

Mexico: Financial Sector Assessment Program Update—Detailed Assessment on the Implementation of the IOSCO Objectives and Principles of Securities Regulation

This Detailed Assessment on the Implementation of the IOSCO Objectives and Principles of Securities Regulation for Mexico was prepared by a staff team of the International Monetary Fund and the World Bank as background documentation to the Financial Sector Assessment Program Update with the member country. It is based on the information available at the time it was completed in November 2006. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Mexico or the Executive Board of the IMF.

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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE
MEXICO

**DETAILED ASSESSMENT ON THE
IMPLEMENTATION OF THE IOSCO
OBJECTIVES AND PRINCIPLES OF
SECURITIES REGULATION**

NOVEMBER 2006

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GLOSSARY

AFORE	<i>Administradora de Fondos para el Retiro</i>
AMAI	Association of Independent Investment Advisors
AMIB	The organization of securities firms
AML	Anti-Money Laundering
ASIGNA	Central Counterparty for the clearing of derivatives
<i>Bolsa</i>	Stock Exchange
BOM	Bank of Mexico
CB	<i>Certificado bursátil</i>
CCV	Central counterparty for Equity Clearance and Settlement, a subsidy of INDEVAL
CEO	Chief Executive Officer
CINIF	<i>Consejo Mexicano para la Investigación Desarrollo de Normas de Información Financiera</i>
CLOB	Central limit order book
CNBV	National Banking and Securities Commission
CNSF	National Insurance and Sureties Commission
COFEMER	Federal Commission for Regulatory Improvement
CONDUCEF	Consumer Protection Agency
CONSAR	<i>Comisión Nacional del Sistema de Ahorro para el Retiro</i>
DVP	Delivery versus payment
ETF	Electronic Funds Transfer
FSAP	Financial Sector Assessment Program
GAAP	Generally accepted accounting principles
GDP	Gross Domestic Product
IAS	International Accounting Standards
IASB	International Accounting Standards Board
INDEVAL	Institute for the Deposit of Securities
IMCP	Mexican Institute of Public Accountants
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPC	<i>Indice de Precios y Cotizaciones</i>
LCNBV	National Banking and Securities Commission Law
LMV	Securities Market Law
LSM	Mexican Corporation Law
MexDer	Mexico's derivatives market
MG	<i>Mercado Global</i>
MOU	Memorandum of Understanding
NAV	Net asset value
OTC	Over-the-counter
PGR	General Attorney's Office
SAPI	Investment promotion vehicles aimed at facilitating the listing on the stock market of small- and medium-sized enterprises
SEIFORE	<i>Sociedad Especializada de Fondos para el Retiro</i>
SHCP	Secretariat of Finance and Public Credit
SIF	Integrated Financial Service
SRO	Self-regulatory Organizations

I. IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

A. General

1. This is an assessment of the National Banking and Securities Commission (CNBV), and other relevant regulatory agencies and self-regulatory organizations (SRO). This assessment is an update of an earlier assessment prepared in 2001. Both assessments were performed as one component of an assessment of the Mexican financial system under the Financial Sector Assessment Program (FSAP) conducted jointly by the International Monetary Fund (IMF) and the World Bank. Both assessments were prepared by Mr. Jonathan Katz (consultant, formerly with the U.S. Securities and Exchange Commission).

B. Information and Methodology Used for Assessment

2. This assessment was prepared in accordance with the guidance contained in the IOSCO Assessment Methodology Guidelines (December 2003 version). Material contained in the 2001 IOSCO Assessment Report was used when applicable. This assessment was based primarily upon interviews conducted between February 22 and March 6, 2006 with employees of the CNBV, officials of other Mexican government agencies, representatives of the pertinent SROs in Mexico and persons knowledgeable about the Mexican financial services industry and capital markets and regulatory system. These interviews were augmented by appropriate reference materials and discussions with other members of the FSAP mission team.

C. Institutional and Macprudential Setting, Market Structure

The debt market

3. The Mexican securities market is dominated by daily trading in short-term government debt securities, primarily through repo transactions among banks, brokers, institutions, and private investors. This trading, which occurs in the over-the-counter market, represents over 97 percent of the daily trading volume and approximately 60 percent of this trading is through repo transactions.¹ Virtually all of the trading occurs electronically, and a substantial proportion occurs through the Integrated Financial Services (SIF), an interdealer broker partially owned by the Mexican Stock Exchange. The Institute for the Deposit of Securities (INDEVAL) clears and settles debt market trading, including repos of longer than two days, on a bilateral netting basis.

4. The 2001 FSAP noted significant structural issues in the Mexican repo market and recommended government action to create a standard master agreement for repo transactions,

¹ Source, INDEVAL.

to formalize recordation, clearance, and settlement of underlying collateral and to expand the institutions permitted to engage in repo transactions. In 2003 the Bank of Mexico (BOM), which has primary regulatory authority over the repo market (and actively uses overnight repo-style transactions with member banks to manage money supply and credit), issued a new regulation requiring the use of a standard master agreement (for repos longer than three days), permitted securities lending and permitted corporate bonds to be traded in the repo market. Some restrictions still exist. For example mutual funds are only permitted to engage in repos as the recipient not the lender of the security. Also, because INDEVAL clears and settles on a T+2 cycle, repos of one- or two-day durations are still processed bilaterally. As a result collateral assignment may not be perfected and the transaction may not be subject to the standard master agreement.

5. In its December 2005 Selected Issues Paper on Mexico, the IMF concluded that “The development of Mexico’s government securities markets, and its positive impact on the rest of the financial sector, has been rapid in recent years. The country boasts an extended yield curve in the local government debt market, with maturities up to 20 years issued at a fixed rate. Although the size of the local bond market is still smaller (in relation to GDP) than in some other emerging markets, the liquidity of the debt market (public and private), as indicated by a high turnover ratio (695 percent in 2004), also reflects the important role these instruments play in the functioning of the Mexican financial market, as opposed to a much lower turnover in countries where they act mainly as a safe investment vehicle for the local banks.”²

6. In comparison, the corporate debt market in Mexico continues to be small, approximately 2 percent of GDP in 2003-04³ and to a large extent it is available only to the largest Mexican companies having investment grade ratings. Mexican pension plans,⁴ are the principal investors in investment-grade corporate debt, although it represents only a very small portion of these pension portfolios.

7. An important legal change in 2001 positively affected the corporate debt market. The *Ley del Mercado de Valores (LMV)* created a new form of debt security, *Certificado Bursátil (CB)*, that could be issued without shareholder action and that could contain payment guarantees back by asset funds and other characteristics of a structured note. The flexibility of the notes and the inclusion of credit enhancements made the notes popular with corporate issuers and sub-sovereign entities, such as the Mexican states and state-owned Mexican companies. In 2002, there were 10 offerings of long term CBs by state entities for approximately US\$500 million and in 2005 the offerings had grown to 21 offerings for more

² Selected Issues Paper, Mexico, paragraph 4, IMF, December 2005.

³ Source, Economist Intelligence Unit country profile report, page 33, February 2006.

⁴ AFOREs (*Administradoras de Fondos para el Retiro*) are private pension funds administrators. SIEFOREs are private pension funds.

than US\$7.3 billion. Similarly, in 2002 there were 59 long term corporate CB issues which raised nearly US\$3.4 billion and in 2005 a small increase to 62 corporate offerings raised more than US\$6.6 billion.⁵

8. Additionally, Reuters operates an electronic system for spot transactions in government securities and the *Bolsa* operates, jointly with Garvans, a trading system for overnight repos in government securities, the SIF. These systems are not registered as an exchange but as an interdealer broker.⁶

Equity Market—The *Bolsa Mexicana de Valores* (The *Bolsa*)

9. The Mexican Stock Exchange (*Bolsa Mexicana de Valores*, BMV or *Bolsa*) is a member-owned-for-profit institution. From 1995 through 2001, activity on the *Bolsa* declined and stagnated. The number of listed companies decreased from 190 in 1993 to 168 in 2001.⁷ Following a series of compulsory delistings by the CNBV the number of listings declined to 132 (155 listed stocks) in 2005. The average daily value of the stocks traded in the *Bolsa* declined from US\$249 million in 1993 (an average daily trading volume of 112 stocks) to US\$238 million in 2001 (an average daily trading volume of 125 million stocks) and the total market capitalization of listed companies dropped from US\$201 billion in 1993 to US\$127 billion in 2001.

10. In recent years the overall Mexican economy has rebounded and trading activity on the *Bolsa* has grown as well. The primary equity market index (*Indice de Precios y Cotizaciones*, IPC) rose nearly 46.5 percent in 2004 and nearly 44 percent in 2005. However, its daily trading volume remains highly concentrated in a very small number of issuers. Four stocks comprise approximately 50 percent of the IPC—Telmex, AMX, Walmex, and Cemex. Total market capitalization of the *Bolsa* has grown from US\$104 billion in December 2002 to US\$236 billion at the end of 2005.⁸ The *Bolsa* estimates that 45 percent of the market is foreign owned.

11. The *Bolsa* equity market is entirely electronic, with no specialists or market makers. There is an electronic central limit order book, visible to member firms, but not to other traders, who only see the best bid and offer and accompanying size and the last reported trade. Informally, it is believed that member firms often provide full book visibility to some customers.

⁵ Source, SHCP and BMV. In Mexico, all subsovereign debt offerings must be registered with and reviewed by the CNBV.

⁶ In Mexico, interdealer brokers are not considered market intermediaries.

⁷ Source, *Bolsa Mexicana de Valores, Anuario Bursátil*. The listed companies include those in the service, industrial, and commercial sectors, as well as listed financial institutions.

⁸ Source, *Bolsa Mexicana de Valores, Indicador Bursátil*, December 2005.

12. Securities listed on the *Bolsa* are divided into two categories, with separate trading procedures. There are 90 stocks traded through the continuous market system. These are the securities with the larger free floats and greater daily activity. There are 53 less liquid stocks traded through the continuous auction process. Stocks are included in this group if they have fewer than eight million free float shares or less than 12 percent of capitalized shares are free floating, if there are fewer than 100 investors or if there have been fewer than 36 trades in the stock in a six-month period. When an order is received for a continuous auction stock, the order must be exposed, for price improvement, to an open auction for a one-hour period. The *Bolsa* explained that this procedure was adopted to reduce the number of trading halts occurring because of a trade occurring more than 15 percent above or below the last previous trade. The *Bolsa* estimates that this new procedure has significantly improved the price quality of executions and the number of trading halts has declined by roughly 80 percent.

13. The seven largest cap Mexican stocks are dually listed in the United States of America (U.S.A.) and the bulk of daily trading occurs in the U.S.A. As a result arbitrage opportunities exist between the markets and the *Bolsa* believes that this is another significant amount of daily volume. Because this trading tends to be computer generated program trading, the orders are often cancelled because the trade could not be executed in the time required to obtain the beneficial arbitrage. At times, the volume of automated orders, and cancelled orders has taxed the capacity of the *Bolsa's* systems. The *Bolsa* reports that, as a result, it has substantially expanded order processing capacity in the past year to approximately 10 times current peak order volume.

14. Consistent with overall positive developments in the Mexican economy, there has been a gradual increase in the number of securities (both equity and debt) offerings in Mexico. During the past two years, more than 50 debt offerings have been issued. In Mexico the initial underwriter's distribution to the underwriting syndicate occurs on the *Bolsa*, with debt securities then distributed OTC.

15. However, Mexico's equity market remains relatively small and illiquid, and is not a major source of financing for most companies. Of the eight largest economies in the Americas, Mexico has the second smallest stock market, relative to GDP. The free float is limited and trading volumes are also low. The stock market displays a high level of concentration, with the top 10 companies representing close to 70 percent of market capitalization. Ownership of listed firms is also highly concentrated, and listed firms traditionally issued different types of nonfungible shares in order to avoid dilution of corporate control, which fragmented the securities market and reduced liquidity. Legal reforms enacted since 2001 have significantly restricted the ability of companies to issue multiple classes of securities and CNBV regulations, codified in recent legal reforms, have prohibited acquirers via tender offers or mergers from paying a premium for shares with greater voting power.

16. Larger companies have increasingly preferred to list on international markets. This has usually taken the form of cross listings in the U.S. market, through American Depositary Receipts (ADRs). In 2000, almost half of listed firms had a foreign listing or had raised capital abroad, and trading in foreign stock markets exceeded domestic trading. Outstanding ADRs reached US\$48.9 billion in May 2005, equivalent to more than 20 percent of Mexican market capitalization.

17. In 2003 the *Bolsa* created the *Mercado Global* (MG) to permit domestic trading in approximately 200 foreign-listed equities, including 12 foreign exchange-traded funds (ETF's). An investor may submit an order for one of these securities to a *Bolsa* firm, which then purchases the share in the foreign market in a largely riskless-principal capacity. The transaction is exposed for 20 seconds on the *Bolsa* system for price competition and then transacted. If a superior bid or offer appears in that 20 second window, it is entitled to 5 percent of the trade. The executed trade is cleared through INDEVAL which maintains a foreign custodian arrangement for the designated securities via the Deutsche Bank. Foreign shares sold through the MG are not subject to Mexican capital gains tax and any dividends received on a share purchased through the MG are taxed at a low 10 percent income tax rate. Trading in foreign unlisted shares on the MG represents 10-30 percent of daily trading volume. A substantial segment of this trading is by AFOREs trading in foreign ETF's, as the pension funds are not permitted to purchase individual equities. INDEVAL reports that its custodian account at the Deutsche Bank contains more than US\$2 billion in securities.

The derivatives market—*mercado mexicano de derivados* (MexDer)

18. MexDer began operations in December 1998 as the national derivatives market. It is a privately-owned market, with the *Bolsa* owning 78 percent. Initially an open-outcry market, its futures market became fully electronic in March 2000 and in March 2004 it began operation of a fully electronic options market. MexDer offers futures on foreign currency exchange rates, the IPC, five fixed income products and on five individual equities (Cemex CPO, Femsa UBD, Gcarso A1, Telmex L, and Amx L). There are listed options on the IPC, two individual stocks (Amx L, Nafrac 02) and on two foreign exchange traded funds (ETF)—the NASDAQ 100 index (QQQ) and the iShares S&P500 Index (IVV). MexDer reports that it is now the fifth largest futures market in the world. Trading activity is highly concentrated in its interest rate futures product, more than 90 percent of daily trading volume.

19. The main users of the derivatives exchange has been its four clearing members. Each is a legal trust created and owned by a major bank. Foreign investors are increasingly active participants, and recent regulatory changes now permit foreign brokers to trade though an omnibus account with a clearing member, without having to register as a securities firm with the SHCP (which must be notified and may veto a relationship). Private pension funds are now permitted to invest a limited percentage of assets in derivatives and mutual funds are seeking similar authority.

Investors

20. Mutual funds (*sociedades de inversión*) have grown substantially since the 2001 reform to the *Ley de Sociedades de Inversión*. Thirty-four licensed mutual fund operators (23 are owned by other financial institutions and 11 are independent) manage 425 funds, with US\$47 billion in total assets and over 1 million investors, as of 2005. The industry has grown 72 percent in asset size since 2001. Mutual fund assets are overwhelmingly invested in debt over equity. Mutual funds are prohibited from investing in derivatives (although such authority is likely in 2006).

21. The private pension system in Mexico has seen similarly dramatic growth since it was created in 1997. By October 2004, AFOREs were managing pensions for 32.9 million people. Of these, 60 percent of the number of registered accounts were concentrated in the five largest AFOREs. AFOREs may invest in investment grade debt, a limited amount of futures contracts (allocations determined by the BOM regulations) and indices of funds of equity securities. They may not invest in individual equity securities.

22. There is also a well-established pool of individual high net worth investors in Mexico, estimated at over 50,000 accounts with combined assets of more than US\$60 billion. In addition, foreign investors are a major presence in the Mexican markets. The *Bolsa* estimates that 45 percent of listed equities are owned by foreigners, primarily institutional investors

II. DESCRIPTION OF REGULATORY STRUCTURE AND PRACTICES

A. The Securities Regulatory Environment

23. Mexico has a complex regulatory structure involving several government agencies with distinct responsibilities but interlocking supervisory structures and numerous legal responsibilities to consult prior to taking action.

24. The National Banking and Securities Commission (CNBV) was created in 1995 by the National Banking and Securities Commission Law (LCNBV), which merged the previously independent National Banking Commission and National Securities Commission. The CNBV is headed by a 10-member Board of Governors. Five members, including the President of the Commission, are appointed by the Secretary of Finance and Public Credit (SHCP), three members are appointed by the BOM, and the pension regulator (CONSAR) and the insurance regulator (CNSF) each appoint one member. The SHCP has broad supervisory responsibility over the CNBV, such as setting its annual budget, the final authority over legal interpretations of the relevant laws and final authority over referral of matters to the Ministry of Justice for criminal action. The SHCP has final responsibility for approval of exchange licenses, derivative firms and banks, with a duty to consult with the CNBV and the BOM. Until 2005 it had similar responsibility for licensing securities firms. The BOM has final authority over matters involving the government debt market and over matters dealing with the extension of credit.

25. COFEMER is a Mexican agency created in 2001 with advisory responsibility over governmental regulations. All CNBV regulations are subject to review by COFEMER, which has the responsibility to publish proposals in its web site and oversee the public comment process. CONDUSEF is a government agency with broad authority to act as an informal ombudsman for involved in consumer disputes. It does not possess enforcement authority.

B. Self-Regulatory Organizations⁹

26. There are several private entities that have been designated self-regulatory organizations under Mexican law. These include the *Bolsa*, the Mexican stock exchange; MexDer, the derivatives exchange; AMIB, the organization of securities firms; AMAII, the association of independent investment advisers; INDEVAL, the national securities depository and its subsidiary the CCV, the central counterparty for equity clearance and settlement, and ASIGNA, the central counterparty for clearance and settlement on MexDer.

27. The *Bolsa* performs limited regulatory functions. Its surveillance function is limited to staff monitoring trading activity and imposing trading halts when a stock moves more than 15 percent within a day or when there is the possibility that an issuer has not disclosed material information. It also reviews the prospectuses of all new listings in conjunction with the CNBV to ensure that listing standards are met. Because the *Bolsa* does not have the authority to compel testimony or disclosure of information by its members or its members' employees, it is unable to conduct investigations. Accordingly, it does not take disciplinary actions against member firms or their employees. All suspicious activity is referred to the CNBV. MexDer, which is owned by the *Bolsa*, performs analogous functions in the futures market.

28. AMIB conducts licensing exams for employees of securities firms, mutual funds, and bank employees who are involved in selling securities. It adopts regulations for securities firms concerning internal operations, such as compliance and risk management functions and receives and monitors member firms compliance with CNBV capital requirements. It has the authority to fine its members for failure to file required reports or for filing incorrect reports.

29. AMAII is a voluntary organization. It has 25 members (out of 45 registered independent advisers) who have agreed to be inspected periodically. AMAII has contracted with a big four accounting firm to perform eight inspections annually.

30. INDEVAL, the securities depository, performs some self-regulatory functions, primarily pertaining to monitoring the securities positions of its members and requiring additional reserves for firms with increases in failed transactions. However, it has no

⁹ In addition to the powers enjoyed by self-regulatory organizations, the CNBV maintains regulatory oversight over those sectors.

disciplinary authority. INDEVAL owns and operates the CCV, the central counterparty for equities clearance and settlement. The CNBV periodically audits INDEVAL and CCV.

C. Mexican Legal Framework for Securities Markets

31. The 1934 Mexican Corporation Law (LSM) and 1975 Securities Market Law (LMV) form the framework for securities regulation. The LMV was substantially amended in April 2001 and a New Securities Market Law was issued in December 2005. This has significantly expanded the authority of the CNBV to perform its key regulatory responsibilities. The CNBV has broad authority to adopt regulations and procedures to implement the requirements of the law. Specialized divisions of the CNBV regulate bank and securities activities.

32. IOSCO has identified three core objectives of securities regulation: (i) the protection of investors; (ii) ensuring that markets are fair, efficient, and transparent; and (iii) the reduction of systemic risk. The Mexican regulatory system is designed to address each of these objectives. However, as described more fully below, certain legal limitations impeded the ability of the regulators in these areas. In March 2001, when the first assessment was performed five such limitations were discussed with the CNBV:

- The scope of the CNBV's enforcement authority, its ability to publicize its actions and thereby promote investor confidence in the securities markets and deter misconduct by others;
- Promoting market efficiency and reduced regulatory overhead by introducing greater flexibility in the regulatory structure;
- Enhancing public confidence in regulation by adopting procedures to ensure public input into the regulatory process and to enhance procedural due process in the disciplinary process;
- Enhancing minority shareholder rights through improved corporate governance standards and easier access to the courts to protect these rights; and
- Difficulty obtaining assistance from overseas regulators when pursuing investigations of possible Mexican securities law violations due to an inability to provide reciprocal assistance to foreign regulators because of Mexican bank secrecy laws.

33. In 2001 CNBV and SHCP officials were in agreement with the need for greater legal authority in these areas and proposed legal reforms to the Mexican Congress. In April 2001, Congress enacted a series of legal reforms designed to address each of these core areas. These changes expanded the authority of the CNBV to conduct investigations and to publicly disclose disciplinary actions, to share information with other government regulators and with foreign regulators, to enact secondary regulations to protect minority shareholder rights and to shift from a merit-based to a disclosure-based system of securities offering review. The law also mandated changes in public listed company governance, such as creation of an audit subcommittee of a company's Board of Directors, mandatory minimum percentage of

independent directors on a company Board, and specific rights of representation for minority shareholders with 10 percent holdings and the right to initiate private litigation by holders of 20 percent interests. The law governing mutual funds was also amended to require fundamental changes in the legal structure of mutual funds that were designed to expand competition and to increase fund investor protections by requiring the separation of certain operational functions.

34. These changes and their impact are referenced in the comments to the applicable principles. In the 2001 assessment it was noted that, as a result of these changes in the law, a future assessment may find greater implementation of substantially all of the IOSCO principles. This assessment confirms that hypothesis.

35. Following passage of the 2001 amendments, the CNBV used these legal reforms to significantly expand its activities. It addressed some of the concerns over its operational transparency by revising, updating, and comprehensively codifying many discrete secondary regulations into unified regulations. It utilized its information sharing authority and was approved to become a signatory to the IOSCO multilateral agreement on information sharing. It began publicizing basic information on completed disciplinary actions. Consistent with other newly enacted law, it began systematically soliciting public and industry input in the development of secondary regulations, both through informal communication and through formal publication for notice and comment of regulatory proposals through COFEMER's web site. In the area of minority shareholder rights it adopted a secondary regulation on tender offers that required price equality for different classes of securities, even with different voting rights.

36. In 2004, President Fox, at the request of the SHCP and the CNBV, proposed to Congress further reforms of the Mexican securities law, the LMV. In December 2005 a New Securities Market Law was enacted, to be effective in June 2006. The changes brought by the new Law can be grouped into three broad categories:

- Further expansion of the CNBV's authority;
- Substantial changes in the corporate governance of publicly listed companies;
- Creation of two new corporate vehicles, designed to facilitate the ability of small and medium-sized companies to raise capital and transition to public listed company status.

37. The new law transfers the authority to license securities firms from the SHCP to the CNBV and the CNBV may now issue limited function brokerage licenses. Also the CNBV will have the authority to appoint special administrators to manage failing securities firms and, if necessary, revoke a firm's license. The CNBV was given additional enforcement powers. It now has the power to investigate and sanction attorneys, auditing firms and external auditors, and corporate officers and Board members responsible for securities law violations and refer such misconduct to the Ministry of Justice for criminal action. The new

law also clarified what is prohibited insider trading and manipulative activities in the derivatives market.

38. The 2001 amendments to the LMV made fundamental changes in the responsibilities of listed companies that were designed to increase the rights of minority investors. The boards of listed companies were required to include at least 25 percent of independent directors. An audit subcommittee of the board was required, to be composed of a majority of independent directors and chaired by an independent director. Companies were required to have a *comisario*, an internal reviewer and certifier of the external audit report. Shareholders controlling 10 percent of the company stock were given the right to appoint a second *comisario*. At each annual general meeting, the *comisario* was required to deliver a report on the accuracy, adequacy, and rationality of financial and other information presented to the board, including an opinion on whether the financial statements were prepared in accordance with Mexican accounting standards. While these persons were not required to be licensed accountants, in practice they were typically an accountant at the firm that performed the external auditor. Under Mexican law, they were subject to personal civil or criminal liability for failure to perform their duties, although enforcement was rare. Investors with 20 percent of a company stock were also authorized to bring a private lawsuit against a company for violation of Mexican law. Finally, the CNBV was given the authority to adopt a secondary regulation on tender offers.

39. The December 2005 legal reforms further expanded the minority shareholder protections of the 2001 law. The CNBV secondary regulation on tender offer enacted in 2003 (described in principle 14) was codified into law. Audit committees are now required to be composed of 100 percent independent directors. The law created the title of company *Director General* (comparable to an American CEO) and explicitly delineated the responsibilities of the CEO and the company Board. The CEO was made responsible for the company's books, records and accounting process and the Board, through the Audit Committee, was given responsibility for review of the external audit and the duties previously assigned to the *comisario*. This function was eliminated for publicly listed companies. Of great significance, the law created the concept of a single economic unit. The Board's responsibilities extended to any company subsidiary or affiliate that is part of a company single economic unit. The audit committee now has the power to require appearances by all company employees to discuss accounting and auditing questions, including employees of these subsidiaries.

40. The 2005 law also, for the first time, specifies that company board members and officers have fiduciary duties to the company and its shareholders, a duty of due care and a duty of loyalty. Board members are specifically prohibited under the law from the following:

- Cannot authorize related party transactions without full disclosure and formal actions;
- Cannot vote if a conflict of interest exists;

- Must disclose any conflicts;
- Cannot use privileged information;
- Cannot take advantage of company assets or corporate activities without authorization.

41. Violation of these duties can be punished in civil litigation brought by the company or a minority shareholder owning 5 percent, a reduction from the 2001 law (although private derivative litigation in Mexico continues to be rare). A private action can be resolved through a negotiated settlement, with the explicit approval of the company Board. The CNBV can bring an action under the law to suspend or bar an officer or a director for up to five years.

42. The third substantive area of the 2005 legal reform created two new corporate vehicles, SAPI and SAPI B corporations. These entities are designed to make it easier for small and medium private companies to raise capital and make the transition to public listed company status.

- A SAPI corporation will be able to issue securities to institutional investors and qualified investors in private transactions, without having to register with the CNBV or on the National Corporate Registry. In addition to having no disclosure obligations, a SAPI will not be subject to the corporate governance and auditing requirements that apply to listed companies, and there will be no restrictions on the types of securities it may offer or special features it can attach to a security.
- A SAPI B corporation will be a three-year transitional status for a SAPI corporation interested in becoming a listed public company. During the three-year period a SAPI B will have special listing status on the *Bolsa* while it implements a plan to fully conform to the legal obligations of listed companies.

D. Findings of the 2001 FSAP Assessment

43. The 2001 Assessment noted several areas where regulatory improvement was warranted:

- The debt market suffered from the lack of a standard master agreement for repo transactions.
- The CNBV required additional legal authority to implement its enforcement responsibilities, including full subpoena authority and broader sanctioning authority.
- The CNBV regulatory process would benefit from greater transparency and the opportunity for public and industry comment.
- The CNBV would have greater visibility and effectiveness as a regulatory authority if it was permitted to fully disclose and publicize its enforcement actions.
- Greater legal protection of minority shareholders was necessary and the minimum thresholds for private legal action had to be lowered.

- International best practices for corporate governance should be adopted, particularly concerning transfers of control, and limitations on officer and director self-dealing.
- International standards for sharing information with foreign regulators and with other domestic regulatory authorities should be adopted.

44. As discussed in the detailed assessment below, substantial progress has been made in all of the areas identified in the 2001 assessment.

III. PRINCIPLE-BY-PRINCIPLE ASSESSMENT

Table 1. Principle-by-Principle Assessment of Observance of the IOSCO Objectives and Principles of Securities Regulation

Principles Relating to the Regulator	
Principle 1. The responsibilities of the regulator should be clear and objectively stated.	
Description	The 1934 Mexican Corporation Law (LSM) and 1975 Securities Market Law (LMV) establish the framework for securities regulation. In 2001 the LMV was amended to expand the authority of the CNBV to require registration by independent investment advisors and to require bank employees who sell securities to comply with CNBV rules and pass certification exams administered by AMIB, a securities firm self-regulatory organization. The CNBV also obtained expanded authority to demand information through its investigation process and to share information with other government agencies, both foreign and domestic. In 2005, a new Securities Market Law was issued to further expand and clarify CNBV authority. The law will take effect in June 2006. These new Law transferred securities firm licensing authority from the SHCP to the CNBV. The CNBV also received the power to bring enforcement actions against Officers and Directors of publicly listed companies, as well as attorneys, auditing firms, and external auditors who are responsible for company violations of the laws or CNBV regulations. The CNBV may bar these individuals for up to five years.
Assessment	Implemented.
Comments	The 2001 amendments to the LMV and the 2005 New Securities Market Law provided the CNBV with all authority required to perform its regulatory responsibilities. In 2004, the CNBV decided to revise its secondary regulation on independent investment advisers. This decision was based upon the large number of advisers who registered and the limited resources of the CNBV to effectively supervise and inspect all registrants. The BOM continues to be the primary regulator of MexDer, the futures market, with the CNBV performing the ongoing oversight functions.
Principle 2. The regulator should be operationally independent and accountable in the exercise of its functions and powers.	
Description	The CNBV was created in 1995 by the National Banking and Securities Commission Law (LCNBV), which merged the previously independent National Banking Commission and National Securities Commission. The CNBV is headed by a 10 member Board of Governors. Five members, including the President of the Commission, are appointed by the SHCP, three members are appointed by the BOM, and CONSAR (pension regulator) and the CNSF (insurance regulator) each appoint one member. Appointments are not for fixed terms. The SHCP has broad supervisory responsibility over the CNBV and final authority over certain key functions. Many of the responsibilities of the CNBV are subject to consultation or review by another government agency. For example all CNBV regulations must be submitted to COFEMER, an agency that has responsibility for publication of all secondary regulations in Mexico and the authority to submit comments based upon its own review. Similarly, when the CNBV determines that an investigation should be referred for criminal prosecution, it must submit a recommendation to the SHCP, which has responsibility for referral to the Ministry of Justice.
	As noted in 2001, the CNBV no longer has the ability to control its own budget, based upon fees collected. Annually, it submits a fee collection formula and a requested budget to the SHCP and, ultimately to congress for approval. Typically, the CNBV budget represents approximately 80 percent of the fees too be collected.
Assessment	Broadly implemented.

Comments	<p>As noted in 2001, the CNBV appears to be operationally independent in the exercise of its functions. At the same time, there is no certainty that this will continue into the future because various other agencies have the authority to intervene and overrule CNBV activities. For example, while it has not happened, the COFEMER could delay the adoption of a secondary regulation; the SHCP could prevent criminal referrals and could significantly reduce the effectiveness of the CNBV by substantially reducing its budget. Similarly, the lack of fixed-term appointments for the Board members makes them, potentially, subject to informal external pressure.</p> <p>While there is no indication that there has been interference in the independence of the CNBV, the existence of these possibilities should be recognized and reviewed in the future.</p>
Principle 3. The regulator should have adequate powers, proper resources, and the capacity to perform its functions and exercise its powers.	
Description	<p>The 2001 amendments and the new Law provided the CNBV with comprehensive regulatory powers, including licensing and inspection powers over securities firms, mutual funds and investment advisers,¹⁰ inspection and subpoena powers, and enforcement authority. The CNBV budget is set annually by the SHCP, based in part on fees paid by regulated entities, as determined under a formula developed by the CNBV and approved annually by Congress. The CNBV reports that its budget is approximately 80-90 percent of the total of fees paid.</p>
Assessment	Broadly implemented.
Comments	<p>As described in Principle 1, the CNBV now has adequate powers to perform its regulatory responsibilities. Since the loss of budgetary independence in 2000, the CNBV reports that it has received adequate operating budgets, albeit at levels that are less than the fees collected for regulation. The staff indicated that the budget is sufficient to staff all functions adequately, although with somewhat fewer professionals than they believe necessary. Computer resources appear adequate.</p> <p>The 2001 assessment identified this budgetary issue and suggested that it should be monitored. In the past five years, it does not appear to have resulted in a material limitation on the CNBV. However, the ability of the SHCP to restrict the CNBV budget creates a potential for future limitations to be imposed on resources. This uncertainty is the basis for the broadly implemented, rather than fully implemented assessment.</p>
Principle 4. The regulator should adopt clear and consistent regulatory processes.	
Description	<p>There have been significant improvements in the transparency of CNBV operations since 2001. Secondary regulations are now drafted with the active participation of members of the financial services industry. Draft regulations are published for 20 days through.</p>
	<p>COFEMER's web site and public comments are requested. These comments are reviewed by COFEMER as well as the CNBV. In addition COFEMER requires agencies to include a regulatory impact statement and cost benefit analysis. Following completion of the comment period, COFEMER must provide a public opinion of support or nonsupport for the proposal. While an agency may disregard a COFEMER nonsupporting opinion and adopt a final secondary regulation, this may increase the likelihood of legal challenge.</p> <p>CNBV undertook a comprehensive review, updating and consolidation of its series of secondary regulations. For example in, 2003, it issued its <i>Circular Única for Issuers</i>, a single document containing all secondary regulations related to issuer disclosure obligations and accounting policy. This process partially addresses the 2001 assessment concern about the existence of nonpublic interpretive positions. In 2004, the CNBV issued its <i>Circular Única for Market Intermediaries</i>.</p>
Assessment	Broadly implemented.

¹⁰ In this case, the new Law envisages that oversight should be undertaken by the relevant SRO.

Comments	<p>There have been significant improvements in the transparency of CNBV operations since 2001. Secondary regulations are now drafted with the active participation of members of the financial services industry. Draft regulations are published for 20 days through COFEMER's web site and public comments are requested. These comments are reviewed by COFEMER as well as the CNBV. In addition COFEMER requires agencies to include a regulatory impact statement and cost benefit analysis. Following completion of the comment period, COFEMER must provide a public opinion of support or nonsupport for the proposal. While an agency may disregard a COFEMER nonsupporting opinion and adopt a final secondary regulation, this may increase the likelihood of legal challenge.</p> <p>The CNBV continues to provide nonpublic information clarifications of the law to requesting parties. Publication of these clarifications would promote consistent industry compliance and the appearance that the CNBV provides uniform treatment to all.</p> <p>While the CNBV can now disclose disciplinary actions, it can only disclose a basic notice identifying the person, the violation and the sanction. It is not permitted to issue a full description of the acts or misconduct upon which the violation was based. The ability to describe and explain the misconduct would be a useful method of informing regulated persons of the types of conduct that is unacceptable. Also, because CNBV disclosure is delayed if a sanction is challenged in court, there is now a greater incentive for persons to challenge the sanctions.</p> <p>The 2001 assessment noted that there is less than optimal transparency in the adjudication of regulatory violations found by the CNBV. This is an area that warrants further consideration. The CNBV disciplinary process is still largely internal and provides only limited due process protection. Subject matter staff submits its allegations of violations and makes a recommendation to the CNBV legal office which determines whether a sanction should be imposed. The amount of sanction is determined based upon internal sanction guidelines, or in the absence of a relevant guideline, by a committee of CNBV Board delegates.</p>
Principle 5.	The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.
Description	<p>CNBV employees are prohibited from directly owning individual securities, although they may own mutual funds and individual stocks may be beneficially owned through trust accounts managed by others. Annual financial statements must be filed. Within the CNBV there is an independent Internal Comptroller who monitors staff performance and reports to the Ministry of the Comptroller.</p>
	<p>The CNBV staff must adhere to a code of conduct, which includes a prohibition on the use or the public disclosure of any confidential information, including information concerning investigations, inspections or disciplinary actions taken by the CNBV. While CNBV staff does not have immunity from legal action arising from the performance of official duties, there is now a separate fund to pay for the legal defense of the staff, although if an employee loses, they must reimburse the fund for the expenses.</p> <p>Mexico enacted a civil service reform law in 2003 that requires all applicants to submit applications for vacancies (even current CNBV staff applying for a promotion) to another agency for review and to pass competency exams prior to being hired.</p> <p>The CNBV has the authority to pay its staff salaries which are above the governmental norm.</p>
Assessment	Implemented.
Comments	<p>A direct prohibition on employee ownership of stock may not be necessary if appropriate procedural safeguards, such as transaction reporting and restricted lists, are in place. A disclosure-based system might be preferable since the ban on trading in individual securities may be circumvented through the use of a nonblind trust account.</p> <p>The creation of a fund to pay for legal expenses of CNBV staff, who are sued for activities in the course of their official duties, is beneficial. However, it is not a full substitute for legal immunity for lawful performance of their duties.</p>

Principles of Self-Regulation	
Principle 6.	The regulatory regime should make appropriate use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.
Description	<p>There are several private organizations that have been designated self-regulatory organizations (SROs). These include the <i>Bolsa</i> and MexDer, AMIB (the organization of securities firms), AMAII (the Association of Independent Investment Advisors), INDEVAL (the central securities depository for clearance and settlement) and ASIGNA (MexDer's clearance and settlement entity). Each organization performs a specific regulatory function,</p> <p>The <i>Bolsa</i> performs limited self-regulatory organization functions such as monitoring trading activity and imposing trading halts when a stock moves more than 15 percent within a day or when there is the possibility that an issuer has not disclosed material information. It also reviews the prospectuses of all new listings in conjunction with the</p> <p>CNBV to ensure that listing standards are met. Because the <i>Bolsa</i> does not have the authority to compel testimony or disclosure of information by its members or its members' employees, it is unable to conduct investigations. Accordingly, it does not take disciplinary actions against member firms or their employees. All suspicious activity is referred to the CNBV. MexDer, which is owned by the <i>Bolsa</i>, performs analogous functions in the futures market.</p> <p>AMIB conducts licensing exams for employees of securities firms, mutual funds, and bank employees who are involved in selling securities.</p> <p>AMAII is a voluntary organization. It has 25 members (out of 45 registered independent advisers) who have agreed to be inspected periodically. AMAII has contracted with a big four accounting firm to perform eight inspections annually.</p> <p>INDEVAL, the securities depository, performs some self-regulatory functions, primarily pertaining to monitoring the securities positions of its members and requiring additional reserves for firms with increases in failed transactions. However, it has no disciplinary authority. INDEVAL owns and operates the CCV, the central counterparty for equities clearance and settlement. The CNBV periodically audits INDEVAL and CCV.</p>
Assessment	Implemented.
Comments	While there are numerous SROs in Mexico performing limited regulatory functions, none have investigative or disciplinary authority over its members.
Principle 7.	SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	Each of the SRO's identified in principle 6 can be recognized by the CNBV and is subject to governmental oversight by the CNBV and in some cases by the SHCP. The CNBV must review and can veto all SRO rules, typically after consultation with the SHCP and the BOM. For example, areas involving credit or financial derivatives are subject to oversight by the BOM. The BOM is actively involved in oversight of the MexDer and INDEVAL.
Assessment	Implemented.
Comments	Each SRO is subject to governmental oversight, in some cases by more than one regulator. The overlapping authority was cited by some industry officials as impeding market innovation, as the regulators may not reach consensus quickly. An example of this problem is the stalemate over mutual fund authority to purchase derivatives.
Principles for the Enforcement of Securities Regulation	
Principle 8.	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	The CNBV conducts a comprehensive inspection program. Its staff conducts an annual review of all 29 registered securities firms. Securities inspections cover firm automated systems and back-office operations, financial operations and net capital computations, risk management systems, segregation of

	<p>client security holdings from firm proprietary positions and customer files and accounts and records of order executions. The 34 mutual funds operators (managing 425 funds) are also subjected to extensive inspections. Every fund manager receives an onsite inspection during the CNBV review of an application to be a fund. Subsequently there are annual audits, typically of half of the registered operators. The CNBV also performs audits of the <i>Bolsa</i>, the MexDer, INDEVAL and the various interdealer brokers, at least annually. A written report is prepared after all inspections and a Letter of Observation is sent detailing the inspection findings.</p>
	<p>Disciplinary fines are common for violations found during the audit.</p> <p>In 2001 the CNBV obtained the authority to register and inspect investment advisers. The CNBV will stop inspecting investment advisors in June 2006, since under the new Securities Market Law they will be only subject to a self-regulatory regime.</p> <p>The 2001 legal reforms greatly expanded the CNBV's ability to conduct investigations by empowering it to demand production of documents and testimony from firms subject to its regulation. The new Securities Market Law expanded this authority to encompass auditing firms, external auditors, attorneys, and others who may have violated Mexican securities laws. The CNBV was also given the authority to take action against corporate officers and Board members, including imposition of fines or suspensions for up to five years.</p> <p>CNBV inspections also cover firm's compliance with SHCP anti-money laundering rules.</p>
Assessment	Implemented.
Comments	The CNBV has a comprehensive inspection program and all firms, except independent investment advisers, are inspected at least once in two years. The AMAII inspection program for the largest independent advisory firms appears to be a suitable alternative to CNBV inspections.
Principle 9.	The regulator should have comprehensive enforcement powers.
Description	<p>The CNBV may impose fines, suspensions, and industry bars administratively. It may stop the issuance of securities and suspend trading in listed securities. When the 2005 legal reforms are effective, the CNBV will be able to investigate and take action against attorneys, auditing firms, external auditors, and corporate officers and directors responsible for violations by public companies.</p> <p>Individuals may be prosecuted criminally by referral to the General Attorney's Office (PGR). All criminal referrals must be submitted to the PGR through the Fiscal Attorney's Office in the SHCP.</p> <p>The CNBV cannot take action to enjoin ongoing violative conduct by public companies and it cannot order restitution to compensate defrauded investors.</p> <p>Any sanction imposed administratively by the CNBV may be challenged in court.</p>
Assessment	Implemented.
Comments	<p>The CNBV now possesses comprehensive enforcement powers and has demonstrated a willingness to utilize this authority. Since 2001, the CNBV states that it has expanded its enforcement program, consistent with its broader legal authority. To date, most of its enforcement actions have been based upon violations identified by its inspection program. Because there is a significant time lag between completion of an inspection and the final imposition of a sanction, it is difficult to measure the impact of this progress. For example, as of February 2006, no final sanctions were imposed based upon an investigation or inspection in 2005. However, in 2005 the CNBV commenced an action against a major public company, in conjunction with a related enforcement action by a foreign regulator in a country where the company was dually listed.</p> <p>The 2005 legal reforms also provided additional private rights of action for investors against companies and officers who violate the securities laws. Traditionally, private securities litigation in Mexico has been a rare event.</p>
Principle 10.	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance, and enforcement powers and implementation of an effective compliance program.

Description	<p>As described above, the CNBV conducts an active inspection program that is the primary source of enforcement actions. As previously stated, all securities firms and all mutual funds annually receive an onsite inspection. The surveillance programs of the <i>Bolsa</i> and the CNBV halt trading in securities when aberrant trading patterns appear or when the price of a stock moves 15 percent intra day. Net capital and proprietary portfolios must be reported to the CNBV on a regular basis and the CNBV has automated systems to review and confirm the firm's calculations. The 2001 legal reforms eliminated a prohibition on public disclosure of disciplinary actions, applicable to violations occurring after enactment of the law.</p> <p>All CNBV inspections result in a written report to the firm identifying any deficiencies. Firms may then provide a written response to the draft report challenging any findings or conclusions or recommended sanctions. Following submission of this response, a member of the legal office of the CNBV determines whether the sanction should be imposed.</p> <p>The CNBV actively monitors market activity and may summarily suspend trading in a security if a listed company fails to timely file disclosure reports or fails to issue public notice explaining events that have caused an abnormal trading pattern. All listed securities on the <i>Bolsa</i> halt trading if the market price moves 15 percent or more in one day.</p>
Assessment	Implemented.
Comments	<p>The 2001 assessment identified several limitations in the CNBV program. These included the CNBV's limited ability to subpoena or compel production of information, especially from persons not employed by a securities firm and its inability to bring enforcement actions against law violators not employed by a company subject to CNBV regulation. Other issues were also identified. The CNBV did not have the authority to order corrective action of ongoing misconduct by a company and could not obtain restitution for defrauded investors. It was prohibited from publicizing enforcement actions. Finally, as noted in Principle 4, its disciplinary process was opaque and provided limited protections to persons or entities charged with a violation.</p> <p>Several of these limitations have been addressed. As noted above, the CNBV may now demand testimony or documents from anyone, if necessary to conduct an investigation. It may now provide limited public notice of its actions. The CNBV may require securities firms and other regulated firms to correct deficiencies identified in an inspection. However, there are still limitations on its ability to obtain restitution for defrauded investors. There continues to be room for improvement in the due process protections in its disciplinary process.</p>
Principles for Cooperation in Regulation	
Principle 11.	The regulator should have authority to share both public and nonpublic information with domestic and foreign counterparts.
Description	<p>There have been significant changes in the legal authority of the CNBV to exchange information with other Mexican regulators and with foreign regulators. Article 25 of the 2001 legal reforms provided the CNBV authority to share with foreign regulators information concerning securities firm operations, if an Memorandum of Understanding (MOU) is in place¹¹ and the information is requested by foreign regulator for use in its supervisory functions. The new Securities Market Law has expanded CNBV authority. Article 192 requires regulated firms to provide the CNBV all information concerning services rendered. Article 358 authorizes CNBV to provide to other regulators any information it receives under its supervisory powers or that firms are required to provide to the CNBV or that the CNBV obtains from any party through its investigation powers.</p>
Assessment	Implemented.
Comments	<p>The 2001 and 2005 legal reforms substantially addressed the legal limitations on CNBV's ability to share information. It may now share information with a foreign regulator for any recognized regulatory function, including both investigation and licensing function.</p> <p>The CNBV has broad authority to obtain any information from regulated entities based on the legal</p>

¹¹ Based on the principle of reciprocity.

	framework and it may share that information with foreign regulators following the established provisions in the relevant MOUs.
Principle 12.	Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts.
Description	<p>Following passage of the 2001 legal reforms, Mexico applied for and, after an IOSCO peer review, became a signatory to the IOSCO Multilateral MOU. This entitles the CNBV to obtain information from other signatories and obligates Mexico to provide reciprocal assistance. The CNBV has established procedures for processing information sharing requests from foreign regulators that demonstrate an ability and willingness to provide reciprocal assistance.</p> <p>The CNBV regulates banks and financial services entities and its staff reports that substantial information is shared with other domestic regulators. Formal MOU's exist between the CNBV, the CNSF (insurance regulator), CONSAR (pension regulator), and the AML Intelligence unit in the SHCP. There is a separate MOU between the CNBV and the BOM.</p>
Assessment	Implemented.
Comments	CNBV staff indicated that information sharing with other Mexican regulators is improving.
Principle 13.	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	<p>As explained in principle 11, the CNBV may provide information to foreign regulators with whom it has an MOU or to foreign regulators that demonstrate an ability and willingness to provide reciprocal assistance. The information must be requested for a legitimate regulatory purpose.</p> <p>The CNBV may provide any information that it possesses or that it requests and obtains through its investigative functions when investigating a violation of Mexican law.</p> <p>The 2005 legal reforms now permit the CNBV to compel information from lawyers, auditing firms, and external auditors concerning disclosure by listed companies.</p>
Assessment	Implemented.
Comments	CNBV staff identified numerous tangible cases as examples of the effective use of its information-sharing authority. The staff also indicated that it frequently has provided information to foreign regulators performing licensing reviews.
Principles for Issuers	
Principle 14.	There should be full, accurate, and timely disclosure of financial results and other information that is material to investors' decisions.
Description	<p>CNBV regulations encompass a comprehensive issuer disclosure system, including requirements to file periodic reports, full prospectuses when securities are issued and timely disclosure of special events. All documents are filed electronically and are publicly available on EMISNET, an internet-based system operated by the <i>Bolsa</i>. Material event reports must be filed "promptly" and made public via Emisnet. These reports must be used for any company actions or related party transactions involving 10 percent of a company's assets or concerning 25 percent of a company's revenues. The CNBV can order the <i>Bolsa</i> to halt trading in a stock if filings are not made timely and the halt will continue until the filing is made or the company provides a satisfactory explanation for the delay or the failure to file.</p> <p>In March 2003 the CNBV issued the <i>Circular Única of Issuers</i>, a comprehensive codification, including updates and expansions of its secondary regulations on disclosure. For the first time, listed companies could refer to a single CNBV publication to identify all filing and disclosure requirements. Listed companies must provide CNBV with audited annual financial statements prepared in accordance with Mexican GAAP no later than three working days after approval by the annual general shareholders' meeting. Unaudited quarterly financial statement must be filed within 20 (for first, second, and third quarters) or 40 (for the last quarter) subsequent working days. Also, by June 30 of the following year, listed companies must provide an annual report in a CNBV-prescribed format to the securities regulator and to the Mexican Stock Exchange for communication to the public. This</p>

	<p>standardized report, which is published on the CNBV's website, generally provides more detailed information than the company's annual report.</p> <p>The 2001 assessment noted the limited disclosure of transactions by company executives and directors, consisting of a statement of holdings contained in the company annual report. While this requirement has not changed, due to personal privacy and security concerns, the CNBV has adopted a notification system for acquisitions as part of its tender offer rules. Purchasers of 10 percent or more of a company's stock must notify the CNBV and the <i>Bolsa</i> when this threshold is reached. If the purchaser intends to purchase 30 percent or more of the stock, this intention must be stated. Additional purchases of 5 percent or more must also be disclosed. The CNBV tender offer rules (now law) require acquisitions of 30 percent or more of a company's stock to be effectuated by a tender offer. Any partial tender offer must be for a minimum of 10 percent of the company stock, across all classes. The tender offer price must be the same, pro rata, for all classes of company stock.</p> <p>The CNBV states that it reviews all company annual reports, all material event reports and all prospectuses filed for the issuance of securities. CNBV staff explained that all prospectuses are viewed by both an accountant and a lawyer, to ensure adequate disclosure of all items contained on a CNBV checklist. An internal policy requires staff comments to be sent to the prospective issuer within eight days after filing. The CNBV has recently begun publishing these comments on its website.</p> <p>A significant component of the 2005 legal reforms is the creation of two new corporate vehicles, SAPI and SAPI B. A SAPI corporation is intended to be a quasi-public company, with virtually no listing or disclosure obligations and no obligation to adhere to the corporate governance or codification of Board duties required of listed companies. A SAPI corporation is permitted to issue securities of any kind to institutional investors and up to 100 qualified individual investors (defined as having approximately US\$450,000 of investable net worth and an annual income greater than approximately US\$150,000). These securities would be freely tradable among qualified investors.</p> <p>A SAPI B corporation is designed as a transitional status, providing a SAPI corporation with a three-year period to modify its structure and disclosure in order to become a fully listed company on the <i>Bolsa</i>. During the three-year transition the company would be permitted to have its securities listed and traded on the <i>Bolsa</i>. The law directs the CNBV to develop secondary regulations to cover company disclosure obligation during this period.</p> <p>The creation of a new debt instrument, the <i>certificado bursátil (CB)</i>, has had a positive impact on Mexican debt offerings, by corporations and subsovereign governments and state-owned entities. The CB provides a great deal of flexibility in the structure of the debt, and permits the use of credit enhancements, such as loan guarantee pools to be funded after issuance of the debt. The CNBV reviews all debt offerings by subsovereign governments and state-owned entities.</p>
Assessment	Implemented.
Comments	<p>The 2001 assessment highlighted the limited disclosure of officer and director transactions and the intention of the CNBV to draft and adopt tender offer rules, as permitted in the 2001 law.</p> <p>This assessment highlights the substantial progress made in both areas, although further progress in officer and director transactions would be beneficial. Comments from the private sector indicate that the CNBV prospectus review and comment process has improved significantly. These comments suggested that the improvement has been primarily in comments on the disclosure required by law, such as disclosure of risks, management operations, and related party transactions. It was suggested that the CNBV should undertake to increase its attention to review of financial statements and accounting issues. The creation of the SAPI and SAPI B vehicles is an interesting proposal to facilitate the creation of a new generation of public companies. At this time it is impossible to predict what will happen. However, under the 2005 law, the CNBV must develop disclosure rules for SAPI B corporations. CNBV staff indicated that they are currently planning to impose no disclosure obligations on a SAPI corporation and very limited disclosure obligations on a SAPI B corporation. This approach appears reasonable at this time. As these companies and the market for their securities evolve, the CNBV should carefully monitor whatever rules it adopts to ensure that they are sufficient for the developing market. In this regard, it may be beneficial for the CNBV to require each new SAPI corporation to file a brief summary document identifying the company, its control persons and the amount and type of securities issued, so that it has the ability to monitor the development of the</p>

	<p>market.</p> <p>If a robust secondary market develops in SAPI corporation securities, in the future it may be appropriate for the CNBV to consider disclosure requirements. The key is regulatory flexibility and careful observation of developments.</p> <p>If the CNBV is able to develop and adopt its secondary regulations in a timely manner, consistent with the June 2006 effective date, it will be an important demonstration to the financial services industry of the competency and responsiveness of the CNBV.</p>
Principle 15.	Holders of securities in a company should be treated in a fair and equitable manner.
Description	<p>The 2001 amendments to the LMV made fundamental changes in the responsibilities of listed companies that were designed to increase the rights of minority investors. The boards of listed companies were required to include at least 25 percent independent directors. An audit subcommittee of the board was required, to be composed of a majority of independent directors and chaired by an independent director. Companies were required to have a <i>comisario</i>, an internal reviewer and certifier of the external audit report.</p> <p>Shareholders controlling 10 percent of the company stock were given the right to appoint a second <i>comisario</i>. At each annual general meeting, the <i>comisario</i> was required to deliver a report on the accuracy, adequacy, and rationality of financial and other information presented to the board, including an opinion on whether the financial statements were prepared in accordance with Mexican accounting standards. While these persons were not required to be licensed accountants, in practice they were typically an accountant at the firm that performed the external auditor. Under Mexican law, they were subject to personal civil or criminal liability for failure to perform their duties, although enforcement was rare. Investors with 20 percent of a company stock were also authorized to bring a private lawsuit against a company for violation of Mexican law. Finally, the CNBV was given the authority to adopt a secondary regulation on tender offers.</p> <p>In December 2005 (effective June 2006) Congress approved the new Securities Market Law, expanding further the minority shareholder protections of the 2001 law. The CNBV secondary regulation on tender offer enacted in 2003 (described in principle 14) was codified into law. Audit committees are now required to be 100 percent independent directors. The law created the title of company <i>Director General</i> (comparable to an American CEO) and explicitly delineated the responsibilities of the CEO and the company Board. The CEO was made responsible for the company's books, records and accounting process and the Board, through the Audit Committee, was given responsibility for review of the external audit and the duties previously assigned to the <i>comisario</i>. This function was eliminated for publicly listed companies. Of great significance, the law created the concept of a single economic unit. The Board's responsibilities extended to any company subsidiary or affiliate that is part of a company single economic unit. The audit committee now has the power to require appearances by all company employees to discuss accounting and auditing questions, including employees of these subsidiaries.</p> <p>The 2005 law also, for the first time, specified that company board members and officers have fiduciary duties to the company and its shareholders, a duty of due care and a duty of loyalty. The law specified acts and circumstances that would violate these duties. For example, Board members are specifically prohibited under the law from the following: (1) Cannot authorize related party transactions without full disclosure and formal actions; (2) Cannot vote if a conflict of interest exists; (3) Must disclose any conflicts; (4) Cannot use privileged information; and (5) Cannot take advantage of company assets or corporate activities without authorization. Violation of these duties can be punished in civil litigation brought by the company or a minority shareholder owning 5 percent, a reduction from the 2001 law (although private derivative litigation in Mexico continues to be rare). The CNBV can bring an action under the law to suspend or bar an officer or a director for up to five years.</p>
Assessment	Implemented.
Comments	The requirement that any tender offer or for company shares pay the same price for all classes of securities, notwithstanding different voting rights or other material characteristics is a creative approach to solving a problem of long-standing. While to a foreigner it may seem unworkable to expect that control persons will accept the same tender price for shares with clearly differing economic valuations, CNBV officials believe that the process has been effective. This pattern should be carefully

	<p>monitored, as there exists a possibility that the requirement could become a statutory “poison pill” that effectively precludes most tender offers, by imposing too high a purchase price for voting and nonvoting shares.</p> <p>The protections for minority shareholders created in the 2001 amendments to the LMV and the 2005 New Securities Market Law dramatically change the legal protection of minority shareholders. These legal reforms have been supplemented by the commitment of the CNBV to promote and enforce these protections, as demonstrated by the enactment of the secondary regulation on tender offers in 2003 and the successful codification of this regulation into the 2005 law.</p> <p>However, the real test of the effectiveness of these reforms will ultimately rest with a company’s Board of Directors and a Board’s willingness to act in accordance with the spirit and the letter of its legal responsibilities. There is not a long tradition of Board independence in the corporate culture of Mexico and so it is important for the CNBV, the <i>Bolsa</i>, and other professional organizations to make a coordinated effort to educate and train independent directors in their new responsibilities and to promote a private system to identify candidates for these positions. It has been suggested that more than one university in Mexico is developing educational programs to train and educate candidates for board membership. This should be encouraged to the maximum extent possible.</p> <p>Finally the continuing issue of private litigation should be noted. The 2001 law was designed to make it easier for minority shareholders to enforce their legal rights. It appears to have had little impact because the ownership threshold was high. The 2005 law dramatically reduced that standard. However, it remains to be seen whether there will be a material change. This is noteworthy because the new law gives the CNBV some authority in the area but assigns the actual ability to obtain corporate redress to private shareholders. This aspect should also be monitored over time.</p>
Principle 16.	Accounting and auditing standards should be of a high and internationally acceptable quality.
Description	<p>In 2001 the <i>Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera</i> (CINIF) was established as an independent nonprofit Mexican accounting standard setter. It was directed to review and update Mexican GAAP to be consistent with IAS. CINIF is governed by an independent board composed of government officials and industry representatives. Since its creations, CINIF has succeeded in issuing comprehensive updated accounting standards, that industry officials describe as in conformance with IAS. CINIF standards are subject to CNBV review and acceptance and have been incorporated in disclosure requirements through the <i>Circular Única</i>.</p>
	<p>CINIF does not have responsibility for Mexican external auditor standards. The IMCP, the Mexican association of professional accountants retains this responsibility. The IMCP also has responsibility for an accounting code of conduct and for examination and certification of professional accountants in Mexico. The CINIF does not have disciplinary powers over accountants. The IMCP and the CINIF are funded by private industry.</p> <p>When the <i>circular única</i> was adopted in March 2003, the CNBV substantially augmented its existing standards on external auditor independence, including a prohibition on an audit firm receiving more than 10 percent of its revenue from one client, a list of nine activities incompatible with the position of external auditor, and compulsory signing-partner rotation every five years. Furthermore, the <i>Circular Única</i> requires the audit firms of registered external auditors to maintain a quality assurance program to ensure compliance with the CNBV’s regulations.</p> <p>As in other countries, the “Big Four” international firms dominate Mexican auditing, performing audits for approximately 80 percent of all companies listed on the <i>Bolsa</i>.</p> <p>The 2005 New Securities Market Law significantly altered the oversight of Mexican auditors. The Audit Committee of the Board must propose the external auditor for Board action and oversee the auditor’s activities. The audit committee must make a formal report to the Board annually on its oversight. This committee replaces the comisario function.</p> <p>The 2005 legal reform also expanded the authority of the CNBV to oversee auditors. The CNBV now has the authority to demand production of auditor work papers and to inspect and review auditor activities. If warranted the CNBV may take disciplinary action against auditors and accountants for company disclosure violations including fines and suspensions and bars up to five years.</p>

Assessment	Implemented.
Comments	<p>This principle is another example of the progress made since the 2001 assessment. That assessment noted that CINIF had just been created and would undertake a comprehensive review and updating of Mexican GAAP, using IAS as a model. CINIF has largely been successful in this effort. With regard to the inflation accounting standard, interviewees explained that IASB has agreed to consider adjustments to the current inflation standard through the development of a new IAS inflation standard that will be developed by Mexico and Argentina, the two countries where it has been used extensively.</p> <p>The next goal should be a comparable examination of Mexican auditing standards. The 2005 New Securities Market Law is likely to lead to fundamental changes in the scope, structure and oversight of external audits. For example, the creation of the legal concept of a single economic unit may require an expansion in the scope of an audit and the level of effort assigned to review of subsidiaries. The elimination of the comisario position increases the responsibility of the audit committee to review audit work and the likelihood that companies will expand internal control processes. Finally the ability of the CNBV to take action against auditors is likely to cause increased attention to internal audit process and documentation of efforts and decisions.</p>
Principles for Collective Investment Schemes	
Principle 17.	The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.
Description	<p>The new Mutual Funds Law issued in 2001 authorized the CNBV to register and regulate operators, distributors, and marketers of mutual funds, whether owned and operated by banks or securities firms. The CNBV relies upon an examination and certification process operated by AMIB, which has SRO status, for individuals selling mutual funds.</p> <p>Mutual fund operators are licensed by the CNBV in conjunction with the creation and registration of a mutual fund. The registration process of operators and distributors includes a background check and financial review of the control persons, and an on-site inspection of their offices.</p> <p>The CNBV examines all mutual fund groups annually. Currently there are 34 registered fund operators, including 23 affiliated with a holding company, bank or broker. There are also seven registered distributors.</p> <p>Ongoing operations are regulated through weekly portfolio holdings reports to the CNBV, annual inspections of all funds, operators and distributors and requirements for publication of holdings and net asset value. Funds are required to have annual audits. There are explicit limitations on the types of investments that funds may make. For example, equity funds may not short stocks or purchase derivatives. Independent price vendors and valuers are responsible for ensuring the accuracy of the net asset value of a fund.</p> <p>The CNBV has disciplinary authority to fine, suspend or bar funds, and fund operators. and distributors.</p>
Assessment	Implemented.
Comments	The 2001 assessment encouraged reconsideration of an expensive requirement to mail and obtain a signed receipt for the prospectuses to all investors. This requirement was eliminated. Under the new Law, those who market mutual funds are obliged to provide information to investors as to where they will be able to consult, analyze, and approve funds' prospectuses and their changes.
Principle 18.	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.

Description	<p>The 2001 Mutual Funds Law mandated structural changes in all mutual funds. Fund operators must be legal entities separated from banks or securities firms (although these entities may be the owners of the fund operator). The fund operator and the other service providers mentioned in the Law, are subject to oversight by a fund Board, with a minimum of a third of independent directors. The Board of a new fund is appointed by the fund operator if he/she participates as a shareholder. Otherwise, the Board is elected by the investors, and is responsible for reviewing all arrangements between the operator and the parent bank or broker, such as fees for distribution and sales, custodian or trading services. Mutual funds are required to use banks, securities firms, operators and distributors as custodians of fund shares, with the assets deposited in a segregated account at INDEVAL.</p> <p>In addition to periodic inspections by the CNBV, mutual funds must be audited annually.</p> <p>The 2001 Mutual Funds Law also enabled the CNBV to permit fund to charge different fees based upon size of investment which should be clearly disclosed in prospectuses, and to create funds of funds.</p>
Assessment	Implemented.
Comments	<p>The 2001 reforms created explicit separations of fund management functions from sales, custodian and trading functions. However, approximately half of all funds are owned subsidiaries of the firms providing these services and the Board that oversees the fees charged for these services are appointed by the fund operator.¹² Consideration should be given to the effectiveness of this structure in controlling mutual fund fees and expenses, since the Board members are all selected by the fund operator, which in turn may be a wholly-owned subsidiary of the bank or securities firm that is providing the contracted trading and marketing services.</p> <p>While there is a clear and explicit legal structure for mutual funds, it was reported that insurance companies are marketing as a mutual fund, an insurance-type product that does not comply with the requirements for a mutual fund. CNBV staff are working with the CNSF (insurance regulator) to resolve this problem.</p>
Principle 19.	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
Description	<p>All mutual funds must be sold through a prospectus, after review by the CNBV. CNBV regulations require extensive discussion of fund investment objectives in the prospectus. Based upon its investment policies, a fund is identified within one of a series of portfolio classifications established by the CNBV and this must be disclosed in the prospectus and in all periodic reports. This classification restricts a fund's portfolio allocations.</p> <p>Mutual funds are prohibited from engaging in repo transactions as a lender of securities, may not lend equity securities for longer than five days, may not engage in short selling, or invest in futures or derivatives.</p> <p>Additionally, funds in debt instruments must be rated by an independent rating agency and this rating must be disclosed to all investors in their monthly account statement and portfolio. The rating includes separate evaluations of the fund's credit rating and of the market risk of the fund portfolio. Also, the fund must publish in a newspaper a statement of its portfolio holdings. Weekly portfolio reports must be filed with the CNBV.</p>
Assessment	Implemented.

¹² Even though in new funds, as stated above, the fund operator can appoint the Board of Directors, being the fund's sole shareholder, its members should be elected by the investors themselves.

Comments	The CNBV regulatory system for mutual funds is a hybrid of disclosure and merit/ prudential limitations on the investment freedom of a fund operator. This greatly affects investment discretion and likely results in a diminution of competition between funds in the same category. Mutual funds have been attempting to obtain permission to invest in a wider array of investments, such as derivatives and REITS. A CNBV regulation providing this authority has been drafted and under review for an extended period of time. Approval for mutual funds to invest in derivatives is required from the BOM . The CNBV will shortly forward to the BOM a proposal of draft regulation.
Principle 20.	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p>The Mexican system requires the use of an independent price vendor to price portfolio holdings, with computation of net asset value (NAV) performed by a third party valuator (<i>valuador</i>). There are two established price vendors in Mexico, one of which is owned by the <i>Bolsa</i>.</p> <p>Redemption procedures must be disclosed in the fund prospectus. The prospectus must also disclose the circumstances under which suspension of redemption is permitted. CNBV approval is not required.</p> <p>The 2001 Mutual Funds Law authorized the CNBV to adopt secondary regulations on alternative price valuation methods. The CNBV has determined not to adopt a regulation and, instead rely upon the existing system.</p> <p>The CNBV does not have the authority to suspend or delay the redemption of fund shares.</p>
Assessment	Implemented.
Comments	<p>Staff at the CNBV and knowledgeable private sector professionals expressed confidence in the efficacy of the price vendor system. Both price vendors have established valuation procedures to use if a market price is not used. Informally, however, persons indicated that the vendors use their alternative valuation process infrequently, as its use creates a liability risk for the vendor.</p> <p>With the exception of a small number of equities and certain key government debt instruments, the Mexican debt and equity markets are illiquid and trading in specific issues may be very infrequent. For example, more than half of the equities listed on the <i>Bolsa</i> are traded through a special auction process because of the infrequency of trading and the tendency for wildly fluctuating pricing. Similarly, there are a large number of government, or government-affiliated lenders in the debt market and an increasing number of private debt issuers. In such a market, over reliance upon stale market prices may result in inaccurate portfolio valuations. If mutual funds are in the future permitted to invest in derivatives and structured products, these securities may also be difficult to price in a thinly-traded market.</p> <p>For these reasons, the CNBV should give careful consideration to the activities of the two price vendors, including a review of their activities. Based upon this review the CNBV will be better able to assess whether secondary regulations should be enacted to specify procedures for the use of alternative pricing and circumstances when it would be required.</p> <p>The CNBV should also consider whether to seek authority to suspend fund redemptions, in case of financial emergencies or in circumstances where it is temporarily not possible to accurately value fund shares.</p>
Principles for Market Intermediaries	
Principle 21.	Regulation should provide for minimum entry standards for market intermediaries.
Description	<p>The 2005 legal reforms transferred responsibility for securities firm licensing from the SHCP to the CNBV. There are 29 registered securities firms. Previously, the CNBV had consultative responsibility and the SHCP had final approval authority. CNBV review entails background checks of all principals for past securities related offenses, ethical qualifications and financial capacity. Principals must demonstrate their qualifications and market intermediaries must kept a file documenting those qualifications. The firm must satisfy initial minimum capital requirements and the CNBV must review their business plan. The CNBV conducts an onsite inspection of new firms during the first year. The application process is typically completed in three months.</p> <p>The 2005 reforms also transferred to the CNBV responsibility for revocation of firms and created a</p>

	<p>procedure for the CNBV to appoint a third party to take control of a firm that has a capital failure or default.</p>
	<p>The 2005 reforms also authorize the CNBV to license limited function brokers. The law identifies 25 permitted activities for a broker and the CNBV in approving a license may specify which of the 25 may be performed by a broker. The CNBV must draft regulations to implement this process.</p> <p>Associated persons also must pass an AMIB qualifications examination and apply via a prospective firm to the CNBV. This requirement extends to employees of banks and private pension funds who are engaged in the sale of securities. The AMIB exam includes a section on its industry code of ethics.</p> <p>Participants in the MexDer derivatives market are registered with the BOM and the SHCP. The CNBV may consult during the process.</p> <p>INDEVAL, the national clearing agency and depository, is open only to banks and securities firms. Mutual funds must maintain an account with a bank and trade through the account.</p>
Assessment	Implemented.
Comments	<p>The 2001 assessment identified that investment advisers were not subject to a registration and regulation requirement. This was corrected by the 2001 legal reforms. With the new Securities Market Law, AMAII becomes responsible for the establishment of rules in this regard and their supervision.</p> <p>Implementation of the new category of limited function securities firms requires adoption of secondary regulations by the CNBV.</p>
Principle 22.	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	<p>The CNBV by rule sets both initial and ongoing capital requirements for securities firms. These requirements are based upon firm use of acceptable, commercially available risk management software. Every firm must transmit electronically a daily report of its positions and a monthly capital report. The CNBV states that it routinely reviews these positions and if a firm's capital becomes an issue, it will instruct the firm to sell certain positions or increase capital contributions. The AMIB has the authority to fine members for failure to file a report or for filing an incorrect capital report. The CNBV also compares a firm's proprietary holdings with the positions held at INDEVAL and as part of its periodic inspections; CNBV staff examine firm reports and the system for generating the reports. In addition, under AMIB rules each firm must have a qualified risk management officer, who reports directly to the Board. Firms must have an annual external audit of its risk management program. Smaller firms are permitted to outsource the risk management calculation process, although the risk manager must be an employee resident in Mexico (even for international firms).</p> <p>Under the <i>Circular Única for Market Intermediaries</i>, securities firms should have an officer responsible for the Risk Management Unit. This officer should report to the Chief Executive Officer. The Risk Committee (compulsory) reports to the Board.</p> <p>Interdealer brokers must adhere to limited regulatory standards focused on system capacity rather than capital adequacy since they do not function as at risk principals in trading.</p> <p>The CNBV and the BOM have been working jointly, for an extended period of time, to develop rules to permit securities firms to offer margin credit to customers. The central bank will have responsibility to set margin rates and the CNBV will have authority to oversee and provide temporary exemptive relief as needed.</p> <p>As discussed previously, the CNBV now has the authority to appoint a third party manager of a securities firm that fails to comply with its capital requirements.</p>
Assessment	Implemented.

Comments	<p>The new limited purpose securities firms likely will be subject to different initial and ongoing capital standards, tied to the functions they will be licensed to perform.</p> <p>While AMIB requires member firms to have a risk management officer and a compliance officer, it does not administer a qualification exam for these functions.</p> <p>The CNBV staff is beginning to review capital adequacy on a consolidated basis for affiliated banks and brokers. This process should be formalized and include a review of firm risk management procedures.</p>
Principle 23.	<p>Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.</p>
Description	<p>The CNBV reviews the firm's management structure as part of the application process. It requires key duties to be segregated to avoid conflicts. All firms must segregate customer funds from firm proprietary accounts. Additionally, all firms have a compliance officer and must conduct an annual legal audit and submit it to the CNBV.</p> <p>If a firm fires an employee, it must inform AMIB, which keeps a registry containing, among other data, information regarding any offences. AMIB should inform the Commission accordingly.</p> <p>AMIB requires member firms to have compliance programs, headed by a compliance officer who reports directly to the firm Board of Directors. The compliance officer must have the authority to rescind or cancel a transaction and the power to recommend internal firm disciplinary action against a firm employee, if warranted. The CNBV reviews the firm's compliance program and procedures as part of its onsite inspections. This review also examines firm compliance with SHCP AML rules and a detailed review of a sample of customer accounts to assess the adequacy of firm recordkeeping and firm compliance with suitability standards, AML information and know your customer requirements.</p> <p>Customer funds must be segregated in a separate account at INDEVAL.</p>
Assessment	Implemented.
Comments	<p>The CNBV does not have the authority to require a firm to reimburse customers for legal violations. Another government agency, CONDUCCEF, has the authority to informally intervene to assist in resolving a dispute, but cannot formally resolve a dispute.</p> <p>While AMIB requires firms to have a risk management officer and a compliance officer, it does not have specific qualification standards or an exam for either function. Consideration should be given to development of formal qualifications and a qualifications exam for these essential functions.</p>
Principle 24.	<p>There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.</p>
Description	<p>The CNBV relies upon its procedures for monitoring capital adequacy to minimize the damage and loss to investors and to contain systemic risk. Each member firm must maintain a risk account at INDEVAL to cover failed transactions. If a firm has a significant risk of failure, it may be instructed to eliminate positions or increase capital. The CNBV has the authority to require firms to establish a recapitalization program to dispose of positions to regain adequate capital. Under the new Securities Market Law, the CNBV has increased powers to mandate corrective measures. These measures are meant to be preventive (before insolvency is reached).</p> <p>The 2005 legal reforms authorize the CNBV to appoint a third party administrator of a failed securities firm. The CNBV may select the administrator from a list of three persons submitted by AMIB. The administrator has full authority over the firm. If after nine months, the financial problems have not been resolved, the CNBV may revoke the firm's license.</p> <p>There is no comprehensive insurance for losses in customer brokerage accounts due to a securities firm's business failure (distinguished from guarantees against market risk). The CNBV believes this is unnecessary, given the segregation of customer and proprietary accounts for each firm at INDEVAL.</p> <p>Since 2001, INDEVAL has created a central counterparty (CCV), designated as a self-regulatory</p>

	<p>organization, for all equity transactions. It began operations in February 2004. Member firms are required to make a capital contribution into a central fund. If a member defaults and its capital contribution is insufficient to satisfy outstanding open positions, the CCV may use the common fund to close open positions. The CCV monitors firm open positions (over the three-day clearance cycle) hourly and compares it to a value at risk model based upon historical patterns of each firm's trading. If a firm exceeds its trading limit, it is notified and given 30 minutes to satisfy the capital call. If a firm fails to satisfy the call, the CCV notifies all other member firms that the CCV will decline to act as the contra-party for trades with the defaulting firm. According to CCV staff, this has happened only eight times in two years.</p> <p>There is not a central counterparty for government debt transactions, which is the dominant component of the Mexican markets.</p>
Assessment	Implemented.
Comments	<p>Since the 2001 assessment, Mexico has made two fundamental changes; providing the CNBV with the clear authority to intervene if a firm fails and the creation of a central counterparty for equity trading. However, equity trading is a very small component of the Mexican markets. Government debt is the dominant activity. It may be appropriate to conduct a cost-benefit analysis to determine whether the debt market would benefit from creation of a central counterparty. This is likely beyond the control of the CNBV because the BOM is the primary regulator of the government debt market.</p>
Principles for the Secondary Market	
Principle 25.	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	<p>The three key markets in Mexico are the <i>Bolsa</i>, equity, the MexDer, derivatives/futures and the OTC debt market. The operations of these markets is described in detail in the introductory materials.</p> <p>The <i>Bolsa</i> is a member-owned for profit corporation, authorized by Mexican law as a self-regulatory organization. The <i>Bolsa</i> is the controlling shareholder of the MexDer. Also, it owns one of the two price vendors in Mexico, owns one of the two interdealer brokers in the government debt market (SIF) and owns and operates EMISNET, the electronic dissemination service used by public companies. The <i>Bolsa</i> is directly supervised by the CNBV, which surveys its market, must approve its operating rules and conducts periodic onsite inspections.</p> <p>The <i>Bolsa</i> operates as a fully electronic market, with no market maker or specialist function. Member firms must give priority to customer orders and normal orders must be exposed within five minutes of receipt. There is full public disclosure of the best bid and ask quotations, but the depth of book is disclosed only to member firms. Trading activity on the <i>Bolsa</i> is limited. There are 132 listed companies and 155 equity securities listed. The largest Mexican companies jointly list overseas, typically the US, and the majority of trading in these stocks occurs off the <i>Bolsa</i>. Of the remaining listings, approximately one third trade infrequently and the <i>Bolsa</i> has developed a special "continuous auction" method to improve the quality of execution in these securities. Any order for these designated stocks must be exposed for price improvement for approximately 60 minutes before execution. This process was developed to reduce the frequency of trading halts caused by intraday price changes of 15 percent or more.</p> <p>A major component of daily trading on the <i>Bolsa</i> involves automated arbitrage in dually listed securities between the <i>Bolsa</i> price and the foreign market price. This automated trading (likely by a single foreign hedge fund) has caused a substantial spike in order traffic on the <i>Bolsa</i>, that required the <i>Bolsa</i> to substantially expand its computer capacity in 2005. Because the majority of these orders are cancelled within seconds of submission (due to the evaporation of the arbitrage opportunity), there has not been a significant impact on daily trading volume. The <i>Bolsa</i> estimates that it now has the capacity to efficiently handle spikes in trading of ten times recent peak periods.</p> <p>All equity trading on the <i>Bolsa</i> is cleared and settled on a T+2 cycle via INDEVAL and its subsidiary, the CCV. This is discussed below in Principle 30.</p> <p>In 2003 the <i>Bolsa</i> created the Global Mercado, a market for trading approximately 200 foreign equities (including some ETF's). Investors may submit an order for one of these securities to a broker, who can</p>

	<p>complete the trade by purchasing the requested securities on an international market and completing the trade on the Global Mercado. Such orders must be exposed to other traders for 20 seconds prior to execution. If a superior offer is made, that firm is entitled to 20 percent of the order. Clearance and settlement of the trade occurs through INDEVAL which maintains an omnibus depository account with Deutsche Bank. INDEVAL estimates that the account has securities worth approximately US\$2 billion. Daily volume on the Global Mercado accounts for 10-30 percent of total <i>Bolsa</i> trading. While this trading likely entails higher transaction costs than a direct trade on a foreign market, it has become popular because of significant tax incentives. Trading on the Global Mercado is exempt from capital gains taxation and dividends on Global Mercado securities are subject to only a 10 percent income tax.</p> <p>The <i>Bolsa</i>'s SRO functions are limited to review of initial listings, performed concurrently with the CNBV review of the prospectus, and a very limited form of trading surveillance. The <i>Bolsa</i> will suspend trading in a security if its price moves 15 percent in one day. A request for information will be made to the issuer and trading will resume only when the company has disclosed any material information or issued a statement indicating that there is no material information to be disclosed. The <i>Bolsa</i> will conduct a limited auction to establish an opening price when trading is resumed. Any further investigation is made by the CNBV.</p> <p>The MexDer, the sole futures market, is licensed by the SHCP in consultation with the CNBV and the BOM. All three agencies are involved in oversight of the MexDer and the review and approval of its operations, including the approval of new products. As noted, the <i>Bolsa</i> is the controlling shareholder in MexDer and its clearing and settlement subsidiary, ASIGNA. The market has grown substantially since 2001, although its daily trading is heavily concentrated in a single product. Its interest rate futures contract accounts for approximately 90 percent of total daily volume. There are 20 nonclearing members and four clearing members. Its four full members (legally created trusts, each owned by a major bank) dominate daily trading. For example, in June 2005, one of the four clearing members temporarily decided to trade in a foreign market and caused a 50 percent drop in daily trading volume. Foreign investors are also significant participants. A recently approved rule permits foreign securities firms to trade through an omnibus account at one of the four clearing trusts, without formal registration in Mexico (although the SHCP must be notified and could veto a firm). While private pension funds (AFOREs and SEIFOREs) are permitted to do limited investing in derivatives (consistent with fixed leverage limits set by the BOM), mutual funds are prohibited.</p> <p>MexDer utilizes international standard commercial software (provided by the U.S. OCC) to monitor trading activity and firm risk exposures. Trading margins range from 5-10 percent and firms have one hour to satisfy an intraday margin call. Clearance and settlement through ASIGNA, the central counterparty, occurs on a T+1 cycle. While settlement may be through physical delivery, cash settlement is the norm.</p> <p>The government debt market is the dominant market in Mexico, representing more than 90 percent of daily activity. Approximately 60 percent of this activity occurs via repo transactions. As with most government debt markets, it is subject to limited direct government oversight, primarily by the BOM, and transparency is largely limited to the active participants in the interdealer market which operates through two interdealer brokers, SIF (owned by the <i>Bolsa</i>) and Reuters, which are licensed as interdealer brokers. Quotations are available to participant banks and through banks to significant customers. Bloomberg and other private vendors provides real-time information on liquid issues. Daily transaction reporting is made by banks to the BOM, which publishes aggregate volume information on a next day basis.</p> <p>All debt transactions, except one- or two-day repos, are cleared and settled through INDEVAL.</p>
Assessment	Implemented.
Comments	<p>The equity market in Mexico is still a very small component of the financial markets. The Global Mercado and the 2005 law's creation of the SAPI B corporate vehicle represent creative attempts to increase its vitality. While it is impossible to know whether the SAPI B corporate vehicle will be a successful device to increase the number of listed companies (the law does not become effective until June 2006), it is possible to make some preliminary observations on the Global Mercado. It appears to have succeeded in increasing significantly daily trading volume on the <i>Bolsa</i> and apparently has made international investing easier for Mexican citizens. However this volume is really foreign trading</p>

	<p>activity that is reported and cleared through the <i>Bolsa</i>; somewhat akin to the <i>Bolsa</i> acting as a portal to a foreign market. Furthermore tax subsidies appear to be the motivating force. The costs and benefits of this approach should be carefully evaluated.</p> <p>There may be other methods to improve trading volume and liquidity on the <i>Bolsa</i>, such as permitting brokers to offer margin accounts and encouraging firms (and permitting institutions) to lend securities, to facilitate short selling; a significant component of market depth in most markets.</p> <p>Similarly, the MexDer has grown substantially since 2001, but it is still a limited part of the market and the concentration of activity in the four clearing members may warrant careful surveillance of trading patterns.</p>
Principle 26.	There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	In addition to periodic inspections and review of all rule amendments by the <i>Bolsa</i> , the CNBV conducts its own real time market surveillance. While the <i>Bolsa</i> may suspend trading, all other enforcement or disciplinary investigations or actions must be taken by the CNBV. MexDer rules are subject to joint review and approval by the SHCP, the BOM and the CNBV. The MexDer does not have enforcement powers.
Assessment	Implemented.
Comments	The regulatory approval process for MexDer, requiring consideration and consultation by three government agencies is cumbersome. It has significantly delayed the ability of the MexDer to create and offer new derivative products, impeding its ability to compete with foreign markets.
Principle 27.	Regulation should promote transparency of trading.
Description	<p>The 2001 assessment noted that brokers had 20 minutes in which to submit an order to the <i>Bolsa</i> and recommended a shorter time frame. Since then the <i>Bolsa</i> reduced this time limit to five minutes.¹³ The <i>Bolsa</i> provides real time best bid and offer and size information and last trade reporting information. An automated central limit order book (CLOB) is available to member firms but not to other investors (unless provided informally by a member firm).</p> <p>The Global Mercado rules requires a 20-second exposure period and allocates only 5 percent of order share to superior prices.</p> <p>As discussed in principle 25, there is limited transparency in the debt market for the less liquid government debt issues and corporate debt issues.</p>
Assessment	Implemented.
Comments	<p>The 20 second exposure period on the Global Mercado makes it difficult for competing offers to improve prices and thus to develop true trading competition. Even if a superior offer is made in the 20-second period, it only results in an allocation of 5 percent of the order. If the goal is to develop a genuinely domestic market in international securities, as opposed to an order reporting and settlement process, these rules should be re-examined.</p> <p>A more significant issue that should be addressed is the transparency in the debt market. While this is not significant for the bulk of trading, in highly liquid government issues, it may create problems for less liquid government issues, from subsovereign issuers, and for the increasing number of corporate issues. The lack of multiple quotes and the limited availability of quotes to nondealers combined with the lack of real-time, or quasi-real-time reporting of trades may contribute to market inefficiency, wide spreads and possibly excessive mark-ups. It may also have an impact on the ability of price vendors to accurately price mutual fund and pension portfolios.</p>
Principle 28.	Regulation should be designed to detect and deter manipulation and other unfair trading practices.

¹³ This time limit was established in the *Circular Única for Market Intermediaries* in 2004.

Description	<p>The <i>Bolsa</i> market surveillance program examines all unusual trading patterns or intra day price swings of 15 percent. Any company explanations must be posted on EMISNET, the electronic disclosure system. However, the <i>Bolsa</i> can only request disclosure by the issuer or refer the matter to the CNBV. The <i>Bolsa</i>'s staff may not make information requests from member firms or customers.</p> <p>The CNBV now has sufficient authority to investigate any suspicious trading activity, including the ability to compel testimony and obtain trading records. The 2001 legal reforms defined and clarified illegal market manipulation and provided criminal sanctions for violations. The 2005 legal reforms clarified the definition of insider trading and its applicability to corporate officers and directors and persons receiving information from these persons.</p> <p>CNBV secondary regulations require purchasers of 10 percent of a company's stock to publicly disclose the acquisition and whether they intend to make a tender offer for additional shares.</p> <p>The <i>Bolsa</i> developed its continuous auction process to improve market efficiency and restrict opportunities for deceptive trading practices. The substantial reduction in trading halts due to 155 price movements suggests that it has been effective.</p> <p>The CNBV has market surveillance authority over both the <i>Bolsa</i> and the MexDer and monitors trading using commercial data bases that identify unusual trading activity.</p> <p>All government debt transactions must be reported to the BOM on a same day basis.</p>
Assessment	Implemented.
Comments	Each of the Mexican markets exhibits characteristics that could make them susceptible to improper trading activity. The equity market is illiquid, with some stocks not trading for weeks. The debt market suffers from illiquid trading in some issues and little transparency. The MexDer is dominated by four members. For these reasons, market surveillance and oversight by the CNBV should continue to be a priority.
Principle 29.	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	<p>In order to cover large exposure and default risk, positions of intermediaries are limited by means of a series of prudential ratios set by regulation. The CNBV has prescribed, in cooperation with the <i>Bolsa</i> and INDEVAL certain market default and unwind procedures, as well as rules to halt trading. Clearance and Settlement processes meet the DVP condition. Failure to deliver money or securities in a trade by T+2 results in significant penalties. The CCV conducts intraday monitoring of firm concentrations and open positions and requires collateral deficiencies to be satisfied within thirty minutes. The Risk Analysis committee of INDEVAL meets every two months to review and adjust its VAR model. A system stress test is conducted monthly.</p> <p>As discussed in principle 28, CNBV secondary regulations require disclosure of purchases of 10 percent or more of a security, with updates if additional shares are purchased.</p> <p>In the case of derivatives, MexDer operates a surveillance system and consolidates exposures in cash and derivatives and monitors large exposures, and default risk. MexDer's derivative standards and rules meet international standards. To cover large exposures MexDer imposes open interest limits for market participants. If these limits are exceeded, Asigna (the trade guaranty fund) can close out the positions of the violating party. Asigna maintains strict control over client margins and capital is tiered. Intraday margin calls must be satisfied within one hour.</p>
Assessment	Implemented.
Comments	
Principle 30.	Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.
Description	<p>INDEVAL, and its subsidiary, the CCV, are both SROs, with rules subject to CNBV review. CNBV conducts onsite examinations of INDEVAL and the CCV twice yearly.</p> <p>The CCV for equities began operation in Feb 2004. It conducts hourly dynamic monitoring of</p>

	<p>collateral, based upon three-day open positions covering a 500 day moving average. Clearing firms that receive a collateral call have 30 minutes to satisfy. If a collateral call is not satisfied, the CCV will decline to act as a central counterparty for that firm until the collateral shortfall is satisfied. INDEVAL states that this problem has only occurred eight times in two years. INDEVAL also indicated that it performs monthly stress testing of its processing systems.</p> <p>INDEVAL is in the process of a substantial upgrade of its automated systems for clearance and settlement. It anticipates implementing straight through processing in late 2006. INDEVAL is also operating a securities lending system, through which participating firms may borrow or loan equity securities. Only two Mexican firms are actively lending equity through the system. INDEVAL speculates that this may be due to other firms lacking internal systems for managing stock loans.</p> <p>INDEVAL states that it has a .5 percent failure rate on settlements, largely through settlement delivery imbalance with foreign T+3 systems.</p> <p>In Mexico government debt repo transactions comprise a dominant segment of daily trading activity (estimated at more than 60 percent of the government debt market activity). Repos of three days or longer are cleared and settled through INDEVAL, as any other debt transaction. Repos of one or two days are settled bilaterally between the parties without full clearance of the underlying asset, unless the transaction is between the central bank and a member bank. INDEVAL has a special procedure for processing these largely overnight transactions, during a special one hour process after the close of the market.</p> <p>INDEVAL also clears and settles equity trades in foreign equity traded on the <i>Bolsa's</i> Global Mercado. INDEVAL maintains a special custody account for these instruments via Deutsche Bank in the U.S. Global Mercado trading comprises 10-30 percent of equity trading on the <i>Bolsa</i> daily. These trades, requiring foreign delivery of equities are the largest component of settlement failures due to incompatible T+2 (MEXICO) and T+3 (U.S.) cycles.</p> <p>ASIGNA is the wholly-owned central counterparty clearance system for MexDer. Four member firms (the largest futures brokers on MexDer) each are clearing members. They operate through legally independent trusts. MexDer sets minimum margin levels for each category of contracts (typically between 5-9 percent) and each clearing member must pledge collateral valued at 750 million pesos. ASIGNA relies upon an OCC-licensed risk management software product (TIMS) to manage settlement default risk. Clearing firms must maintain intraday margin of at least 75 percent of daily collateral (calculated on the basis of a firm's historical highest daily trading loss), with one hour to satisfy any margin call. Futures transactions clear T+1, primarily in cash settlement.</p>
Assessment	Implemented.
Comments	<p>As recommended in the 2001 assessment, the 2001 legal reforms established novation as a legal principle facilitating creation of a central counterparty for the equity market and making possible fundamental changes in the repo market.</p> <p>As a result clearance and settlement of transactions processed through INDEVAL appears to be sound. However, there is one segment of the repo market that is not processed via INDEVAL. These are one- or two-day repos between participating firms or between a firm and the firm's customer. These transactions are processed bilaterally between the participants and nonstandard agreements may be used. Underlying collateral held at INDEVAL is not transferred between the member accounts or between the firm account and its customer asset account. Consideration should be given to addressing this remaining gap.</p> <p>As discussed previously, consideration should be given to whether it would be prudent and cost-beneficial to create a central counterparty for the debt market.</p>

Table 2. Summary Implementation of the IOSCO Objectives and Principles of Securities Regulation

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Implemented	27	.
Broadly implemented	3	2, 3, 4
Partly implemented		
Nonimplemented		
Not applicable		

IV. RECOMMENDED ACTIONS AND AUTHORITIES' RESPONSE TO THE ASSESSMENT

Recommended actions

Table 3. Recommended Plan of Actions to Improve Implementation of the IOSCO Objectives and Principles of Securities Regulation

Reference Principle	Recommended Action
Principles Relating to the Regulator (P 1–5)	The independence of the CNBV and its credibility and effectiveness as a regulatory body would be enhanced by budgetary independence and the creation of fixed-term appointments for its Board members. Reduction in the number of areas requiring formal consultation with other governmental entities would also be beneficial. Additional transparency and due process protection in the CNBV disciplinary process would be beneficial.
Principles of Self-Regulation (P 6–7)	The multiplicity of governmental agencies involved in the oversight of SROs has impeded the futures market's ability to innovate and expand.
Principles for the Enforcement of Securities Regulation (P 8–10)	The CNBV should continue to develop its enforcement program and utilize the enhanced powers that it has received. These powers still do not include the ability to require persons or entities to reimburse persons who suffered losses from violations. The CNBV should utilize its authority to publicize its activities to inform the investing public and educate regulated persons about conduct that is improper.
Principles for Cooperation in Regulation (P 11–13)	One limitation still exists on the ability of the CNBV to assist foreign regulators. The CNBV cannot obtain information on behalf of a foreign regulator if it does not pertain to conduct that would be a violation of Mexican law. The CNBV should continue its efforts to promote information sharing among Mexican financial regulators.

Reference Principle	Recommended Action
Principles for Issuers (P 14–16)	<p>The CNBV should continue its efforts to emphasize analysis of financial statements and accounting issues in its disclosure review program. It would be beneficial to enact secondary regulations to implement the SAPI corporation and SAPI B corporation provisions of the 2005 reform law in time for the laws effective date of June 2006.</p> <p>The impact of the tender offer restrictions on share price should be monitored to ensure that it doesn't unintentionally become a statutory poison pill preventing successful tender offers in the marketplace.</p> <p>The CNBV should become a catalyst to assist the private sector in identifying and properly training independent directors and educating them on their responsibilities under the 2005 reforms.</p> <p>Mexican auditing standards should be examined, and if needed, updated to conform to international standards and to reflect the fundamental changes in auditing responsibilities contained in the 2005 reform law.</p>
Principles for Collective Investment Schemes (P 17–20)	<p>The CNBV should continue its trend toward disclosure regulation of mutual funds by re-examining the need for its system of categorizing mutual funds and restricting a fund manager's investment strategies. Secondary regulations to enable mutual funds to invest in derivatives should be finalized and restrictions on stock lending, short selling and repo transactions should be eliminated.</p> <p>The reliance on price valuers makes the effectiveness of the two valuers pivotal to pricing and industry integrity. Their operations should be carefully reviewed to determine whether a secondary regulation is needed on alternative pricing methodology and the occasions when it should be used.</p> <p>The CNBV should complete its efforts to resolve with the insurance regulator the problem of insurance companies' marketing insurance products that are inaccurately described as mutual funds.</p>
Principles for Market Intermediaries (P 21–24)	<p>The CNBV should complete its secondary regulation on licensing of limited function securities firms. AMIB should be encouraged to develop tests for certification of compliance and risk management officers at firms. The CNBV should continue its efforts to monitor risk management on a consolidated basis.</p>
Principles for the Secondary Market (P 25–30)	<p>The futures market would benefit from a streamlined oversight system that does not unduly delay its ability to develop and offer new products.</p> <p>The goals and objectives of the Global Mercado should be examined, in conjunction with the costs resulting from higher transaction costs and lost tax revenue.</p> <p>An effort should be made to improve price transparency in the debt market, by expanded access to quotations and timely access to last sale reporting information on thinly traded debt issues.</p> <p>The uncertainties arising from one and two day repo transactions should be resolved.</p>

Authorities' response

43. The authorities noted that the assessment of compliance with the IOSCO Objectives and Principles for Securities Regulation provides an adequate evaluation of the implementation by the National Banking and Securities Commission (CNBV) of the Principles. They were confident that the New Securities Market law will constitute a very sound framework upon which we will continue our efforts towards the development of the securities markets.

44. As in the case of banking, the authorities considered that the broad challenge ahead remains the achievement of an autonomous status for the CNBV. Although a significant reallocation of powers among financial authorities has already taken place in the securities field, the CNBV emphasized that it must maintain its efforts in bringing proposals to the legislative branch that will ensure an independent supervisor in accordance with international best practices.