhance ring fencing options available for the authorities to effectively protect the bank from indirect risks steaming from the activities of non-regulated financial entities belonging to the same group are limited.
Principle 12	The authorities are recommended to strengthen the current arrangement for consolidated supervision (see recommendations on BCP1).
Principle 14	The authorities are recommended to give more room to expert judgment to assess corporate governance adequacy (refer to recommendation on BCP8 and BCP9).
Principle 15	The authorities are recommended to increase focus on assessing the quality of risk management rather than on compliance with the requirements.
Principle 16	CNBV needs to fully implement Pillar 2 (capital charges). Prior sharpening the CEFER tool would facilitate this implementation.
Principle 17	<p>The authorities are recommended to:</p> <ul style="list-style-type: none"> • Establish a threshold for large loans that must be approved by the board.

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks	
Reference Principle	Recommended Action
	<ul style="list-style-type: none"> Enhance the procedures performed to assess substantive implementation of credit risk management practices, placing greater emphasis on actual management rather than on compliance.
Principle 19	The authorities are recommended to implement the 2016 BCBS standards on large exposures.
Principle 20	<p>Authorities are recommended to:</p> <ul style="list-style-type: none"> Amend Article 73 of the LIC to reduce the 35 percent of capital aggregated maximum limit with standard 'related parties' to a level consistent with international practice. Reinforce the powers of CNBV by providing explicit powers to exert discretion on a case-by-case basis. Amend the LAF to require observance of lending limits on a full consolidated basis at the holding company level and extend requirements to unregulated mixed activity holdings (EC5).
Principle 21	The authorities are recommended to implement minimum regulatory requirements and reporting related to country and transfer risks.
Principle 24	The authorities are recommended to implement minimum liquidity requirements to development banks that take deposits from the public.
Principle 25	The authorities are recommended to enhance risk-based supervision over cybersecurity risks, particularly in terms of staffing and resources to keep abreast of IT development and corresponding risks.
Principle 29	The authorities are recommended to continue advancing towards an AML/CFT full-fledged risk-based supervision.

B. Authorities' Response to the Assessment

37. Mexican financial authorities appreciate the effort and dedication that the IMF and the WB assessors and mission chiefs put into undertaking the assessment of the implementation of the BCPs in the Mexican financial sector, as part of the FSAP. The discussions carried out during the two missions were insightful and provided valuable and useful information on supervision tools and practices.

38. Since the last BCP assessment was completed in 2012, the Mexican financial authorities have made significant progress in strengthening banking regulation and supervision, improving the compliance with the BCPs. This report acknowledges that supervision of AML/CFT has significantly improved as well as the operational risk regulatory and supervisory framework. It highlights that the regulations on overall risk management have been greatly enhanced and compliance with the conditions of the country and transfer risks has been largely achieved.

39. Mexican financial authorities welcome the findings and recommendations in the report. While the authorities greatly value the feedback provided by the assessors and will make the necessary efforts in adopting most of the recommendations, it is important to highlight some considerations for certain grades and recommendations of the report.

40. Regarding the comments on consolidated supervision, Mexican authorities consider that the supervision carried out by the Supervising Commissions (CNBV, CNSF and CONSAR), as specified by the LRAF and the General Rules for Financial Groups, provides a consolidated supervisory legal framework that is mandatory for financial groups, financial entities integrated into a financial group, and also for companies belonging to financial groups. Furthermore, there is also a prudential framework for financial groups that includes minimum requirements for general administration, risks management, internal control, disclosure of information, leverage, and capital, among others.

41. Moreover, as part of the consolidated supervision, when a potential risk is identified in a financial entity integrating the financial group, the Supervising Commissions exchange information under the existing cooperation agreements in order to have a proper and coordinated response. This cooperation includes, among others, the sharing of information collected for the supervisory and surveillance functions of both the financial group and the individual financial entities that comprise it, as well as the timely report on any relevant factor that could affect the financial position of the financial group or of any of its entities.

42. Mexican regulation also sets forth mechanisms to prevent the risk transference from the economic group's entities to financial institutions. These mechanisms include exposure limits with related parties and minimum requirements for transactions between related parties. For this purpose, the CNBV has the attribution of requiring the necessary information, enacting cautionary actions (including additional capital requirements) **if the economic group's entities fell**

into insolvency or illiquidity, financial clean-up or bailout, as well as under corrective financial actions ordered by an authority.

43. Regarding the comments on CNBV's independence and resourcing, the authorities note that the SHCP integrates the budget for all the public federal administration institutions, which is then approved by the Legislative branch of government (lower chamber). CNBV, as a de-concentrated administrative body of the SHCP, has technical autonomy and executive powers; nevertheless, it also follows the same budget rules of other de-concentrated federal agencies.

44. The SHCP appoints some of CNBV's board members. However, these procedures by no means hinder CNBV's efficacy from supervising financial entities or contributing to the overall financial stability, in collaboration with other supervisory agencies.

45. This institutional framework has proven efficiency and stability over the years, and it does not prevent CNBV's governing board or staff to fulfill their main mandate.

46. Regarding the Core Principle "Supervisory approach", where the assessors recommend for the CEFER tool that "...mitigants should rely more on expert judgement rather than on formal checks...", in order to "... facilitate applying a more risk-based approach to supervision, facilitating the application of Pillar 2 measures...", CNBV would like to point out that the mitigants' grade is obtained by the application of the supervision procedures, which since 2015 have been part of a reengineering process with the purpose of carrying out a risk-based supervision, in which, through questions and hints the supervisor determine the root cause of the findings and thereby establish corrective actions to prevent and mitigate risks.

47. Finally, the Mexican financial authorities reaffirm their commitment to continue advancing, in the scope of its mandate and attributions, towards the full compliance with the BCPS. The authorities also look forward to continuing the dialogue with the IMF and WB, and recognize the excellent work of both organizations in carrying out these assessments.