



Asia-Pacific  
Economic Cooperation

**Training Program to Promote Economic Competition in APEC  
Economies  
Competition and Regulation in Regulated Sectors**

Proceedings of four seminars

May 30-31, 2002; October 19-20, 2002; September 11-12, 2003; November 17-18, 2003

**Part IV: Financial Services Seminar Papers**

**Competition Policy and Deregulation Group  
Committee on Trade and Investment  
March 2004**

Prepared for:





APEC Secretariat

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## Training Program to Promote Economic Competition in APEC Economies

### Regulation and Competition in Regulated Sectors

Sponsored by the Asia

Organized by the Mexican Federal Competition Commission

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In 2001, Mexico submitted to the APEC Competition Policy and Deregulation Group a short-term training course to be developed during 2002 and 2003. The project entitled "Training Program to Promote Economic Competition in APEC economies", focused mainly on regulated sectors and complemented existing projects dealing with competition and regulation issues that were successful in building capacity among member economies while providing general guidelines. The project comprised four seminars on specific sectors: energy, transport, telecommunications and financial services.

The purpose of these seminars was to exchange experiences and best regulatory practices in enforcing regulation and competition policies, as well as promoting knowledge and implementation of the 1999 APEC *Principles for Improving Competition and Regulatory Reform* among its member economies. The seminars counted with the participation of high level and experienced speakers in these matters, and were addressed to officials from regulatory bodies and other offices of the Federal Government, legislators, entrepreneurs, advisors, and academics that participate in these sectors.

The first of these seminars focused on the **Energy** sector, and was jointly organized by the Mexico's Federal Competition Commission (CFC or the Commission) and the **Mexico's Energy Regulatory Commission**. It was held on the 30th and 31st of May 2002, at the Fiesta Americana Grand Chapultepec Hotel in Mexico City.

Subsequently, the Commission organized, in coordination with the **Ministry of Communications and Transport**, the Seminar on **Transport**. It was held on the 19th and 20th of October 2002, at the Camino Real Hotel in Mexico City.

The CFC organized the Seminar on **Telecommunications**, which was held on the 11th and 12th of September 2003, at the Sol-Meliá Hotel in Mexico City.

Finally, the Commission organized a Seminar on **Financial Services**, held on the 17th and 18th of November 2003, at the Fiesta Americana Grand Chapultepec Hotel in Mexico City.

This page contains the programs and documents presented at these seminars.

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COMISION FEDERAL DE COMPETENCIA  
MEXICO



Asia-Pacific  
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## Financial Services

### Regulation and Competition in Financial Services

[Home](#)  
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Financial Services

Fiesta Americana  
Grand Chapultepec Hotel  
Mexico City

November 17th and 18th, 2003

Sessions in this seminar were divided into six. The first two covered characteristics common to the whole sector, as well as regulation and competition issues shared by each of the four relevant sub-sectors in Mexico, such as: the existence of important asymmetries in information, potential synergies that have resulted from exchanging information among agents, the expansion of financial networks and complementary facilities, as well as challenges faced by the sector and competition regulators. The remaining four sessions discussed more specific issues for four sub-sectors: Afore (pension funds administrators), insurance, exchange markets, and banking.

Monday, November 17th

### Competition and Regulation of the Financial Sector

	Speaker	Topic
9:20 – 9:40	<b><u>Moises Schwartz Rosenthal</u></b> General Coordinator of Advisers Ministry of Finance and Public Credit MEXICO	<a href="#">Challenges of Regulating a Dynamical Sector</a>
9:40 – 10:00	<b><u>Oscar Levin Coppel</u></b> President National Commission for the Protection and Defense of Financial Services Users MEXICO	<a href="#">The Importance of Information and Confidentiality for the Financial Services User</a>
10:00 – 10:20	<b><u>Fernando Sanchez Ugarte</u></b> President Federal Competition Commission MEXICO	<a href="#">Competition Policy in Financial Services</a>
10:20 – 10:40	<b><u>Peter J. Wallison</u></b> Resident Fellow, Co-director of AEI's Financial Deregulation Project American Enterprise Institute	<a href="#">Policy Changes and Events Affecting the Financial Services Sector in the United States</a>

## Competition and Regulation in the Financial Sector (cont.)

	Speaker	Topic
11:40 – 12:00	<p><b><u>Adalberto Garcia Rocha</u></b> Commissioner Federal Competition Commission MEXICO</p>	<p><a href="#">Competition in the Financial Sector</a></p>
12:00 – 12:20	<p><b><u>Rafael del Villar Alrich</u></b> Research Economist Central Bank of Mexico MEXICO</p>	<p><a href="#">Financial Service Information Available to the Public for the Best Operation of the Markets</a></p>
12:20 – 12:40	<p><b><u>Carlos Arce Macias</u></b> Head Federal Regulatory Improvement Commission MEXICO</p>	<p><a href="#">The Federal Program for Regulatory Improvement and the Financial Sector</a></p>
12:40 – 13:00	<p><b><u>Alejandro Gutierrez Gutierrez</u></b> Senator Mexican Senate MEXICO</p>	<p><a href="#">Regulatory Reforms in the Financial Sector: Challenges and Perspectives</a></p>

## Competition and Regulation in Pension Funds Management

	Speaker	Topic
15:40 – 16:00	<p><b><u>Mario Gabriel Budebo</u></b> President National Commission of the System of Savings for Retirement MEXICO</p>	<p><a href="#">The Pension System of Workers Affiliated with the IMSS</a></p>
16:00 – 16:20	<p><b><u>Javier Beristain Iturbide</u></b> General Director Afore Siglo XXI MEXICO</p>	<p><a href="#">Pension System Contribution to Financial Markets Efficiency</a></p>
16:20 – 16:40	<p><b><u>Guillermo Larrain Rios</u></b> Superintendent Superintendence of Pension Fund</p>	<p><a href="#">Competition in the Chilean Pension System</a></p>

	Administrators CHILE	
16:40 – 17:00	<b>Jorge Melendez Barron</b> Secretary General Interamerican Conference on Social Security MEXICO	<a href="#">Afores' Industry: Analysis of its Structure and Recommendations on Competition and Regulation Policy</a>

Tuesday, November 18th

## Competition and Regulation in the Insurance Markets

	Speaker	Topic
9:00 - 9:20	<b>Manuel Calderon de las Heras</b> Vice-President of Institutional Operations National Commission for Insurance and Securities MEXICO	<a href="#">Regulation in Insurance Markets. Basic Principles and International Standards</a>
9:20 – 9:40	<b>Jose Antonio Gonzalez Anaya</b> General Director of Securities and Insurance Ministry of Finance and Public Credit MEXICO	<a href="#">Competition and Regulation in the Insurance Market</a>
9:40 – 10:00	<b>Juan Ignacio Gil Anton</b> Member of the Board Grupo Nacional Provincial (GNP) MEXICO	<a href="#">Regulation and Information in the Insurance Sector</a>
10:00 – 10:20	<b>Oswaldo Macias Muñoz</b> Intendent Securities and Insurance Superintendence CHILE	<a href="#">The Chilean Experience in The Insurance Market</a>

## Competition and Regulation in Exchange Markets

	Speaker	Topic
11:20 – 11:40	<b>Guillermo Prieto Treviño</b> President Mexican Stock Exchange MEXICO	<a href="#">Strategic Map of the Stock Exchange: Outlook from the Perspective of the Mexican Stock Exchange</a>
11:40 – 12:00	<b>Jorge Familiar Calderon</b> Vice-President of Exchange Supervision National Banking and Exchange Commission	<a href="#">Regulation in Exchange Markets</a>

	MEXICO	
12:00 – 12:20	<p><b><u>Lorenza Martinez Trigueros</u></b></p> <p>Research Economist Central Bank of Mexico</p> <p>MEXICO</p>	<a href="#">The Stock Market: Progress and Challenges</a>
12:20 – 12:40	<p><b><u>Keith Waehrer</u></b></p> <p>Economist Antitrust Division U.S. Department of Justice</p> <p>USA</p>	<a href="#">Changing Market Institutions and the Role of Competition Authorities</a>

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## Competition and Regulation in the Banking Sector

	Speaker	Topic
15:00 – 15:20	<p><b><u>Pascual Garcia Alba Iduñate</u></b></p> <p>Commissioner Federal Competition Commission</p> <p>MEXICO</p>	<a href="#">Mexico's Experience with Banking Regulation and Competition</a>
15:20 – 15:40	<p><b><u>Carlos Isoard y Viesca</u></b></p> <p>Member of the Board of Governors Institute for the Protection of Bank Savings</p> <p>MEXICO</p>	<a href="#">Sector Regulation and Protection of the Bank Saver</a>
15:40 – 16:00	<p><b><u>Chenyng Zhang</u></b></p> <p>Professor School of Law, Tsinghua University</p> <p>PEOPLE'S REPUBLIC OF CHINA</p>	<a href="#">Competition in the Banking Sector: The Chinese Experience</a>

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	Speaker	Topic
16:40 – 17:00	<p><b><u>Alberto Gomez Alcala</u></b></p> <p>Director Economic Studies Banamex</p> <p>MEXICO</p>	<a href="#">Banking Sector Competition and Regulation</a>
17:00 – 17:20	<p><b><u>Manuel Sanchez Gonzalez</u></b></p> <p>Corporate Director of Economic Studies BBVA-Bancomer Financial Group</p> <p>MEXICO</p>	<a href="#">Banking Competition and Regulation: BBVA-Bancomer Experience</a>

## Closing Remarks

Francisco Gil Diaz

Minister

Ministry of Finance and Public Credit

MEXICO

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## Attendees Contributions

Attendee	Topic
Ivan H. Reategui Palomino Analyst, Department of Competition in the Insurance Sector Superintendence of Banking and Insurance PERU	<a href="#">Financial Services and Competition in Peru</a>



# CHALLENGES OF REGULATING A DYNAMICAL SECTOR <sup>1</sup>

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Competition and  
regulation in the  
financial sector

November 17, 2003

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## Index

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- I. Introduction
- II. The Mexican Financial System
- III. Competition
- IV. New regulations
- V. Challenges of the System

## The financial system's role in the economy

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- Financial markets perform two important functions: facilitate scarce resources allocation, reduce transaction and information collecting costs.
- Empirical evidence shows that the financial markets development has a positive impact in economic growth. A country's financial development level is a good indicator of its future growth.
- For example, Ross and Levine: a 10% increase in financial markets deepening (M2/GDP) would imply a 0.28% increase in the annual GDP per capita.\*

\* See Levine, R. (1997). "Financial Development and Economic Growth: Views and Agenda", Journal of Economic Literature vol. XXXV.

## The financial system's role in the economy

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- A higher Financial Intergration (FI) in the domestic and international arena leads to better opportunities for agents to diversify their consumption and investment plans through time.
- FI fosters internal financial markets due to a greater competition and to services and technology imports.
- The advantages of a higher FI are not automatic. Lack of strong institutions and the presence of distortions hinder FI's positive effect on economic growth.

## Achievements of the Mexican Financial System

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- Since the mid-nineties the Mexican Financial System has experienced a deep restructuring:
  - ✓ Adoption and implementation of internationally accepted accounting standards.
  - ✓ Adoption of satisfactory capital requirements and risk administration practices.
  - ✓ Liberalization of foreign investment restrictions.
  - ✓ Establishment of a new legal framework.
- Coherent macroeconomic policies and reforms have allowed Mexico to face the world economic slow-down within a financial and price stability context.

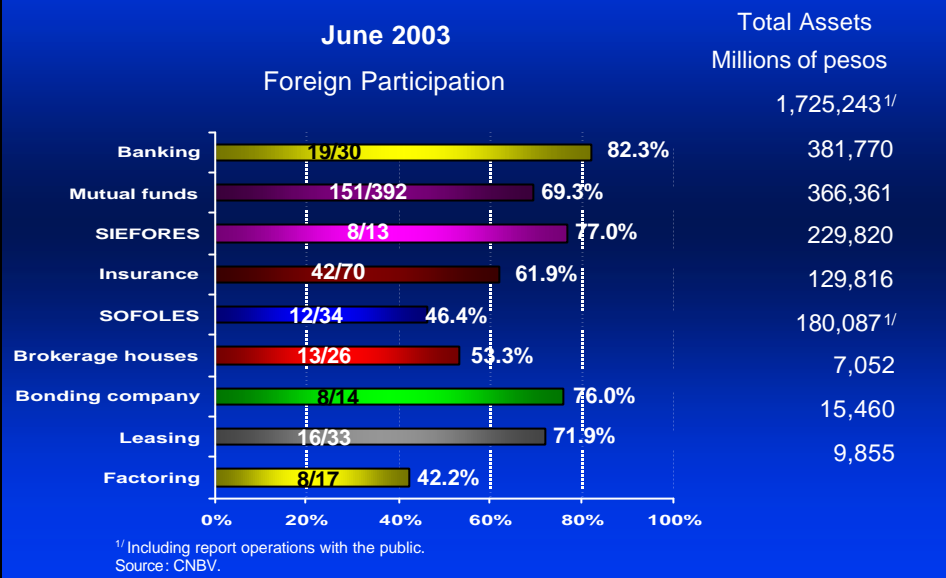
## Achievements of the Mexican Financial System

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- In the last three years an important number of laws have been enacted in order to strengthen regulation and oversight by introducing good corporate governance.
- This has fostered:
  - ✓ Better oversight of financial entities.
  - ✓ Financial System risk reduction.
  - ✓ Development of different financial entities that complement the supply of services and products that were traditionally supplied by commercial bank.

III. COMPETITION

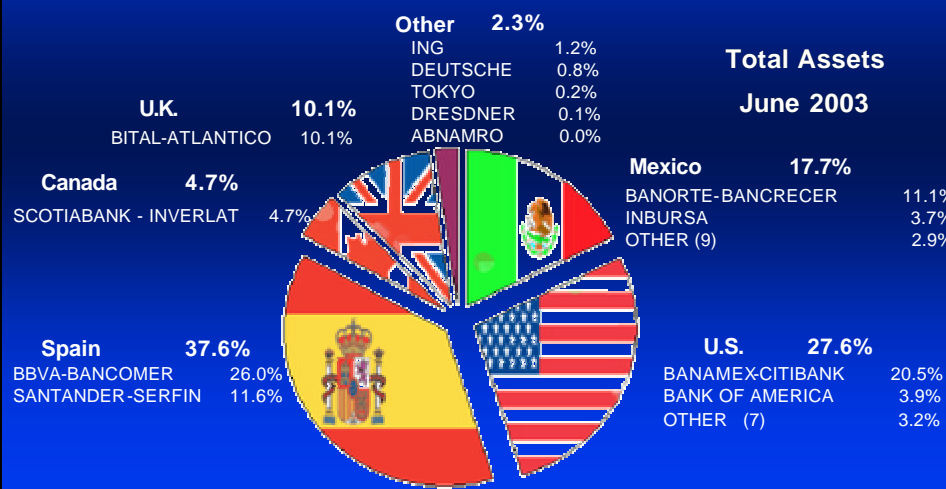
Opening to foreign capital has transformed the financial system structure



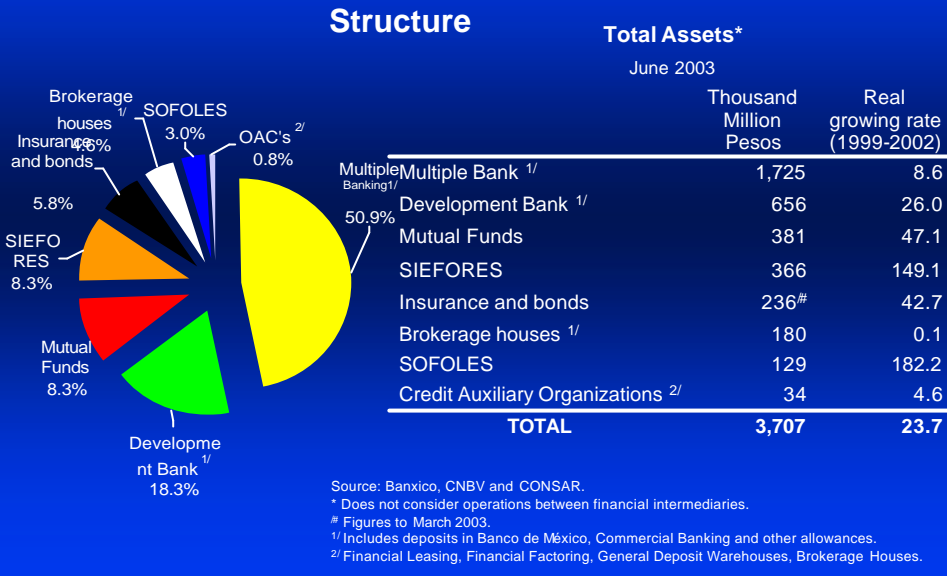
III. COMPETITION

Capitals arrive from all over the world...

- With the acquisition of Bital, Banamex and part of Santander by non-Spaniard banks, bank control by country of origin was diversified.

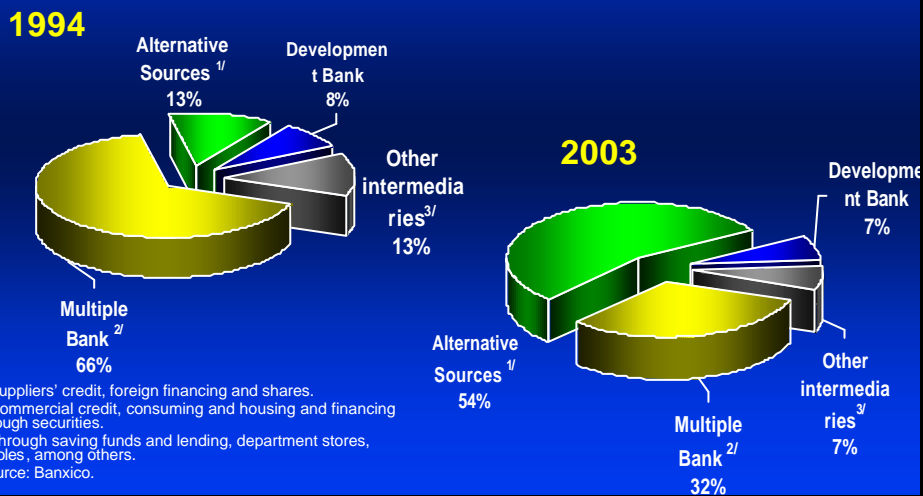


### Development of new financial entities has also contributed to transform the financial system profile



### Commercial Bank faces competition in financing private sector

- Commercial Bank financing private sector dropped from 66% in 1994 to 32% in 2003.

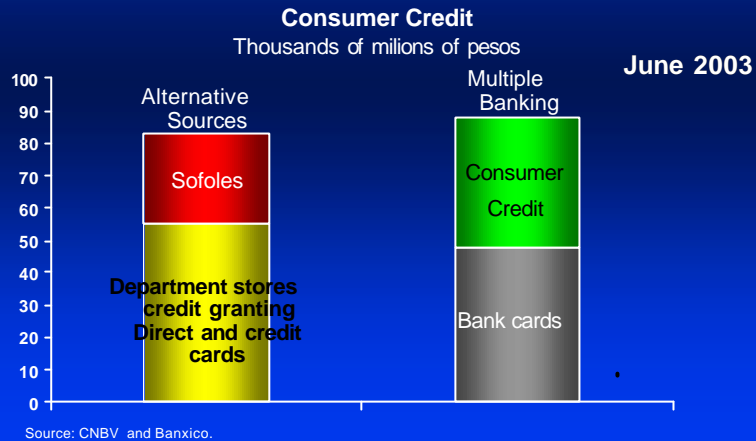


### III. COMPETITION

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## We may even talk about specialization regarding the type of granted credit

- De-intermediation of banks financing private sector is mainly reflected in the consumer credit.
- Although consumer credit is the main growing service in bank balances, consumer credit granted by department stores is higher.

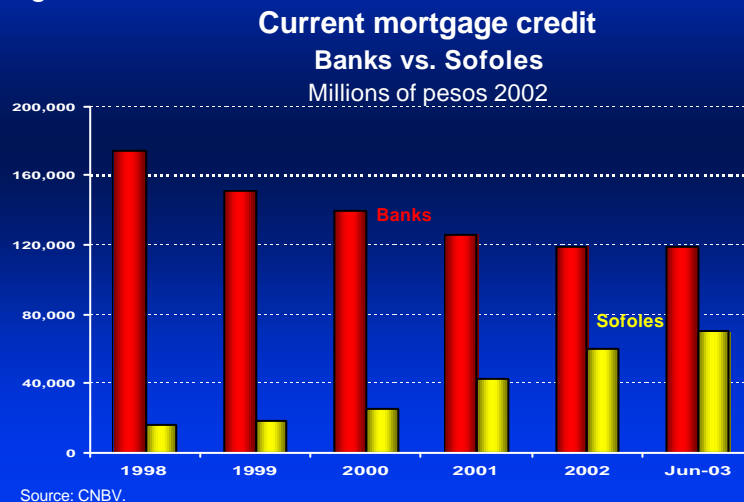


### III. COMPETITION

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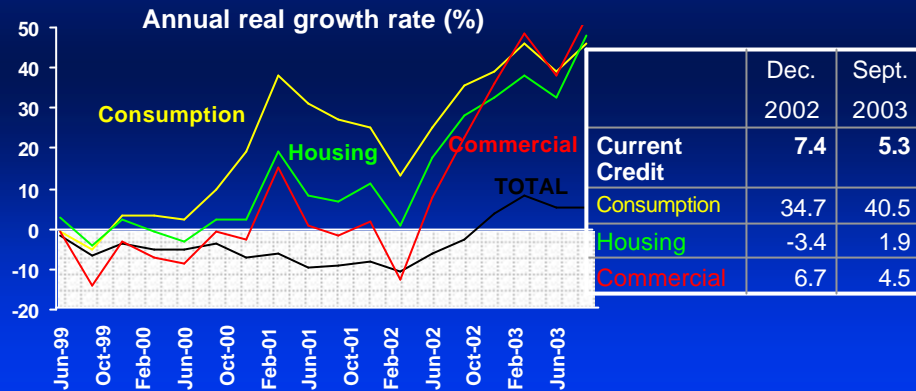
## Sofoles stand out due to their dynamism

- The annual flow of current mortgage credit shows that Sofoles have gained market from banks



### Evolution of current Commercial Bank credit

- Credit to private sector is growing although the growth rate for mortgage credit is relatively low.
- Banks face Sofoles competition.



Source: Banxico.

### Sofoles stand out due to their dynamism

#### Sofoles

June 2003

(Millions of pesos and percentage)

Sector	Sofoles	Total Portfolio	Participation %	Real Annual Variation %
<b>System</b>	<b>33</b>	<b>122,916</b>	<b>100.0</b>	<b>28.6</b>
Mortgages	17	72,520	59.0	44.8
Automotive	2	40,316	32.8	10.4
Capital and Transport	2	2,950	2.4	-3.2
Business	8	3,687	3.0	47.6
Consumer Goods and Personal Credits	4	3,442	2.8	42.2

#### Indicators SOFOLES vs. Banks <sup>2/</sup>

Total Assets Sofol / Total Assets Banks	7.5%
Total Loans Sofol / Total Loans Banks	12.8%

<sup>1/</sup> SHCP with information from the CNBV.

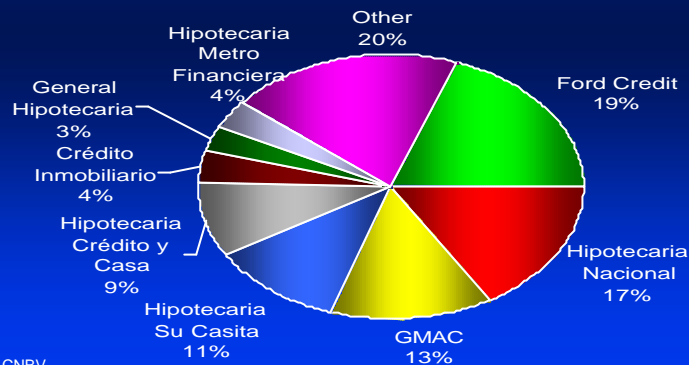
<sup>2/</sup> includes Banco del Atlántico.

Source: CNBV

### Sofoles: Structure in terms of total assets

- The four larger Sofoles concentrate 61 per cent of the assets.
- Two automotive Sofoles concentrate 33% and the two larger mortgage Sofoles 28%.

June 2003

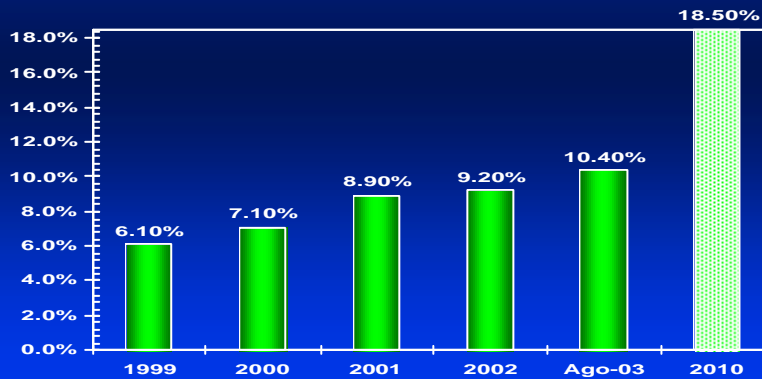


Source: CNBV.

### Sofoles are not the only financing alternative source

Pension funds have experienced an important growth. Nevertheless, these funds represent a low GDP percentage compared to Chile, where the indicator reaches up to 53 percent.

Pension Funds in Mexico as percentage of the GDP\*



\* Includes SAR92, INFONAVIT and Siefores.  
Source: CNSF.



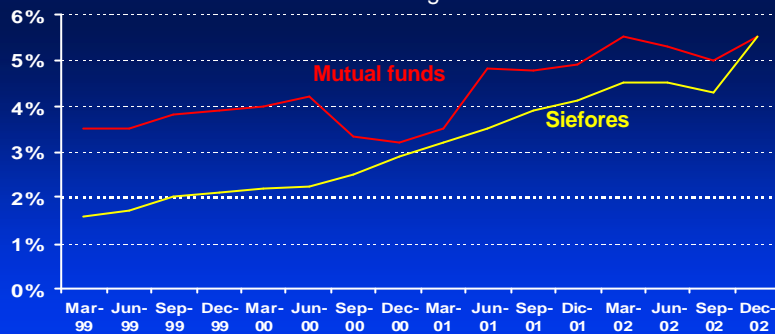
### Pension Funds System

- In the last trimester of 2002 Siefores' assets increased by 25,000 million pesos, and reached the same amount of resources administrated by mutual funds.

#### Mutual Funds and Siefores

Total Assets / GDP

Percentage

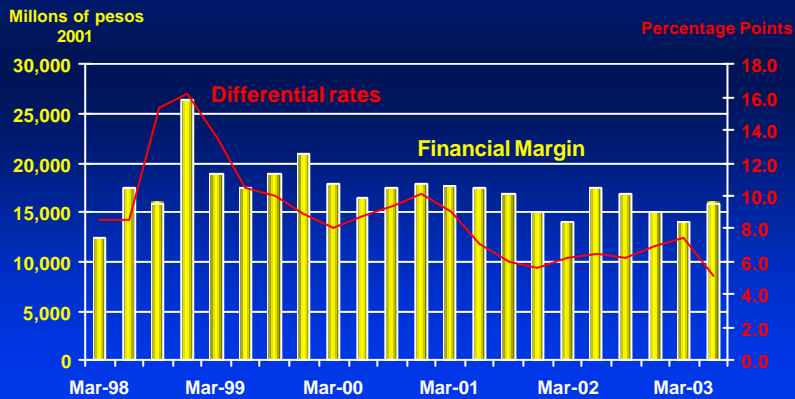


Information regarding Siefores does not include INFONAVIT neither SAR92.  
Source: CNBV

### The transformation of the financial system structure has represented a challenge to commercial bank

- In the last year, the reduction of the rate differential has reflected on a parallel contraction of banks' financial margin.

#### Rate Differential (TIIE-CPT) vs. Financial Margin

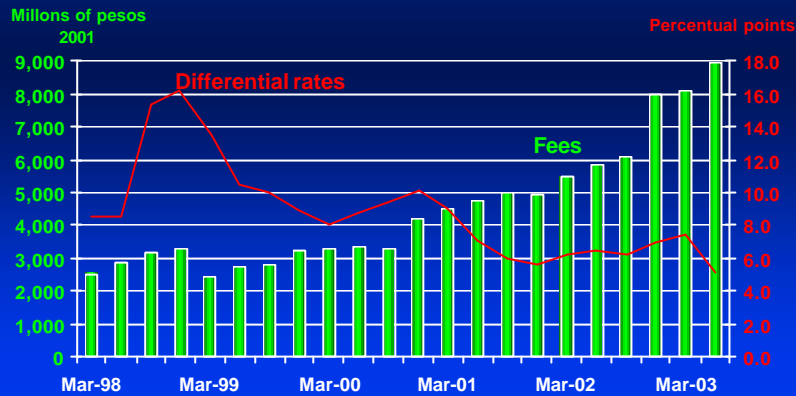


Source: Banxico and CNBV.

**Along with interest rates evolution, this has been an incentive for banks to re-design their operations**

- Reduction in rate differential has induced banks to charge an explicit fee for each financial service.

**Rates Differential (TIIE-CPT) vs. Net fees**



**The new strategy of commercial banking**

- Fees show an increase as a percentage of total income.

**Balance**  
Millions of pesos 2002

	1994	1996	2002	June 2003
Financial margin	72,028	61,237	75,507	37,426
%	79.4	64.4	67.3	68.6
Fees	12,198	13,080	28,684	15,279
%	13.4	13.8	25.6	28.0
Total income	90,742	95,016	112,226	54,558
%	100.0	100.0	100.0	100.0

Source: CNBV.

## Fee percentage structure

- Fees charged for account management and for credit cards are the most important within the total.

### Percentages

	BANAMEX	SERFIN	BANCOMER	SANTANDER	BITAL	SCOTIABANK	BANORTE
Total	100	100	100	100	100	100	100
Guaranties and stock acquisition / sales	0	1	1	2	0	1	2
<b>Account management</b>	<b>24</b>	<b>24</b>	<b>22</b>	<b>32</b>	<b>31</b>	<b>14</b>	<b>22</b>
<b>Credit cards</b>	<b>46</b>	<b>48</b>	<b>26</b>	<b>15</b>	<b>15</b>	<b>34</b>	<b>17</b>
Trust activities	10	5	14	5	3	7	8
Fund transferring	0	1	6	3	4	3	5
Electronic banking	3	7	11	7	19	16	12
Mutual funds and others	17	15	19	35	27	26	35

<sup>1</sup> Cashier cheques, certified cheques, traveller cheques, remittances in progress, bank remittances, goods deposit, safety boxes and others.

## Fee percentage structure

- Based on the amount of fees and the number of transactions we can infer that the transaction fees charged by Mexican banks are higher than those in the U.S. but lower than in Spain.

	Mexican pesos	
	Mexico	United States
Account management fee	107.1	80.2
Issued cheque fee	5.5	5.7
Returned cheque fee	884.0	230.0

### Average cost of Bank Transactions\*

	Fees in Millions of dollars	Number of transactions (in millions)	Cost per transaction in dollars
Mexico (Dec '01)	3,008	1,578	1.91
Spain (Dec '99)	5,460	2,962	2.78
Canada (Dec '99)	3,525	5,433	0.65
United States (Dec '99)	76,688	99,178	0.77

\* Cheques, payments with credit card, credit transferences and direct debt.

### The financial system legal framework has experienced a deep reform that fosters competition.

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- Stock Exchange Law.
  - ✓ Guarantees minor stockholders rights, punishes the abuse of privileged information and market manipulation, it permits the operation of new intermediaries in the stock exchange and introduces new instruments for long term financing.
- Mutual funds Law.
  - ✓ Introduces the mutual funds distributor figure and avoids conflicts of interest among mutual funds and operating bodies.

### Likewise, reforms aim at reinforcing popular savings

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- National Savings and Financial Services Bank Organizational Law.
  - ✓ Reinforces the popular savings and creates a financial culture in low-income sectors.
- Reform to the Pension Funds System Law.
  - ✓ Grants access to all workers to the individual account system, creates complementary saving funds for different matters, generates more information and control of the Saving Funds System.

#### IV. NEW REGULATIONS

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They additionally foster competition and the development of financial services and products.

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- Reforms to Bank and Development Institutions.
  - ✓ Modernize and make more efficient the development bank administration, enhancing good corporate governance.
- Credit Institutions Law and Law for the regulation of Financial Groups.
  - ✓ Improve the banking operation framework, strengthen regulation and oversight and promote good corporate governance.
- Rural Finance Law.
  - ✓ Fosters the development of agricultural, forest, fisheries and all economic activities linked to rural activities.
- Credit Guarantees Law.
  - ✓ Allows diminishing times of conflicts resolution without reducing the rights of borrowers.

#### V. CHALLENGES OF THE SYSTEM

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Some sectors within the financial system still need restructuring

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- Pending reform initiatives:
  1. Money laundry.
  2. Reform of credit organizations: Modernization of the legal framework of Sofoles' operations, leasing, factoring and deposit companies and credit unions.
  3. Bank crisis resolution: through a bank intervention, liquidation and bankruptcy mechanism for commercial banks.
  4. Modernization of justice administration and public property register in the States of the Country.

## Enhanced financial integration

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- For financial deepening and integration to generate benefits to economic growth and development there is need:
  - ✓ To reduce transaction costs facilitating a better use and allocation of capital.
  - ✓ To diminish information asymmetries to reduce market uncertainty and promote financial systems integration.
  - ✓ To have strong and well defined property rights and a reliable legal framework.

## Enhanced financial integration

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- In a little more than a decade Mexico has substantially transformed its financial system.
- Regulation and oversight frameworks of the Mexican financial system are nowadays more transparent and comparable to those of its commercial partners.
- This fosters financial integration and deepening.
- Reduce transaction costs facilitating a better capital use and allocation.
  - ✓ By facilitating matching issuers and investors.
  - ✓ By offering a higher investment yield and confidence to domestic and foreign investors.
  - ✓ By increasing accessible capital sources to Mexican entrepreneurs.

## Financial integration into North America

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- Up till now economic convergence has been a non-planned result of a coherent macroeconomic policy.
- Financial systems have been converging although in a slow fashion.
- When negotiating NAFTA, it was clear that countries had financial systems in different development stages.
  - ✓ The optimum was that each country maintained its own regulatory approach.
- Financial Integration was not within Mexico's reach.

## Financial integration into North America

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- Reaching a higher FI in North America would be beneficial for Mexico. The Mexican financial system is now different to the one when the NAFTA was negotiated.
  - ✓ Greater harmonization in regulation and oversight but not identical.
  - ✓ Greater synchronization in the way of making business.
  - ✓ Capital flows towards the best investment option.
  - ✓ More synchronized payment systems
  - ✓ Lower financial costs for companies and individuals.

**ADDRESS BY OSCAR LEVÍN COPPEL, PRESIDENT OF THE COMISIÓN NACIONAL PARA LA PROTECCIÓN Y DEFENSA DE LOS USUARIOS DE SERVICIOS FINANCIEROS (CONDUSEF) (NATIONAL COMMISSION FOR THE PROTECTION AND DEFENSE OF FINANCIAL SERVICES USERS), AT THE SEMINAR ON COMPETITION AND REGULATION IN THE FINANCIAL SERVICES SECTOR, HELD THIS DAY, AT THE HOTEL FIESTA AMERICANA GRAND CHAPULTEPEC.**

**MEXICO, D.F., 17TH NOVEMBER, 2003.**

**“ON THE FINANCIAL SERVICES USER THE IMPORTANCE OF INFORMATION AND ITS CONFIDENTIALITY”**

**OSCAR LEVIN COPPEL  
INTRODUCTION**

Financial products and services constitute a sector with a broad potential market, vital for the appropriate performance and development of any economy. Its analysis deserves special attention due to its scope and relevance for our society.

To address this topic, we first need to determine some concepts, in accordance with the Law for the Protection and Defense of the Financial Services User, which governs CONDUSEF.

Under this ordinance, any person who contracts, uses, or for any other reason is entitled before a Financial Institution as a consequence of an operation or service rendered, is considered a user of financial services. At the same time, a Financial Institution is understood to be that entity authorized to operate as such by the Mexican financial authorities and is supervised and inspected by these same authorities.

With the objective of creating and promoting an adequate culture in the use of financial products among the users CONDUSEF, is responsible for the diffusion of information and characteristics related to the various services offered by Financial Institutions, including, naturally, the indices of claims presented against each of these institutions. However, the information presented must be global, without identifying the users involved, in order to avoid violating financial secrecy.

In this sense, CONDUSEF must maintain strict confidentiality of the information and documents of which it has knowledge because of its objective, related to deposits, services or any other type of operations carried out by the Financial Institutions, except when these may be requested by a judicial authority. The public servants of this Commission will be responsible for any violation of this confidentiality.

It is clear, then, that the reservations of confidentiality that the Law imposes do not constitute an obstacle to increasing the volume and quality of information that needs to be transmitted to users and to the general population. On the contrary, the impetus of what we have called Financial Culture represents an opportunity to broaden the market to the extent that the diffusion of plentiful, truthful, timely and updated information as its operation becomes transparent, contributes to generating



greater confidence in the system and multiplies the opportunities for institutions offering these services and their potential users. For existing users, information about the characteristics of the different products and services competing in the market constitutes a fundamental decision-making tool and even to foresee the emergence of controversies, because clear information regarding the terms of their contracts eliminates mistakes related to their rights and responsibilities. In summary: information, without betraying the confidences indicated by the Law, is the foundation of a Financial Culture that benefits everyone, contributes to making the financial system more efficient and promotes healthy competition among market intermediaries.

## **PRESENTATION**

The subject of this exposition can be divided in two major segments:

The first is the importance of disseminating of information for a particular group of people and for society in general; that is, the primary recipient of information is the user of the financial product. However, through him and with the support of various means, it may be transmitted to the general population.

The second consists of the confidentiality of information in the hands of financial institutions and of the Authority it self; that is, personal and individual data of customers and specific information about their personal assets and the use that can be made of these, must be, above all, confidential.

## **IMPORTANCE OF DISSEMINATING INFORMATION**

Information is a key resource in the development of science and economy, and its dissemination multiplies opportunities to achieve welfare and progress. Further more, the freedom to choose, an essential characteristic of modern society, implies a responsibility that can only be conceived to the extent that the citizens are sufficiently informed, within the framework of competition principles.

In an imperfect market where participating agents frequently act with an oligopolic character, it is evident that dissemination information fosters greater competition that, in the end, will mean a more balanced distribution of benefits. Therefore, speaking of the roll of information in personal finances, it is important to mention that if a person does not have sufficient information, his finances will very probably be poorly focused and will not allow him develop his economy, thereby affecting his family and surroundings. On the other hand, an informed person will have all the indispensable elements to make decisions, which, seen from a general perspective, will contribute to improve regulation practices and to achieve better understanding of international trends of the financial services market.

Financial information is the characteristic feature of contemporary capitalism. Throughout the world, the determining variables of economic activity such as interest

rates, available credit or investments, are increasingly subject to the movement of capital across borders.

Those who are knowledgeable about personal finance know how to manage their accounts, their assets and their lives; they get prepared for the future, offer well-being to their families and make better decisions. The importance of promoting an adequate financial culture stems precisely from this fact, making it possible for everyone to make responsible decisions about the adequate use of the innumerable financial products and services that the global economy places within their reach.

It is in this sense that CONDUSEF, as its mission indicates, is concerned about widely disseminating financial information necessary for people to be able to take full advantage of the variety of financial instruments found in the market, such as, among others, credit or debit cards, checking accounts, insurance, derivative products and investment funds. Each of these instruments was created to help users meet a specific need, but if their characteristics are not familiar to users, doubts and confusion that result in a series of conflicts and claims against the financial institutions may arise.

This situation worsens when easily operated financial products such as a checkbook are combined with other more elaborate products and services such as a debit card, automatic teller machines and the use of electronic media, since these, while increasing the advantages of the original product, make its operation more complex. Thus the obligation to inform about the use, advantages and risks that may exist when contracting various products and services becomes obvious.

When we compare the knowledge that exists among users about these products and their use, we can see that the level of bank awareness in Mexico is falling behind with respect to industrialized countries, and even behind some Latin American countries less developed than ours. An example of this is the use of cash to make payments, characteristic of less advanced countries or those with little financial depth. In England and the United States the proportion of cash payments is 20% and in developing nations it is 40%, while Mexico is located at a point halfway between both percentages.

If we compare our financial culture with that of the Anglo-Saxon countries previously mentioned, we find greater financial sophistication, since they deal with economies in which business financing is frequently produced through stocks and bonds emissions in the capital markets. Their exchange and debt markets represent investment assets, not only for the privileged classes, but for important middle class segments, this is possible because people are properly informed about these products and as a consequence, know their advantages, disadvantages, risks and benefits and make their investment decisions on these basics. On the contrary, in Spain, as in Mexico, credit continues to be, by much, the principal business financing vehicle and bank on sight deposits and terms are the principal savings instruments.

Thus we see that the lack of financial culture causes users to focus on traditional financial products, leaving aside other sources of financing or investment probably better suited to their needs.

CONDUSEF has included in its priorities that of promoting financial culture. However, we are convinced that this is a responsibility that must be faced jointly with the entire financial sector, and therefore in the last few months, we have signed various Collaboration Agreements with the Asociación de Banqueros de México (ABM) (Mexican Bankers Association), and the Asociación Mexicana de Agentes de Seguros y Fianzas – AMASFAC (Mexican Association of Insurance and Securities Agents). In this way we are designing and carrying out diverse strategies that coincide with the objective of attaining greater financial culture in our country.

Among the activities to be developed are:

- I. Carry out joint dissemination campaigns for better knowledge and use of products and services;
- II. Develop literature regarding the risks and benefits of some financial products;
- III. Arrange seminars, conferences and events that permit information dissemination about the best use of financial products and services; and
- IV. Involve Specialized User Service Units and Telephone Service Centers in the financial institutions so that they serve as integral centers for orientation and reception of complaints.

Following this train of thought, it becomes clear that CONDUSEF, together with diverse organisms, must generate more information about financial products and services, and that as we achieve the dissemination of this information, we will have a more knowledgeable public and better protected against any type of abuse or fraud.

In the third quarter of 2003 alone, we have provided more than 200,000 technical and judicial consultations, that is, users who have consulted this National Commission. Among these, the most recurring subjects are related to: banking products, 22.5%; insurance, 7.7% and 65% related to retirement savings systems. The rest were consultations about other sectors.

In addition, during the same period we directly attended more than 17,000 claims, 63.1% of which were related to the banking sector, 27.7% to the insurance sector and 6.5% to retirement savings systems.

It is important to point out that the Retirement Savings System, being one of the newest and the one that includes the largest number of financial users – with more than 29 million people covered – CONSAR and CONDUSEF have been tasked with of coordinating and multiplying actions to inform about the nature, importance and scope this sector implies for the life of all Mexicans. A fundamental element has been consideration of the educational and income levels of the majority of the people registered in the Afores (retirement plans).

If we add the technical and judicial assistance granted by the Specialized Units of the Financial Institutions themselves to the this data, we would be speaking of

around 3.1 million additional consultations, of which almost 3.5% are translated to user claims against the institutions.

We are convinced that generating and widely and rigorously disseminating information about our financial system is an indispensable task to bring the products and services offered into the daily life of its current and potential users. By doing so with greater collaboration of all the integral parts of the sector, the number (of claims) decrease, to the benefit of the user.

## **IMPORTANCE OF INFORMATION CONFIDENTIALITY**

The second major segment we deal with is the importance of confidentiality in handling financial information, especially secrets that financial institutions and authorities must keep regarding their relations with the users.

On this point, it must be pointed out that both the obligation to disseminate financial information as well as to protect confidential information that CONDUSEF handles in exercising its powers, is framed within the Law that rules this Commission itself, as well as in the Federal Transparency and Governmental Public Information Access Law. Both ordinances share the principles of information publicity and protection of the privacy rights of people.

Therefore, while CONDUSEF informs about the characteristics of existing financial products and services, it also protects information considered confidentiality under the Federal Transparency Law. This implies that it keeps strict confidentiality about information and documents it knows about related to deposits, services or any other type of operation carried out by financial institutions. CONDUSEF respects financial secrecy in terms of its own rules and regulations, in which the users' security and confidence in the system play a fundamental role.

Financial secrets, which cover banking, fiduciary and stock markets, originate from the professional secret; it is based on the professional ethics of those who know the facts and on the rules of public order that society establishes to protect the private life or safety of the people that have revealed facts or data to professionals.

The legislator's reasons for granting this right to citizens and financial users are: (i) to protect individual freedom, the privacy of persons and to promote public interest in the financial profession, and (ii) to establish broader confidence between financial institutions and the public, so that the financial system develops satisfactorily.

On this subject, the legislator cannot avoid the obligation of financial authorities, CONDUSEF included, to observe financial secrecy. Thus, the Commission is obligated by force of law to carry out the exercise of its powers within the framework of respect for the private life of financial services users and the confidentiality of its information.

This becomes evident when the law establishes that in order to foster among its users an appropriate culture in the use of financial operations and services CONDUSEF, will be responsible for disseminating information related to the different services offered by financial institutions as well as the claim indices against each of

them, as far as the information that the Organism provides or disseminates is global and does not identify the users involved.

Attending to this mandate and taking into account the financial instruments most utilized by the general population, that statistically represent those with the most consultations and claims, in the last few months CONDUSEF has taken on the task of publishing, in various daily newspapers, comparative charts of products and services such as credit cards, automobile credit, mortgages and the use of debit cards in automatic tellers. Although its principal objective is to inform users about the various options existing in the market, letting them know the different costs and commissions that the use of one or more products of each institution could represent, we know that this will also promote a healthy competition between the various intermediaries.

CONDUSEF is convinced that the best way to establish competitive commissions and costs for the various financial services and products is through healthy competition, and this is why they will continue to publish comparative charts.

## **FINAL CONSIDERATIONS**

- CONDUSEF, in order to create and foster an appropriate culture in the use of financial operations and services among the users, disseminates information and characteristics related to the different services offered by Financial Institutions.
- In performing its activities, the information of this National Commission is global, without identifying the users involved, in order to avoid violating financial secrecy.
- The Commission must promote the necessary information to make decisions that permit the appropriate election of different financial products and services available in the market.
- CONDUSEF shares its responsibility to foster financial culture with the entire financial sector, implementing different strategies that offer a benefit to the financial user or consumer and to society in general.
- CONDUSEF is willing to collaborate with the Federal Competition Commission (Comisión Federal de Competencia – CFC) within the framework of its respective attributions, in those tasks which encourage healthy competition between financial institutions when offering their products and services, which should translate into greater benefits for users and in the consolidation of the financial system.

If there are any doubts about consultations and claims of financial products and services, please contact CONDUSEF at 5448 7000 in the Federal District, and in the interior of the republic, at 01 800 999 8080 or visit our internet page: [www.condusef.gob.mx](http://www.condusef.gob.mx)



FEDERAL COMPETITION COMMISSION

# Competition Policy in Financial Services

Fernando Sánchez Ugarte

November 17, 2003

1

## **Financial Services:** *Some Characteristics*

2

## Asymmetric information and unobserved actions

- Relationship between agents is asymmetric because one of the parts has more information than the other.
- Creditors do not observe relevant actions of agents looking for funding.

3

## Synergies in financial networks represent challenges for Competition Policy

### Synergies:

- Information exchange among agents eases the problem of asymmetric information
- Financial networks have created and improved the portfolio of products and services
- Services infrastructure can be complementary (automatic teller machines, credit and debit cards' terminals, etc.)

### Challenges for competition:

- There is cooperation among competitors that facilitates collusion
- Exclusive networks may limit competition.

4

## **Financial Services: *Regulation and Competition***

5

## **Regulation and Competition Policy**

- Fostering and promoting competition is fundamental in order to achieve an efficient financial market, and both economic regulation in the sector as well as competition policy seek this efficiency
- Sectoral economic regulation and competition policy are complementary
- Economic regulation must not aim at influencing business decisions of agents subject to regulation, but create suitable conditions that foster a healthy competition and protect public interest when free markets cannot do it

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## Regulation of the Mexican Financial Sector

Important advances towards better international standards:

- Deposit insurance
- Dissemination of relevant information about intermediaries and users
- Better standards in transparency and prudential measures
- Improvements in corporate governance
- Increased judicial certainty for creditors and minority shareholders
- Coordination among regulators

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## Competition Policy in the sector (I)

**The CFC protects the process of competition and free market access in the sector through:**

- Merger control
- Preventing and eliminating absolute and relative monopolistic practices, which restrain available funds and increase costs to users
- Evaluating agents willing to participate in certain biddings and concessions
- Advocating competition principles and culture

8

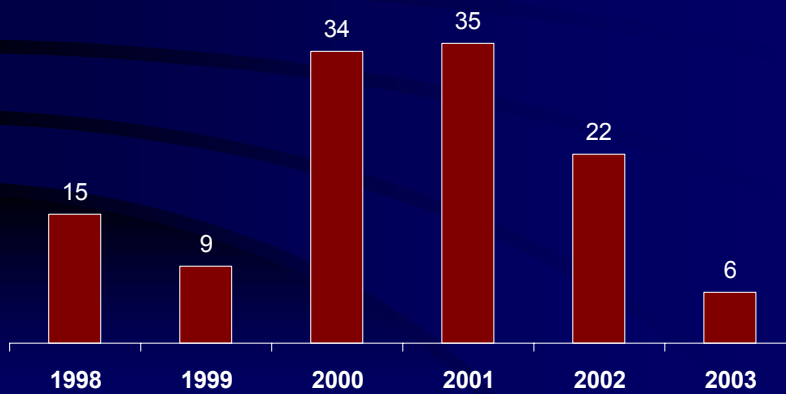
## Competition Policy in the sector (II)

Implementing competition policy in the sector favors the capture of synergies derived from information exchange and from participants' use of networks.

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## Mergers analyzed in the sector

Number of mergers



10

## Monopolistic practices in the Sector

- 1993: Sanction for coordination in CETES biddings
- 1994: Investigation about fixing commissions of credit cards for shops, interest rates for users, mark-ups. Ended with an agreement that suspended the practice
- 1996: Investigation about exclusivity contracts between credit card companies and issuing banks. Ended with the elimination of exclusivity clauses

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## Evaluation of Bids in the Sector

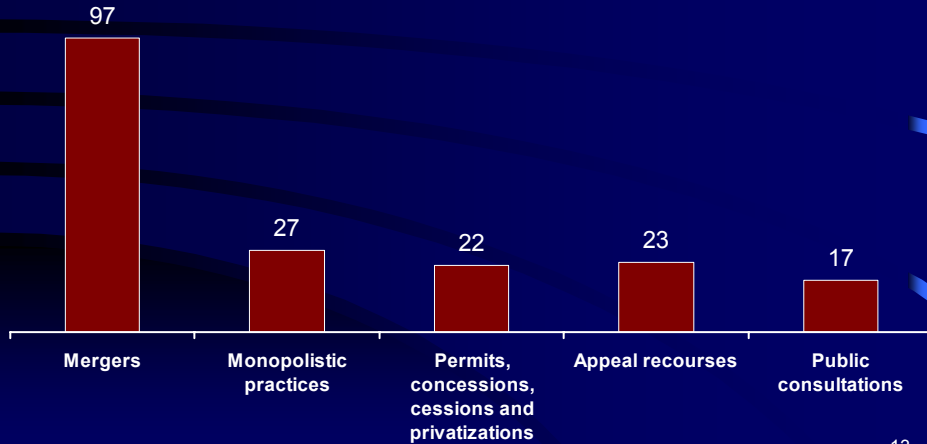
### 2000: Aseguradora Hidalgo, S.A. (AHISA)

- The CFC issued an unfavorable opinion to the agents interested in bidding, since adjudication terms did not establish limits to AHISA's exclusivity in insuring federal public officials
- The bidding process changed by including terms that established the length of contracts to December 31<sup>st</sup>, 2004

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## Summary Cases in the Sector 2000-2003\*

Number of analyzed proceedings



\* Information up to June, 2003

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## Selected Mergers, 2000-2003\*

- 2000 Banorte-Banpaís  
ING Insurance International BV-Seguros Comercial América
- 2001 Citigroup-Banamex Accival  
BBVA-Bancomer
- 2002 Seguros Génesis-Aseguradora Hidalgo  
HSBC Holdings PLC-Bital
- 2003 Bank of America-Santander Serfin  
The Bank of Nova Scotia-Grupo Financiero Scotiabank Inverlat

\* Information up to June, 2003

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## Ongoing Investigations

### Possible monopolistic practices in banking services:

- Opening of an *ex officio* investigation on absolute and relative monopolistic practices in the market of operations related to credit card use as a means of payment in supermarkets.

Decision published in DOF on June 4<sup>th</sup>, 2003.

- Opening of an *ex officio* investigation on possible relative monopolistic practices in the market for complementary or auxiliary services of electronic banking through automatic teller machines.

Decision published in DOF on December 4<sup>th</sup>, 2002.

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## Financial Services: *Performance of the Sector*

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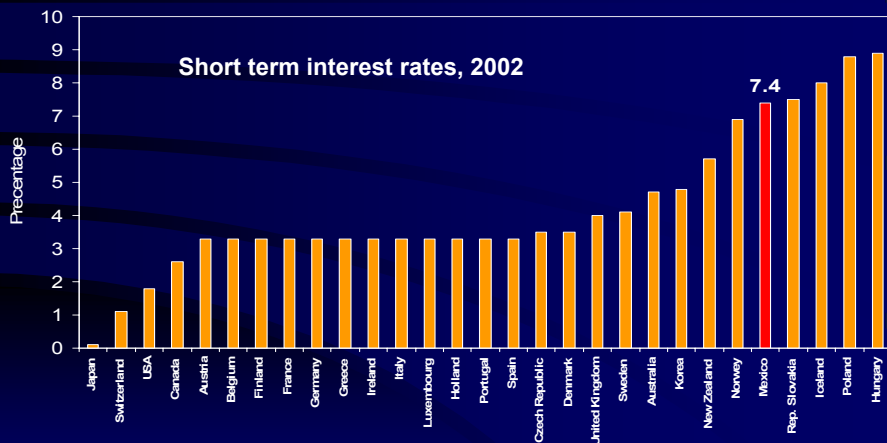
Short term interest rates in Mexico have fallen in recent years...



Source: *Main Economic Indicators*, OECD, Paris, June 2003.

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... but they are still among the highest for OECD countries.

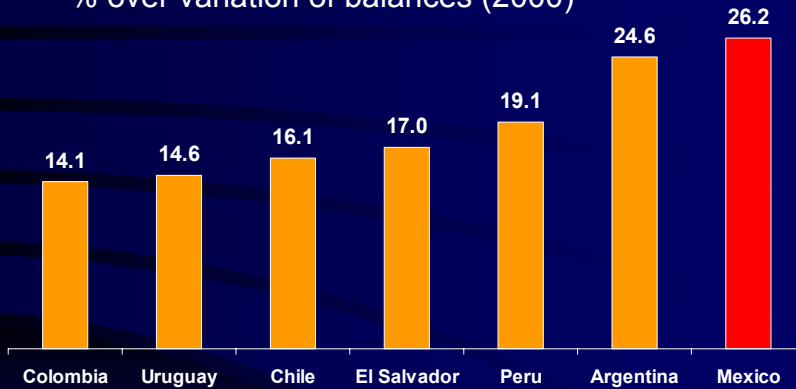


Source: *Main Economic Indicators*, OECD, Paris, June 2003.

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## AFORES fees are high.

% over variation of balances (2000)



Although falling since 2000, fees are still high.

Source: Edward Whitehouse (2000), *Administrative Charges for Funded Pensions: An International Comparison and Assessment*.

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## Stock market in Mexico is very small:

- In 2002, the value of capitalization in the Mexican stock market was 17.5% of GDP, seventh in Latin America.<sup>1</sup>
- Institutional investor funds are 11% of GDP, placing Mexico below Brasil (38%) and Chile (75%).<sup>2</sup>

<sup>1</sup> Report on the Observance of Standards and Codes (ROSC), World Bank-IMF, September 2003, p. 1.

<sup>2</sup> Financial System Stability Assessment, Monetary International Fund, October 2001, p. 13.

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Insurance premiums were only 2% of GDP in 2002.<sup>1</sup>

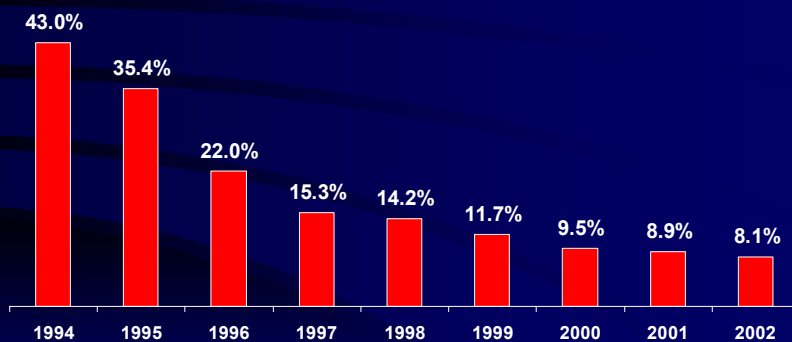
Ratio of people affiliated to Pension Funds over economically active population has increased: from 68.2% in 2002 to 73.9% in 2003.<sup>2</sup>

<sup>1</sup> National Commission for Insurance and Securities [www.cnsf.gob.mx](http://www.cnsf.gob.mx), and Bank of Mexico [www.banxico.org.mx](http://www.banxico.org.mx).

<sup>2</sup> Statistical Bulletin, AIOS No. 9, June 2003, p. 5.

The Banking System has not resumed a generalized supply of credit to the private sector:

Credits to private sector as percentage of GDP



Source: GDP in current prices and Direct Financing to Private Sector Granted by Commercial Banking, Bank of Mexico.



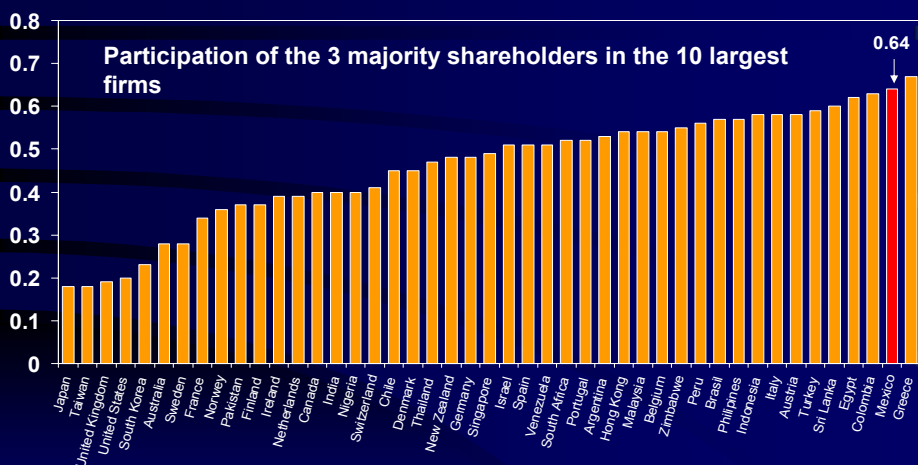
## High Concentration in the Sector

- *Banks*: In June 2003, the 5 largest banks had 77% of all bank assets.<sup>1</sup>
- *Insurance*: In 2002, the 5 largest insurance companies had 69% of all insurance premiums.<sup>2</sup>

<sup>1</sup>National Banking and Exchange Commission

<sup>2</sup>National Insurance and Securities Commission

## Mexico has one of the highest Stock Market concentrations in the world




Note: Data excludes financial firms and government owned firms. The study used a sample of 45 countries.

Source: La Porta, Rafael, Florencio López de Silanes, Andrei Shleifer y Robert W. Vishny, "Law and Finance", NBER Working Paper 5561, July 1996.

## Mexican Financial Sector

- High interest rates and fees
- Low financial penetration
- High concentration



**A more aggressive environment of economic competition would substantially improve efficiency in the financial sector**

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## Conclusions

- Regulatory policy and competition policy are complementary and their coordination favors the effectiveness of both in promoting the efficient development of the financial sector
- It is necessary to promote a more aggressive environment of economic competition to increase financial penetration and lower prices in the sector
- The CFC will continue to strengthen its activities aimed at preventing and eliminating anticompetitive practices that harm the process of competition and free market access in the sector.

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# **Policy Changes and Events Affecting the Financial Services Sector in the United States**

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WORKSHOP ON REGULATION AND COMPETITION  
IN THE FINANCIAL SERVICES SECTOR

Mexico City

November 17, 2003

Changes in the regulation of financial services in the United States over the last quarter century have been driven by two elements: (i) rapidly developing technology, particularly in telecommunications and data processing, and (ii) a widespread view among academics and policymakers that competition within and among the banking, insurance and securities industries fosters better services and prices for consumers and does not result in unstable markets or harmful concentration of resources.

The two seminal events in this field together illustrate this very point. both occurred in the mid-1970s, and both occurred in the securities markets. The first of these changes was the elimination of fixed commissions in the sale of securities. This eliminated one of the most significant barriers to competition within the securities industry and gave rise to substantial growth in volume on US securities markets as commission rates fell under the pressure of competition. This growth turned securities firms into financially powerful enterprises, with the capital and resources to challenge the dominance of banks in the business of financing business corporations.

The second change was the development of the money market mutual fund, which allowed investors to obtain money market rates of interest on what were essentially immediately withdrawable funds. At the time, banks were prohibited from paying interest on immediately withdrawable funds, which were called demand deposits. Money market mutual funds were wholly creatures of technology, since it was only the rapid data processing ability of computers—permitting the virtually instantaneous computation of net asset values—that enabled these funds to offer their customers immediate access to their money. Another related development was the so-called Merrill Lynch CMA, or Cash Management Account, which hitched a checking facility to a money market mutual fund and thus allowed a user to receive interest on what was essentially a checking facility.

Both these developments—which would not have been possible without the new telecommunications and data processing technology then coming into use—placed securities firms into direct competition with banks and set off what became a 20 year war over the scope of banking regulation.

Not only did money market mutual funds offer what was essentially interest on a demand deposit, but as inflation and market interest rates rose in the late 1970s these funds began to offer higher rates of interest than was permissible for banks even on the time deposits for which banks were permitted to offer interest. Bank interest rates were subject to a ceiling of 5 percent, and the time deposits of savings and loan associations (S&Ls) were subject to 5 ¼ percent interest rate cap. As a result, banks and S&Ls began to lose substantial amounts of deposits to money market and other kinds of mutual funds, as consumers sought the higher interest rates that would prevent erosion of their savings in an inflationary environment.

After several failed efforts at the state level to impose interest rate ceilings on mutual funds in order to protect the deposit bases of banks and S&Ls, Congress finally adopted the Monetary Control Act of 1980, which authorized a committee of regulators to eliminate interest rate ceilings on deposits at insured depository institutions. This was the first clear indication from Congress that when an industry was faced with a challenge created by market forces the government would not attempt to protect existing relationships through additional regulation. Congress had acted to eliminate regulatory restrictions, rather than impose new ones.

Changes in technology also aided securities firms as they competed with banks in other areas. With the growth of telecommunications capabilities, information about companies became far easier to acquire, and investors could more easily make judgments about the financial condition of an issuer of debt securities. The comparative advantage of banks had always been their possession of superior information; they knew more about borrowers than lenders could learn without great cost. As long as banks possessed this superior information, they could serve profitably as intermediaries between lenders and borrowers. Now, with the ready availability of information about public companies—delivered electronically and based on current financial disclosures filed with the Securities and Exchange Commission by public companies—lenders found that they did not need banks as intermediaries. In this new environment, securities firms were able to distribute commercial paper and short term notes for corporations at far less cost for corporate borrowers than the short and medium term loans that were the stock in trade of banks. Bank lending and bank assets as a percentage of the financial economy in the United States began to decline.

Beginning also in the early 1980s, the courts began to adopt a new view of regulation, reading regulatory provisions narrowly instead of expansively. Again, this was the result of a change in the way policymakers in the United States

thought about regulation. Beginning in the Carter administration and continuing into the Reagan period, academics and policy makers concluded that regulation was not necessary to prevent either destructive competition or economic or market instability. Although regulation might still be required where market discipline was absent because of government intervention—as in government deposit insurance—it was not necessary or appropriate where it interfered with competition within or among industries.

The Glass-Steagall Act, which purported to separate commercial and investment banking, came under particularly serious challenge in the courts. The banking industry, facing competition from the agency intermediation offered by securities firms, sought to enter the securities business by challenging the breadth of the Glass-Steagall restrictions the courts had regularly upheld. This time, however, the US Supreme Court, which had previously invoked the “spirit” of Glass-Steagall by focusing on Congress’s supposed purposes in enacting the law, now began to parse the precise language of the Act. In this process, many restrictions began to fall. The Court found that the Glass-Steagall Act did not actually prohibit *all* relationships between banks and securities firms, but only relationships between banks and companies that were “principally engaged” in underwriting securities. Thus, it was possible for banking organizations to acquire or create securities affiliates that were engaged in securities underwriting, but only to a limited degree. That opened the first opportunity for banks to compete with securities firms in underwriting equity and debt securities.

Technology also brought life insurance companies into competition with securities firms and later with banking organizations. With the rapid growth in equity values during the 1980s, insurance companies found that they were losing business to mutual funds, as customers realized that they could buy low cost term insurance to cover the risk of death and invest their savings in mutual funds with much higher growth potential than ordinary life insurance policies. Insurance regulators, eager to assure that insurance companies could effectively compete with securities firms for the consumer’s dollar, approved new investment vehicles—called variable annuities and universal life policies—that had variable payoff terms and other benefits, depending on the success of the underlying investments. These accounts had elements of both insurance and securities, and required insurance companies to comply with securities regulations in order to sell these instruments to consumers.

Soon, life insurance companies were offering not only combined insurance and securities products such as variable annuities, but were also offering other investment vehicles that were purely securities, such as mutual funds. Entering more fully into competition with banks, insurance companies also began to offer bank-like products such as Guaranteed Investment Contracts, or GICs. These were very similar to deposits and could even be withdrawn on demand. In fact, after a series of insurance company insolvencies at the end of the 1980s, a number of insurance companies faced serious cash flow problems as customers

began withdrawing funds or canceling their GICs because of fear about the safety and soundness of the insurance industry.

Not to be outdone, the Comptroller of the Currency, the regulator of national banks, ruled in the early 1990s that national banks could engage in selling insurance as agents—a ruling ultimately upheld by the courts.

Thus, by the mid-1990s, the three major factors in the US financial services business were competing with one another for the consumer's dollar. Each was offering products that competed directly with products of one or more of the others. For example, mutual funds offered by securities firms and insurance companies were competing with deposit accounts at banks; banking organizations were able to engage through affiliates, to a limited extent, in securities underwriting and dealing and in insurance brokerage. Securities firms were able to compete with bank lending through distributing commercial paper and medium term notes.

Nevertheless, various impediments to full competition still existed. Congress continued to be concerned about affiliations between banks and commercial firms, and insurance companies continued to be subject to a cumbersome 50 state regulatory system rather than have a single regulator at the federal level.

In the case of banks, because of the reluctance in Congress to permit bank affiliations with other kinds of activities, bank affiliations were still limited. As a result of more liberal court interpretations of the Glass-Steagall Act, banks were now able to affiliate with securities firms that were *not* principally engaged in underwriting securities, but this still placed a significant limit on the securities business of banking organizations. And by law banking organizations could not engage at all in insurance underwriting.

In 1999, Congress approved legislation that completely repealed those provisions of Glass-Steagall that prevented banks from affiliating with full service securities firms. The same law also permitted banks to affiliate with any company that is engaged solely in financial activities, including insurance underwriting. In theory, this meant that companies that control banks would also be able to control securities firms and insurance companies, and that securities firms and insurance companies would be able to control banks. However, in practical terms this was only a partial solution. The law permitted the Federal Reserve Board to determine what is a financial activity, and any company that controlled a bank would automatically become subject to Federal Reserve jurisdiction.

While banking organizations had no problem with this—since they were already subject to Federal Reserve regulations and could now acquire securities firms and insurance companies—securities firms and insurance companies have been reluctant to acquire banks and thus subject themselves to both the jurisdiction of the Federal Reserve Board and restrictions on the kinds of

activities in which they would be permitted to engage. For example, the Federal Reserve has been considering for more than two years the question of whether real estate brokerage is a financial activity. If the Board decides that it is not, then no company that controls a bank will be able to engage in real estate brokerage.

This left a very uneven competitive playing field as between banks on the one hand and insurance companies and securities firms on the other. Banking organizations could now expand into the securities and insurance underwriting business, but securities firms and insurance companies were in effect frozen out of the opportunity to acquire banks. In the race to provide a broad range of services that would give a firm access to the largest number of potential customers, banks now have an advantage. The latest figures show that banks are taking increasing amounts of business from securities firms, largely because they can now both underwrite securities and offer bridge loans and other financial facilities that corporate customers want. Securities firms have only limited resources to provide bridge loan financing. The solution to this problem, among others, is to eliminate the restrictions on bank affiliations, so that securities firms and insurance companies could acquire banks without fear of having their other activities curtailed by regulatory restrictions. Congress, however, does not yet seem ready to take this step.

Insurance companies still have to overcome the problems associated with the requirement that they get the approval of 50 state regulators before they can offer products on a nationwide basis. This process is a severe impediment to their competing with banks and securities firms, which can roll out new product more quickly. The latest effort of the insurance industry is to press for a chartering and regulatory authority at the federal level. Congress has begun limited work on this approach, but it is clear that any such authority is many years in the future.

Thus, the US financial services market today remains in a state of development. Most of the regulatory restrictions that existed a quarter of a century ago, and prevented competition within and among the banking, insurance and securities industries, have now been eliminated by a combination of technological advances and changes in informed opinion about the efficacy of regulation. But the US financial services market is still a long way from being fully competitive. It will be many years before the US completely eliminates the vestiges of regulation that was aimed at creating stable markets by limiting competition.

# Competition in the Financial Sector

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CFC-APEC Seminar  
17th November, 2003

## General

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- Issues that relate to competition in the financial system and the effects of market concentration on costs and intermediation risks.



# Themes

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A. Financial system competition

B. Effects on the industrial structure

# Financial System Services

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**Banking:** deposits, banking bonds, interbanking loans. Credit: commercial, to financial intermediaries, mortgage, to consumption, credit cards, credit to the government, fiduciary services.

**Exchange-Currency Market.**

**Mutual Funds,** Debt (credit instruments), common (share titles) .

## Financial Sector Services (2)

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**Insurance:** life, health and accidents, damages, pensions.

**Stocks (brokerage houses):**  
exchange of stock titles.

### **Afores and Siefores**

**Brokerage**, cash (liquid bills, Cetes and Bondes). Participants in this market include banks, brokerage houses, mutual funds, siefores.

## A. Competition and Stability

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- The main objective of regulation is to avoid excessive risks. How does competition affect the system's stability?
- The effect of competition depends on risk, the incentives to attract deposits and the effect of the cost of credit on debtors' risk.

## Competition for Deposits

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- ❑ Banks obtain resources from depositors under limited liability.
- ❑ By reducing profit margins, competition can cause banks to incur greater risks, since there is an incentive to transfer risk to depositors.
- ❑ The incentive to take-on risk is greater if deposits are insured.

## Competition for Credit

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Competition among banks, by reducing the cost of credit, causes debtors to incur lower risks.

## Other Risk Factors

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- Other incentives for risk-taking :

Market power

Scale economies

## Incentives for Risk-Taking

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- Market power. A bank incurs in greater risks if it expects larger profits in a more than proportionate manner, as it increases its market share.
- Scale economies. If a larger bank reduces costs in a more than proportionate manner, there is an incentive to assume greater risk in order to achieve a greater size.

## B. Financial and Industrial Competition

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- Financial intermediation is a basic input for productive activity:

What is the existing relationship between financial market structure and industrial market structure?

## Scenarios

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- Theoretical arguments point in both directions, depending on the magnitude of incentives to transfer risks and the effect of competition on costs of intermediation.
- If financial concentration induces greater industrial concentration, the lack of financial competition reduces the growth rate.

## Banking Sector Concentration Intensifies Industrial Market Concentration

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- ❑ Banks have incentives to lend more money to firms with market power, as they obtain part of their rents.
- ❑ Banks have incentives to lend more money to bigger, less risky firms.
- ❑ Banks can have conflicts of interests.

## Empirical Evidence

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- ❑ Some studies have found that the net competition effect is positive:  
Banking concentration intensifies industrial market concentration.  
This phenomenon is less intense in countries with mature financial systems.

## Conclusions

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- ❑ Financial competition reduces financial intermediation costs. Although competition creates incentives for greater risk-taking, the net effect of competition is positive.
- ❑ Financial concentration intensifies industrial concentration.
- ❑ The joint effect reduces the growth rate.

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## Financial Service Information Available to the Public for the Best Operation of the Markets

Rafael del Villar  
Central Bank

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- Payment Service Information

- Credit Information

- Considerations on Sound Credit Practices



## Payment Service Information

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### **Background**

- In last years, banks have increased tariffs and commissions of the payment means and systems and have put in place new service schemes such as:
- Account Management
- Use of payment means (Checks, Credit and Debit cards electronic and window transfers)
- ATMS, electronic bank, transfers and internet banking, etc.
- Tariff and commission increases were not widely publized by the banks and many users are annoyed because of these extra charges.

## Payment Service Information

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### **Law of the Bank of Mexico**

- ARTICLE 2.- the Bank of Mexico will have the purpose to provide the economy of the country with national currency. In the attainment of this purpose its priority objective is to procure the stability of the spending power of this currency. The bank also has as goals the **promotion of the healthy development of the financial system and fostering the good operation of the payment system**

ARTICLE 24.- the Bank of Mexico will only be able to issue provisions regarding monetary or exchange regulation, the healthy development of the financial system, the good operation of the payment systems, or the protection of the public interests. The Bank will have to express the reasons that motivate its provisions.

## Payment Service Information

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- Previously the Condusef asked for quarterly information on tariffs and commissions to the banks, nevertheless this information was partial and some banks were reluctant to provide information.
- Condusef could generate incorrect information.

## Payment Service Information

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### **Transparency Measures for payment services**

- The Bank of Mexico issued an administrative provision on the transparency of payment services (Letter 23/2003) on June 16 of 2003. Banks were requested to inform the maximum commissions applicable to their clients for payment services.
- The new form includes complete information of the payment service. It is a formal requirement and is automatically transmitted by the institutions of multiple bank services to the Bank of Mexico. The Bank of Mexico discloses this information and shares it with Condusef.

## Payment Service Information

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### **Benefits of Tariff Transparency for the economy:**

It facilitates users of banking services to know the tariffs of these services and to compare them between financial institutions.

It causes greater competition in the market for banking services, which induces the banks to review their processes to make them more efficient.

It causes that the banks approach their clients and offer better orientation for them to undertake transactions.

### **Costs for the bank:**

Systematic Provision of information to the Central Bank.

The information is updated by the bank when there is a change in tariffs or commissions.

## Payment Service Information

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### **Tariffs and commissions**

The information forms the Central Bank compiles is displayed in two sections:

The first is called "**Summary classified by products**". This section contains the the most interesting information for the consumer, whether the user is an individual with business activity or not.

Consumers are interested in information regarding:

\*Check accounts

\*Saving Accounts

\*Credit cards

\*As well as information related to the cost of check use and operations windows.

The second section is called "**Products and services per bank**". In this section all bank payment services are published, for physical or moral persons.



## Payment Service Information

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### Other Possible Transparency Measures for the Payment Service.

- Banks could publish information in standard formats in their branch offices and in their internet sites.
- Likewise it will be commendable to inform the user in the automatic teller machine and in the Internet Bank of transactions costs and to request authorization before they make transactions that might represent a cost.

- 
- Information of Services of Payments

- Credit Information

- Considerations on Sound Credit Practices

## Credit Information

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### Background

Available information is an important element for the competitive development of markets.

Information disclosure regulation is complementary to the application of the competition rules. It allows consumers to choose the most advisable option.

As long as consumers are better informed, they can choose the best operation, thus, the efficient supplier is awarded and the inefficient one is penalized.

## Credit Information

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- Information disclosure is a relatively complex subject.
- What information should be revealed so that consumers can make informed credit decisions?
  - **Price**
  - **Functionality**
  - **Quality**
- How to inform?
- In such a way that the consumer can:
  - Assimilate the information
  - Compare between similar products.

## Credit Information

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- **The credit price includes the following components:**
  - Interest rates (ordinary and for moratory condition )
  - Commissions (opening, managment, annuity, of prepayment).
  - Expenses (investigation, consultation to the credit bureau, appraisals, etc.).
  - Insurances ( life, responsibility or unemployment).

## Credit Information

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### Functionality

**This refers to the terms and payments set depending on the borrowers needs and payment capacity.**

**Macroeconomic stability has allowed longer term loans. (Fixed or variable rates, in investment unitis, indexed to the wage, in dollars, etc.)**

## Credit Information

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### Quality

\*This refers essentially to the methodology for calculating interest. It includes information on outstanding balances, the global interest rate and the terms for adjusting variable rates.

\*Another element of quality is the possibility of prepaying without penalties.

\*Interest rates calculated on outstanding balances represent a smaller cost than the same rate calculated on global interest. Likewise an annually adjusted variable rate credit certainly transmits less volatility and provides greater payment certainty than if adjustments apply in each payment.

- \* In credit cards the annual commission may be added to outstanding balances but interests would be charged. A credit card of greater quality is the one in which the annual commission payment independently

## Credit Information

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In summary:

A limitless creativity in the design of credit schemes exists.

The consumer has limited capacity to assimilate different credit schemes to compare them and decide in an intelligent way.

The problem for authorities is not to limit creativity so that more credit exists and to facilitate the assimilation of the different credit schemes to consumers so that the credit market operates efficiently.



## Credit Information

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### **Total Annual Cost**

- On December 30, 2002 the “Law for the transparency & competition promotion on guaranteed credit” was approved .
- Based on this law, the Bank of Mexico has implemented the Total Annual Cost (TAC) methodology, which does no limit credit granting creativity while allowing consumer to easily compare options.
- **TAC** is a measure of the real credit. It takes into account all price elements, functionality and quality, in a single variable.
- Although this methodology is currently only applied in mortgage credit in the future it may apply to all types of credit.

## Credit Information

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### **Mortgage Credit Total Annual Cost**

TAC calculation includes:

- a) Credit Amount
- b) Discounts and Bonus
- c) Analysis commissions, granting or opening and/ or management, coverage and collection of credits.
- d) Ordinary Principle Repayment
- e) Ordinary interests
- f) Insurance premium that entities require borrowers to hire.
- g) Appraisal cost that entities demand on hiring the credit
- h) Any other charge or expenditure that the entity directly or indirectly charges.

TAC must not include any notarial or tax expenditures in relation with the acquisition of real estate and their constitution guarantees.

## Credit Information

- The TAC is the annual interest rate that brings the arithmetic sum of the present value of the amounts foreseen in the amortization table to zero, as is defined in the following equation:

where:

$$0 = F_0 + \frac{F_1}{(1+CAT)^{\frac{1}{p}}} + \frac{F_2}{(1+CAT)^{\frac{2}{p}}} + \dots + \frac{F_n}{(1+CAT)^{\frac{n}{p}}}$$

- $F_0$  = is the amount of the Housing Guaranteed Credit, net of the commissions and expenses that the borrower pays before or at the beginning of the contract validity.
- $F_k$  = is the net amount the borrower pays to the Entity in period  $k$ , where  $k = 1, 2, \dots, n$ , as set the amortization table.
- $n$  = is the total number of payment periods during the credit life.
- $p$  = is the number of pay periods considered in a year, for example,  $p = 12$  implies monthly payments  $p = 4$  implies quarterly payments.

## Credit Information

**Credits in pesos with a fixed interest rate for a 15 years term.**

INSTITUTION	TAC
Inbursa	15.93%
BBV Bancomer	16.86%
Scotiabank Inverlat	17.16%
Afirme	17.51%
Santander Serfin	18.13%
Banamex	18.17%
Banorte	22.47%

Source: Mortgage Credits Comparison Comparación, Credits in pesos with a fixed rate. Octubre 2003. Federal Mortgage Society

- 
- Service Payment Information

- Credit Information

- Considerations on Sound Credit Practices

## Considerations on Sound Credit Practices

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- Credits must match the needs and capabilities of the debtor.
- The guarantee demanded on granting a credit must fit the client's payment capability.
- Clear information of the credit cost and conditions must be provided.
- Apply outstanding balance methodology if otherwise it must be indicated as a special issue.
- Terms and conditions changes must always be agreed on writ and anticipated.
- Credits that don't amortize the principle must not be granted.
- Announce particular credits terms to clients receiving publicity.

## Considerations on Sound Credit Practices

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Credit practices that may be considered predatory or abusive by the “Office of the Controller of the Currency” of the US :

- Single amortization credits upon expiration.
- The financing of expenses, commissions, penalties and insurances.
- Prepayment penalties, that are not limited to the first year of the credit.
- Continuous refinancing of credits granted with new credits, in order to be able to receive new commissions.
- Increase in the ordinary interest rate for payment breach.
- Obtaining new credits or second credits giving assets as security.

## Considerations of Sound Credit Practices

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### Rules in Force

#### **Clearly inform of Credit Cost and conditions**

(Circular Letter 2019 number M.21.8)

The Bank of Mexico will consider that institutions incur in acts that move away from sound banking practices, when they do not abide by interest rates provisions .

- Allowed rates of reference, only one of them may be chosen.
- Definition of the reference rate reference date (last published during the agreed period , or the one resulting from the arithmetic mean of these rates) published during the referred period.
- Define substitute rates in case the reference rate, is no longer published or in case that:
- they don't provide the creditor clear and timely information on the cost of granted credits.**

# The Federal Program for Regulatory Improvement and the Financial Sector

**Lic. Carlos Arce Macías**  
**Chairman of the Federal Regulatory  
Improvement Commission.**

November, 2003

# Costs and problems of regulation...

# Regulatory costs and potential benefit of regulatory improvement (% GDP)

Country	Regulation costs	Potential benefit of the regulatory improvement in the long run
United States	7.2-9.5% US\$ 660–870 billions	0.3% US\$ 27 billions
Canada	11.8% US\$ 113 billions	-
Mexico (estimated)	12-15% US\$ 71–88 billions	5% US\$ 29 billions

# The Regulation

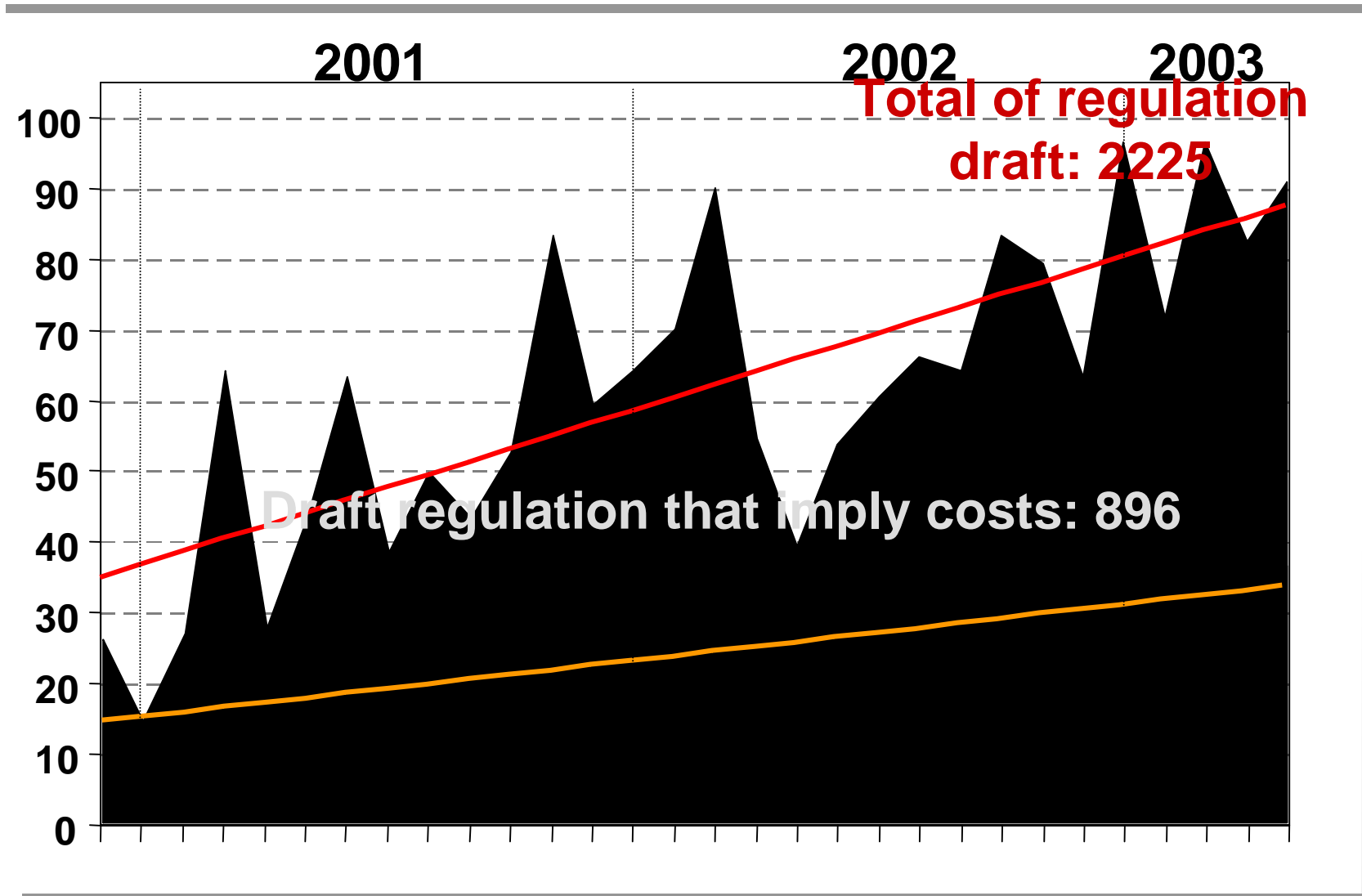
Formal definition: “Regulation is an instrument of public policy that allows the government to intervene in high -priority activities.

Regulation determines the relation between the state and those it governs.

More precisely: they are the rules established by the government, for all economic agents.

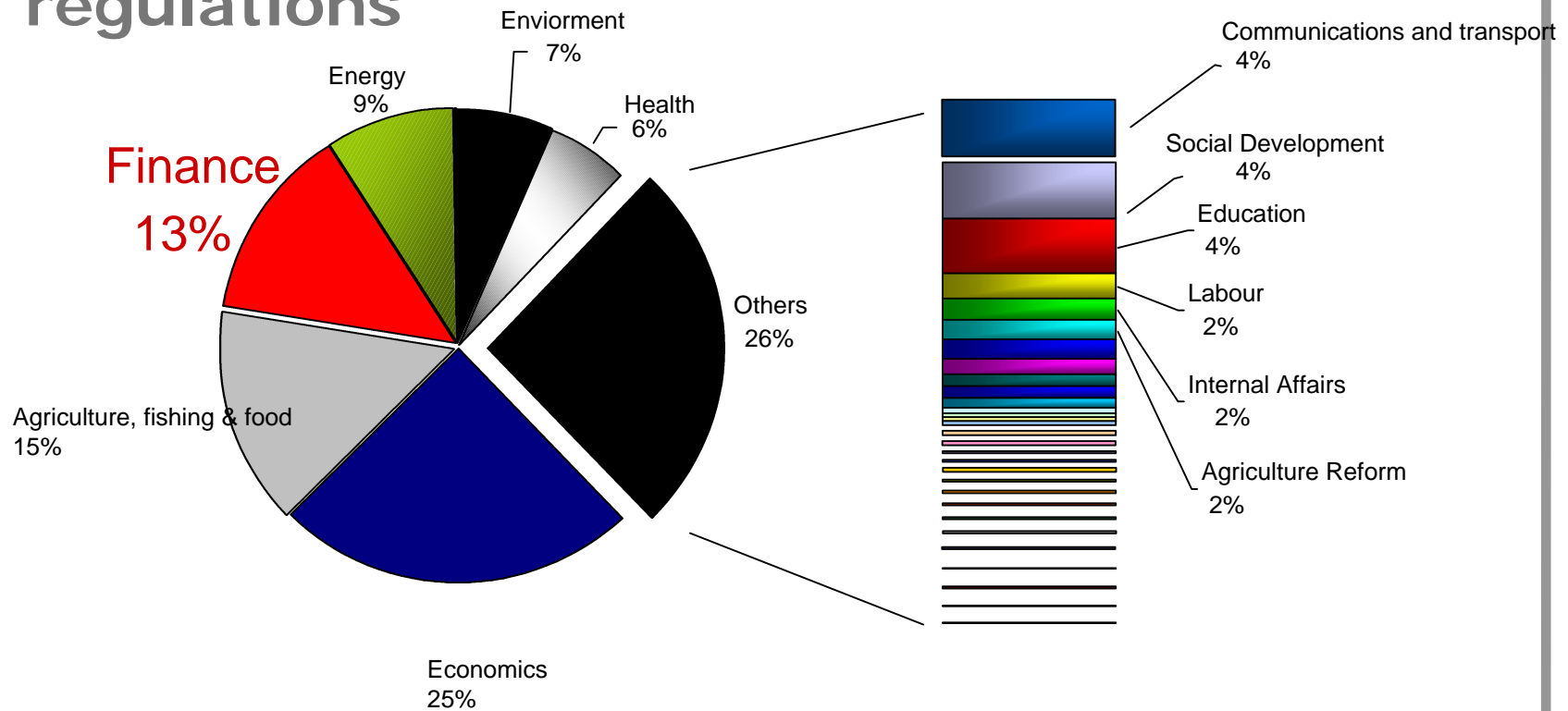


# Regulation trends



# Regulation by Ministry

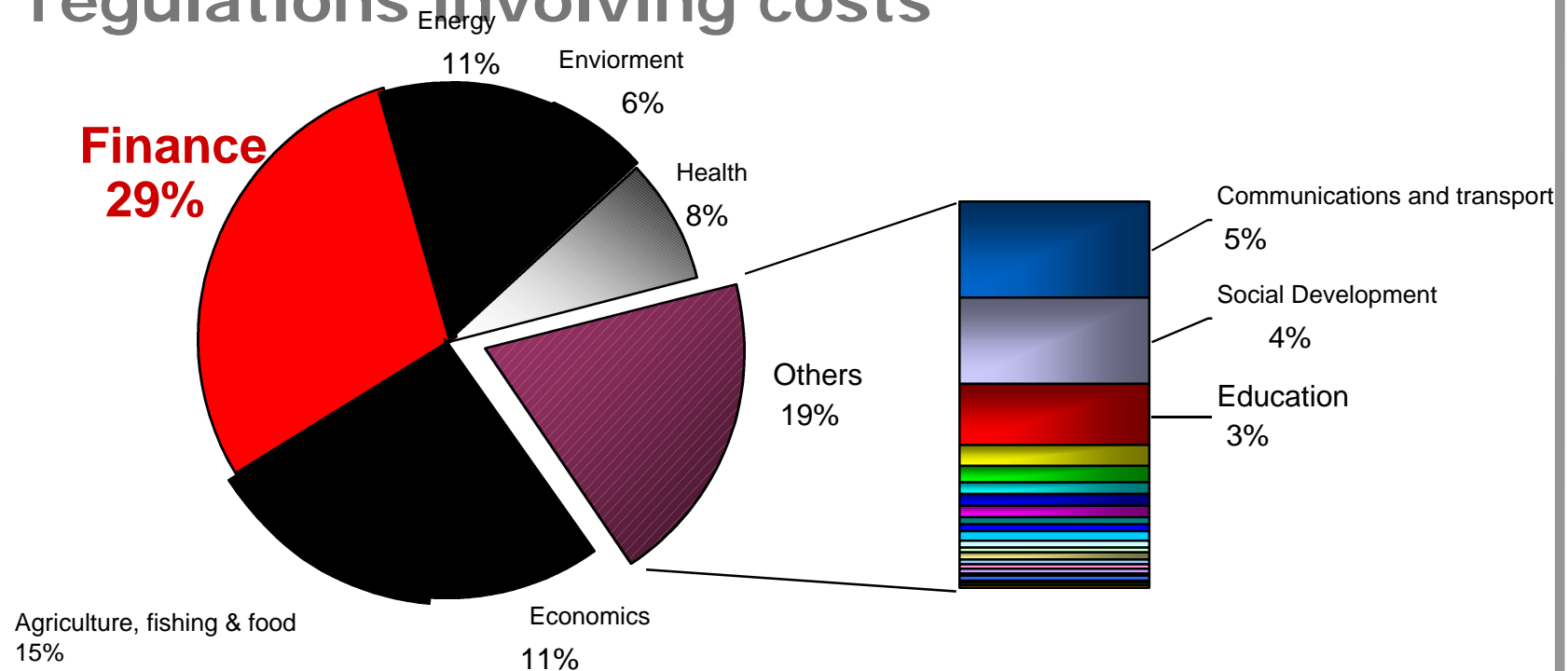
## Total of draft regulations



6 Ministries have sent 74% of the reviewed drafts...

# Regulation by Ministry

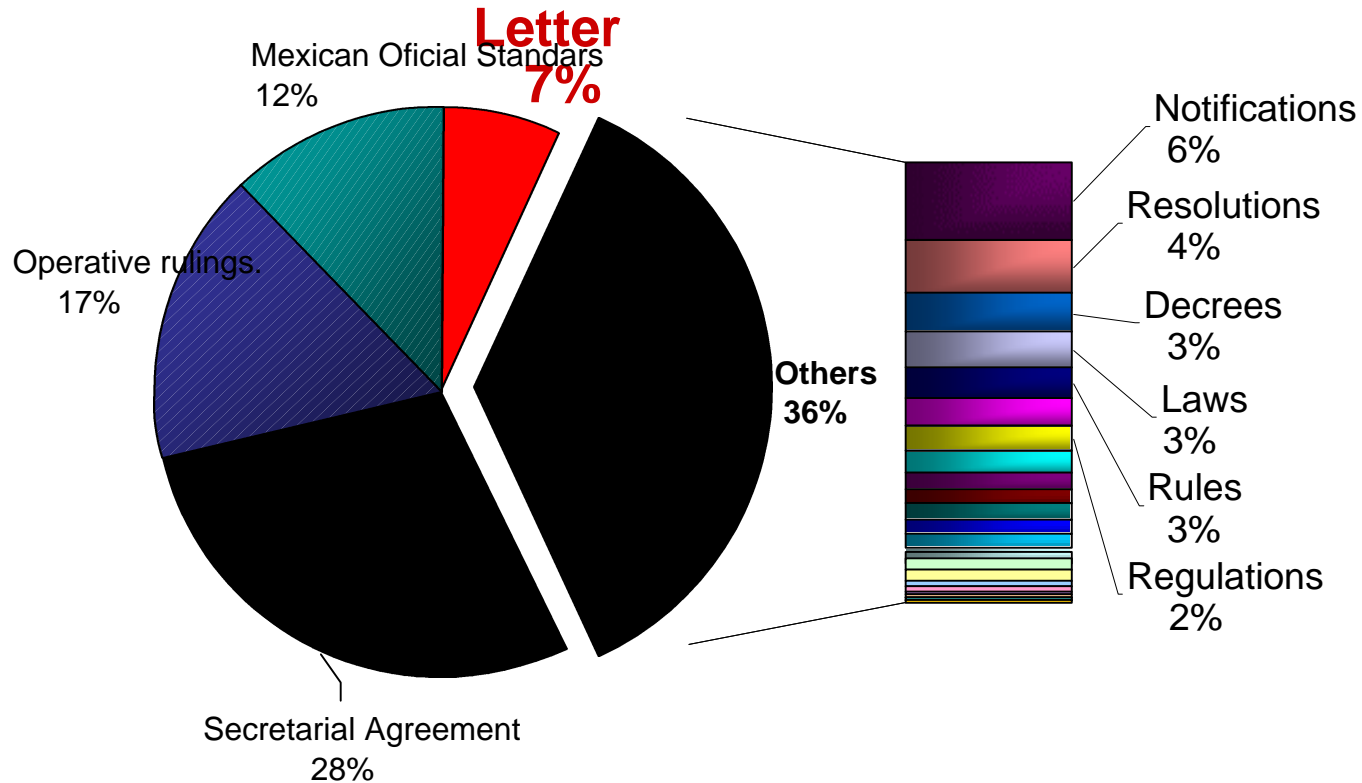
## Total of first draft regulations involving costs



... and same 6 Ministries have sent 81% of the drafts that generate costs.

# Regulation by instrument

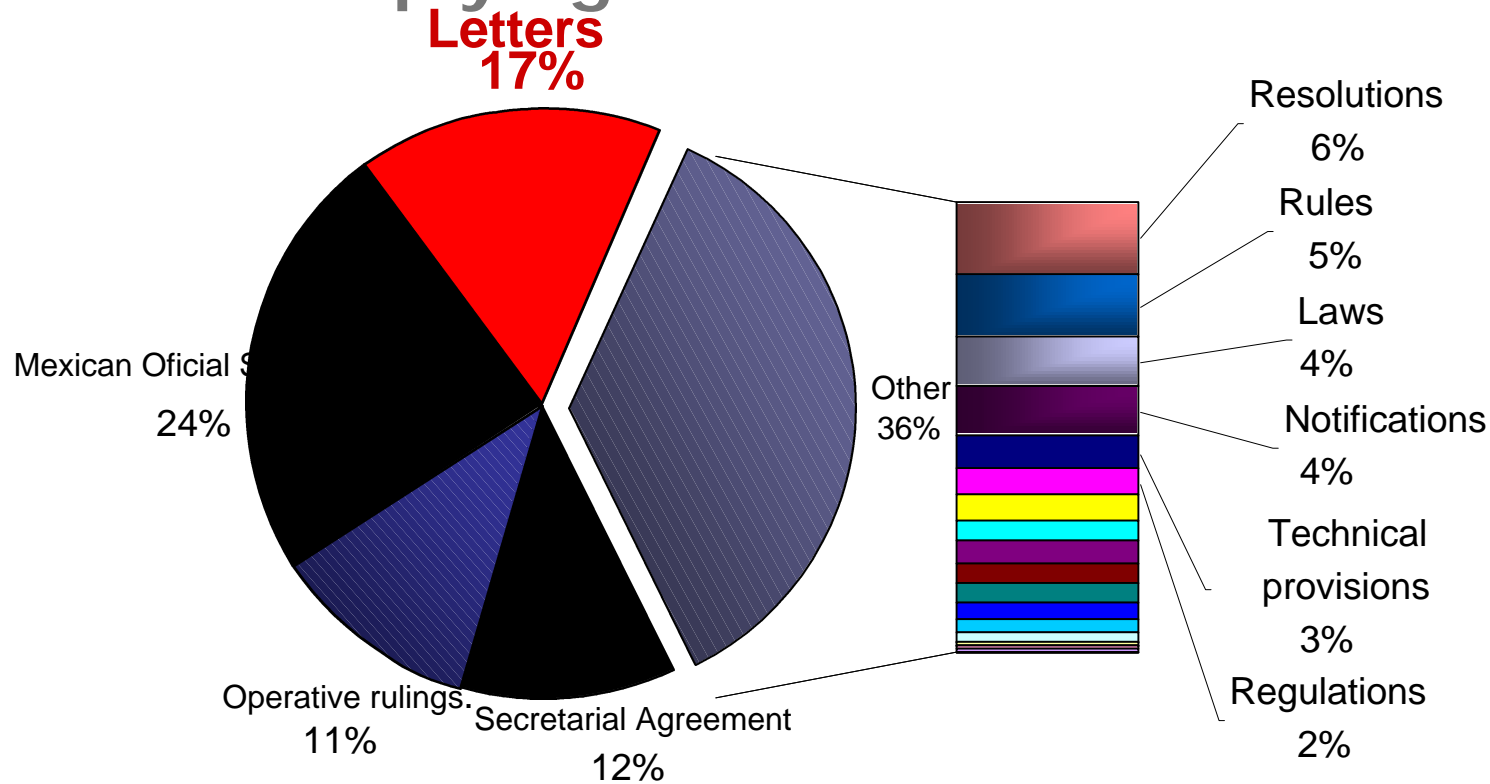
## Total of first drafts



4 types of instruments concentrate 64% of the first drafts received...

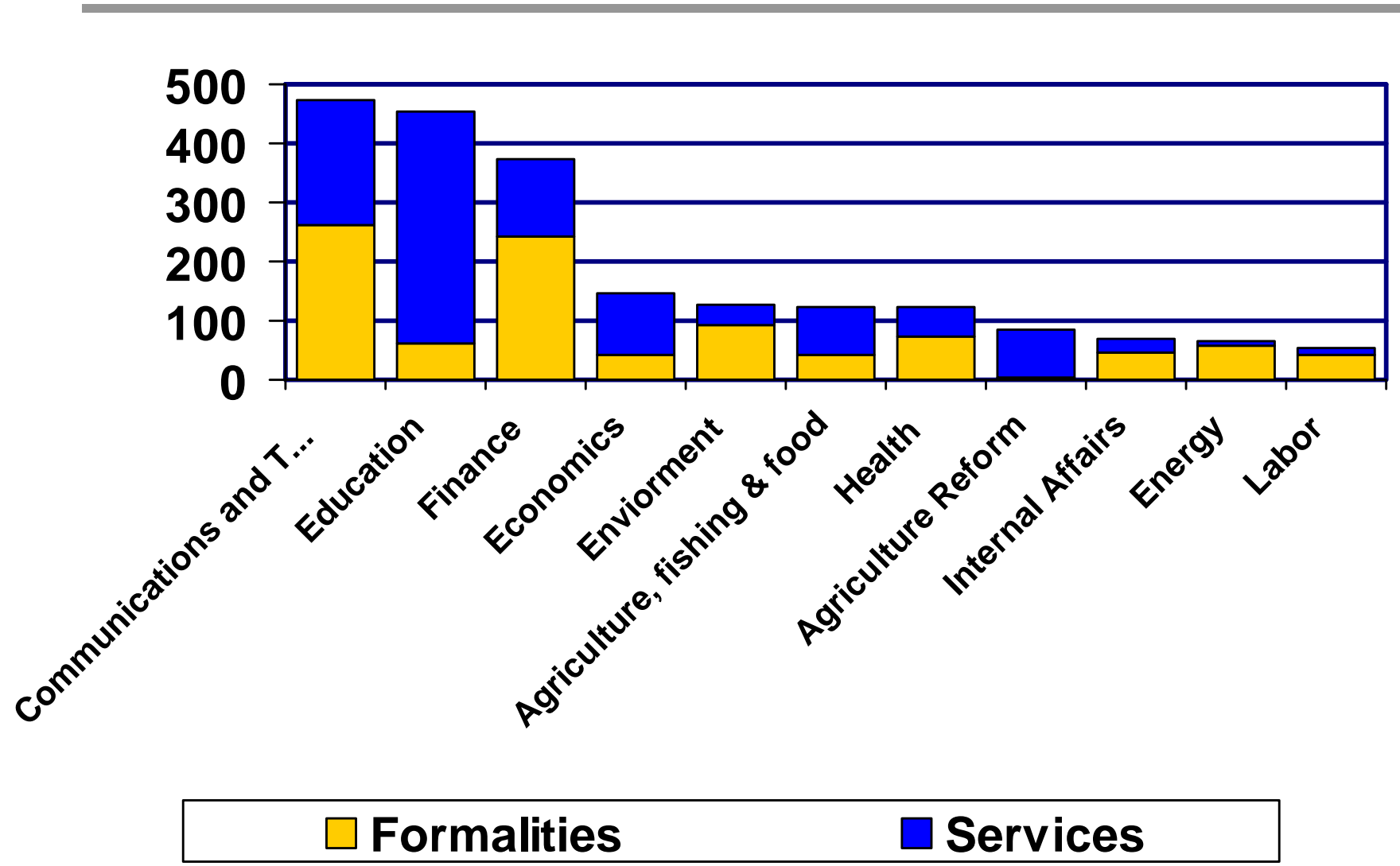
# Regulation by instrument

## Drafts implying costs



... and the same 4 types of instruments concentrate 64% of the drafts implying costs.

# Ministries requiring more formalities and services



# Increase of regulation

The following causes explain regulation increase:

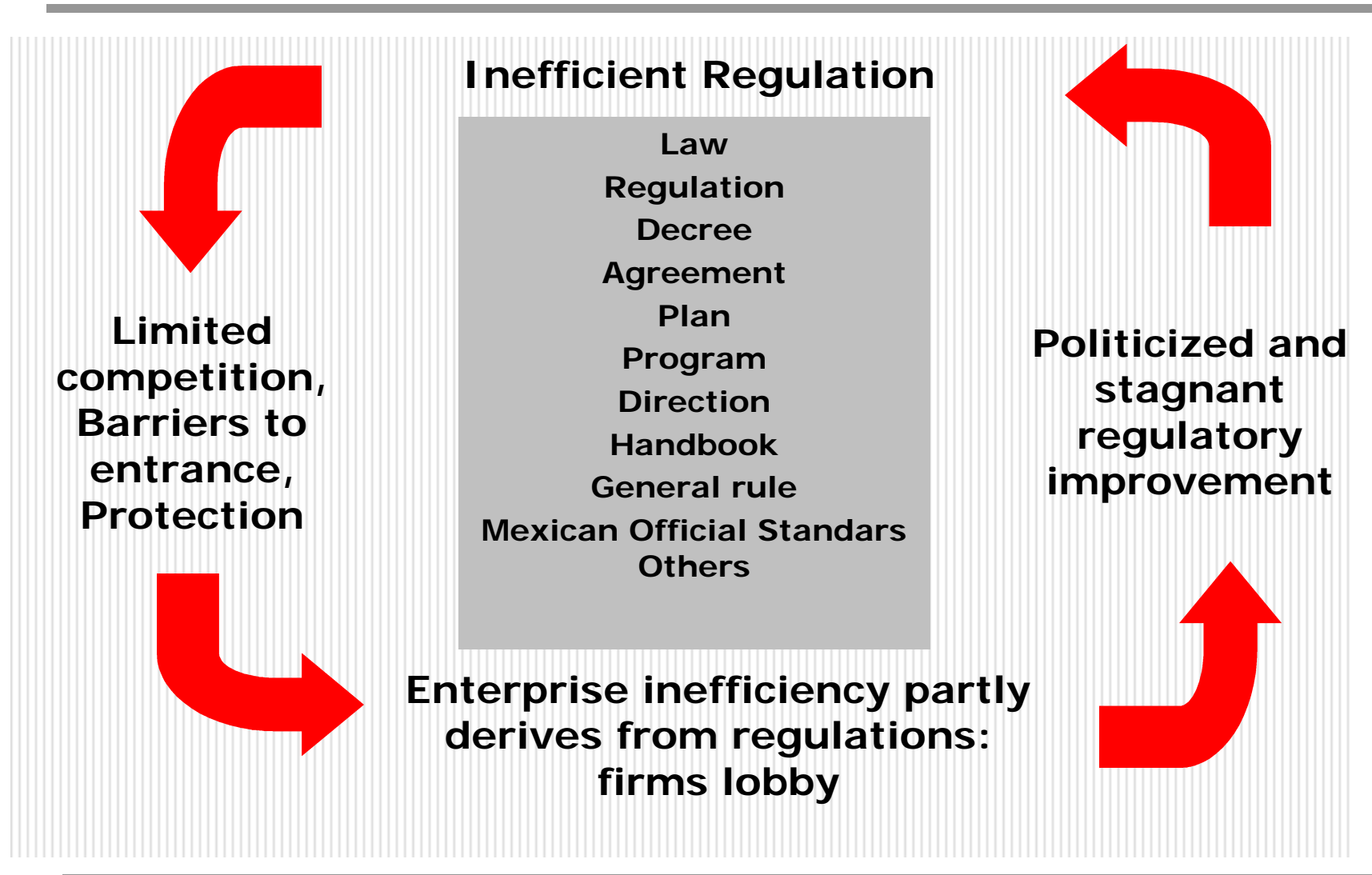
Increased complexity of Societies and Technologies (additional regulation is required as new needs arise)

Bureaucratic inertia (regulators need to justify their existence)

Interest Groups (regulated parties are interested in having regulation that benefits them)

Regulatory capture

# The vicious circle of the inefficient regulation





# The Regulatory Improvement Program...

# What is Regulatory Improvement?

A public policy aimed at subjecting government to a rigorous and systematic normative decision-making process based on:

- The analysis of regulatory alternatives;
- An inclusive and balanced public consultation;
- Monitoring of normative effects;
- Accountability.

This is a self-imposed government discipline.

# Regulatory improvement constituents

Regulatory Improvement is comprised of:

**Regulatory framework reform:** improving the existing regulation (simplifying and flexibilization).

**Deregulation:** eliminating excessive regulation.

**Creation:** designing new regulation

## Cofemer strategies

Review of the draft regulation that involve costs and their Regulatory Impact Manifestations.

Federal Register of Business Formalities and Services.

Biannual Regulatory Improvement Programmes.

Co-operation with local governments

Preparation of diagnosis and regulatory projects.

# What happens if discipline its not applied?

Ill-designed regulation implies:

Costs exceed benefits;

Legal uncertainty;

Corruption;

Increase of administrative judicial reviews  
(amparos);

The accumulation of unsolved and new problems,  
leading to more regulation;

Lack of information – decision making costs.

In sum, lack of competitiveness.

Government = Obstructor of the productive activity.

# Regulatory improvement implementation

In the Federal government:

Applies only to the executive federal power.

State governments:

Almost in the totality of the state executives, with great asymmetries.

Municipal governments:

Some of the main municipalities.

At the moment, this policy has not been implemented at federal, state, or town congresses.

# Regulation of the Financial Sector.....

# Regulation and its drawbacks

Regulation intends to remedy errors that the market does not have capacity to solve in a timely fashion.

In the financial sector, the main regulatory objectives are:

- To maintain the stability and to foster financial system development;
- To reduce information asymmetries;
- To protect users' interests; and,
- To maintain a healthy competition and a diversity of institutions/instruments.

Although regulation has good objectives, it is necessary to maintain a discipline to ensure regulation is not excessive, noneffective, inefficient or lacks transparency.



# Regulation participants

There are numerous governmental participants:

All sector regulators:

- SHCP and its coordinated sector (CNBV, CNSF, CONSAR)

On behalf of users, the CONDUSEF.

On behalf of competition, the CFC.

On behalf of regulatory improvement, the COFEMER.

Sector participants and their organizations (ABM, AMIS, AFIANZA, etc...); as well as sector users.

# Regulation discipline

Regulation determines state intervention on those governed.

In order to avoid excessive or inefficient intervention, it is necessary to maintain a regulatory discipline that ensures that regulation:

- generates more benefits than costs;
- maximizes social welfare;
- meets the goals for which it was created;
- is the best available alternative;
- is clear, safe and transparent.

## Coordination between regulators

Cofemer coordinates with financial sector regulators to verify that its regulation fulfills the best international regulatory practices.

Cofemer will sign an agreement with the CFC, so that the latter verifies the impact of regulation on competition in all sectors, including the financial sector.

Will seek procedures to institutionalize cooperation between Cofemer and the Condusef.

# Conclusion

Regulatory improvement avoids:

That costs exceed benefits;

Legal uncertainty;

Corruption;

Increase of administrative (amparos) judicial reviews;

The accumulation of unsolved problems and creation of new ones, leading to more regulation;

Lack of information— decision making costs.

That the government becomes an obstacle to the productive activity.



## **REGULATORY REFORMS IN THE FINANCIAL SECTOR: CHALLENGES AND PERSPECTIVES**

**Sen. Alejandro Gutiérrez Gutiérrez**

**Secretary of the Finance and Public Credit Commission**

*November 17, 2003  
Mexico D.F.*

1

### **Why regulate?**

**The principal objective  
of regulation in the  
financial system is to  
allow people to  
access, under a  
framework of  
transparency, a range  
of first rate financial  
services provided at  
low cost**

2

## What we currently see in the Mexican market?

- **A high concentration in the credit market that tends to favor anticompetitive conducts**
- **Credit stagnation, mortgage and productive in general**
- **Services charges and fees well above those observed internationally**

3

### 1. High market concentration

As of June 2003, only 3 banks control:

- ➔ **60.52%** of the total portfolio
- ➔ **50.48%** of all commercial credit
- ➔ **69.78%** of all credit to government entities
- ➔ **58.71%** of Fobaproa notes
- ➔ **71.61%** of all mortgage credit
- ➔ **63.19%** of all consumer credit

Source: CNBV, *Boletín Estadístico de Banca Múltiple*, June 2003

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## Over time, the market gets more concentrated

### Control exerted by the 3 largest banks in the system

	2000	2003	Variation	Concentration
Total portfolio	54.39	60.52	11.27	↑
Commercial credit	46.37	50.48	8.86	↑
Credit to government entities	68.21	69.78	2.30	↑
Fobaproa notes	52.58	58.71	11.66	↑
Mortgage credit	67.32	71.61	6.37	↑
Consumer credit	72.54	63.19	-12.89	↓

Source: CNBV, Boletín Estadístico de Banca Múltiple, 2000

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### Comments...

In 2000 as well as in 2003, two institutions stay inside of the 3G

Due to the boom in the supply of credit by non-banking institutions, concentration in consumer credit falls.

**COMPETITION**

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## 2. Credit stagnation

- **The total credit portfolio, decreased 4.24% in real terms between December of 1999 and March of 2000.**
- **Today, the level of portfolio credit is below its level 3 years ago.**
- **Nevertheless, in the first trimester of 2000 banks obtained earnings of 4.811 mdp, against 2.927 mdp registered in the fourth trimester of the last year**

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## Credit portfolio progress (2001 – 2003)

Constant June 2003, Thousand million pesos



Source: CNBV, Boletín Estadístico de Banca Múltiple, June 2003

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### 3. High commissions

- According to the AMB, in the last 3 years banking income from commissions increased by 26%.
- Mexico registers financial services charges well above those of its main competitors and commercial partners.
- The greater financial cost in the country, prevents the expansion of the system and limits national productive competitiveness.

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### International comparison of commissions

	Minimun opening balance	Monthly average balance	Account handling fee	Charged for check	Fee per Bounced check	Fee for deposited and returned check
Laredo National Bank	100 USD	N / A	8.95-100 USD, Depending of the operation volume	no fee	14 USD	4 USD
First National Bank	100 USD	N / A	0-15 USD Depending of the balance account	no fee	14 USD	5 USD
Mexican Bank (case 1)	500 USD	500 USD	100 pesos plus VAT	5 free thereafter 10 plus VAT	780 pesos Plus VAT	50 pesos plus VAT
Mexican Bank (case 2)	500 USD	500 USD	200 pesos plus VAT	5 pesos Plus VAT for check	850 + VAT	100 pesos plus VAT

Source: Generated with data from CONDUSEF and webpages for each bank.

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## **What have we done?**

**2 Initiatives were presented, which now are LAW & regulate specific areas of the financial system and seek to set off the supply of credit and promote competition in the market under transparent conditions**

- **Law to regulate Credit Information Companies (Credit Bureau)**

- **Law for Transparency and the Promotion of Competition in Mortgage Credit (Subrogation Law)**

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## **Credit Bureau**

### **Mexico's Situation**

- **People did not have access to their information in the Bureau.**
- **Could not clarify their credit history.**
- **The customer service mechanism through banks was complex and inefficient.**
- **There were no protection and defense mechanisms for people who disagree with their information.**

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## **With the new Law:**

- **A simplified mechanism for information consultation and correction is established.**
- **Users were granted rights to their information.**
- **Sanctions for user rights violations were established.**
- **New obligations for information accuracy were established.**

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## **What is subrogation?**

**By Law this mechanism :**



**Allows consumers of credit to negotiate conditions for mortgage loans**



**Allows those who have assumed a mortgage to amortize the original credit, cancelling the existing mortgage, and to enter into a new loan agreement with the same or with another institution offering better conditions.**

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**What is the main objective:**

**Stimulate competition between banks, that results in lower interest rates by allowing debtors to transfer their mortgage credit to an Institution that offers better credit conditions.**

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**Also, this Law has important economic impact**

**The scheme detonates the economy by stimulating the construction industry; an industry integrated 96%, and linked to 47 other industries.**

**Contributes to the consolidation of the internal economy.**

**It is a strong impetus and growth and employment generator for the country.**

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## Where are we going?

Recently, a 3rd Law Initiative for Transparency and Organization of Financial Services was introduced. It fundamentally seeks:

- Transparency in charges to the user.
- Encourage the use of quick , secure and efficient means to stimulate economic dynamism.
- To eliminate discriminatory practices between financial Institutions and between these and users.

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## The Initiative considers:

1. **The elimination of interbank fees:** the incentive to make anticompetitive conducts is eliminated.
2. **A unique tariff charge for the use of automatic tellers:** it promotes transparency in user charges.
3. **Allowing employees to choose their bank when receiving pay:** benefits will now be directed to the employee and not to the employer.

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4. **More information to the public:** Banco de México will publish a chart that allows a fee comparison between banks for each service.
5. **The obligation of institutions to include in their balance statement the net cost of financing:** more transparency for the user.
6. **Stimulating the debit and banking system's expansion:** by fostering the use of debit and credit cards.

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7. **Information displayed in the automatic teller screen:** Specifying costs to the user for the operation, and detailing the fee charged by the Issuer and Operator.
8. **Eliminating fees charged by businesses:** by barring them from charging customers a fee for the use of another means of payment.

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## **What remains to be done?**

**Work jointly with the COFECO in designing and implementing a regulatory framework that eliminates possible anticompetitive conducts; that encourages competition and investment for the development of the sector and its infrastructure.**

**Impel specific laws that promote transparency for the user; towards improvement of financial services and the charging of competitive international fees.**

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## **REGULATORY REFORMS IN THE FINANCIAL SECTOR: CHALLENGES AND PERSPECTIVES**

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Mexico D.F.*

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[www.consar.gob.mx](http://www.consar.gob.mx)

## **The Pension System of Workers Affiliated with the IMSS**

Seminar on Competition and Regulation  
in the Financial Services Sector

November 2003



### **Contents**

---

- **Introduction**
- Situation in the new system
- Competition in the industry
- Conclusions





## In 1997 a new pension system, financially sustainable in the long term, entered into operation

The principal characteristics of the new system are:

- Individual accounts with well-defined contributions.
- The pension depends on the accumulated balance of the account, which is determined by contributions, the yield they generate and commissions charged by the Afore to manage the resources.
- Minimum pension guaranteed by the State.
- Organism specialized in the regulation and supervision of the system: Consar, characterised by a tripartite formation, with participation from the labour, business and government sectors.
- The resources are invested in financial assets.
- The worker elects his account manager and manner of retirement.

3



## Reforms in the pension system imply benefits for workers and for economic development

Worker

- The new system ensures that the worker will have an income when he retires
- Each worker has a savings account that is fully his property
- The worker obtains returns only accessible to large-scale savers
- Workers with lower incomes are favored by the social quota and guaranteed minimum pension
- Promotes continuance in the labor market

Public Finances

- The system is financially sustainable in the long term
- The system is not affected by the aging of the population

Economic Development

- Strengthens financial deepening
- Gives savings a broad savings horizon, allowing financing of projects and infrastructure with long maturation periods

4



## Contents

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- Introduction
- **Situation in the new system**
- Competition in the industry
- Conclusions

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**At present there are 12 Afores authorized to manage pension system resources**

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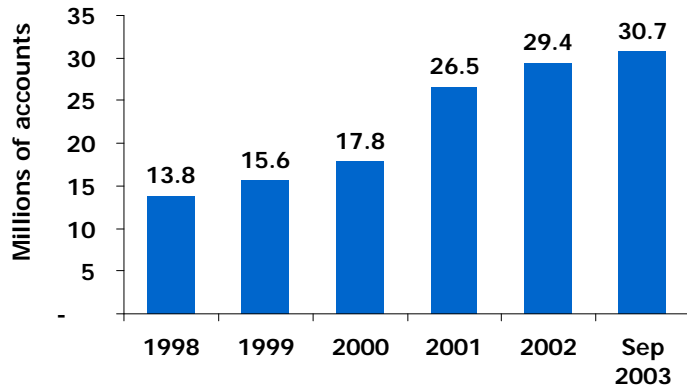
- **Afores with 100% domestic capital**
  - Actinver
  - Azteca
  - Profuturo GNP
- **Afores with minority foreign capital participation**
  - Inbursa
  - XXI
  - Banorte Generali
- **Afores with majority foreign capital participation**
  - Banamex
  - Allianz Dresdner
  - Principal
  - Bancomer
  - ING
  - Santander Mexicano

In March 2003 Afore Azteca began operations and in April, Afore Actinver

6



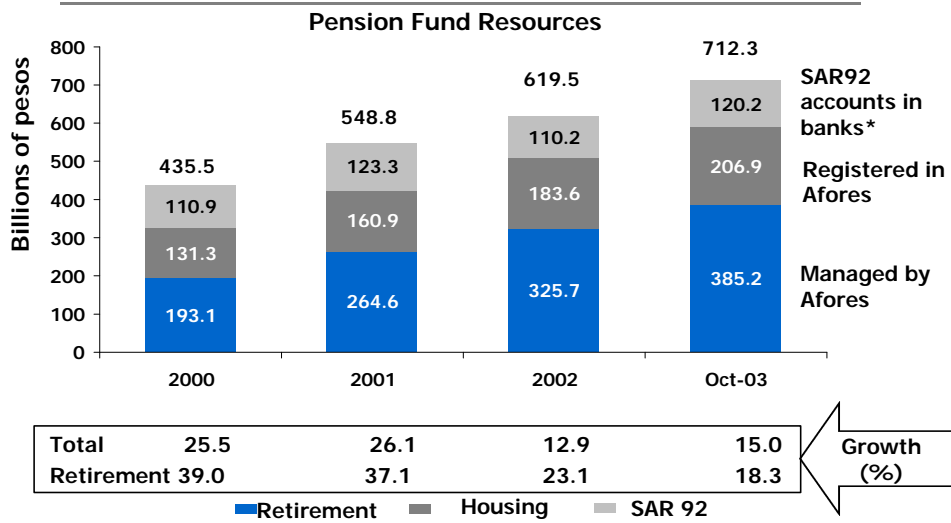
### The Afores manage slightly more than 30 million individual accounts



Figures for the end of each period



### Resources for retirement savings reach 711 billion pesos, equal to 10.7% of GDP



Figures for the end of each quarter in constant pesos October 2003.

October numbers are preliminary

\*Includes retirement and housing sub-accounts



## Siefores are now listed as the fourth largest intermediary in the Mexican financial system

From 1998 to 2003, Siefores registered the largest increase in participation in the financial market

Intermediary	Participation (%)		AARG <sup>1</sup> (%)
	1998	2003	
Multiple Services Bank	66.7	49.8	1.9
Development Bank	16.9	19.0 ↑	11.7
Investment Societies	7.1	11.0 ↑	19.8
<b>Siefores</b>	<b>3.3</b>	<b>10.6 ↑</b>	<b>40.9</b>
Insurance	3.8	5.0 ↑	15.8
Sofoles	1.1	3.8	41.5
Leasing	0.7	0.4	-1.7
Factoring	0.4	0.3	2.3
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>11.8</b>

Siefores explain 25% of the increase in financial assets over the last 12 months

<sup>1</sup> Annual Average Rate of Growth  
Figures as of June 2003

9



## Four Afores concentrate 53% of accounts and 58% of resources

### Accounts and Funds Managed by Afores (September 2003)

Afore	Individual accounts	Participation	Acumulated Shares	Resources (Million pesos)	Participation	Acumulated Shares
Banamex	5,549,672	18.1	18.1	137,238	23.2	23.2
Bancomer	4,334,689	14.1	32.2	126,131	21.4	44.6
Santander Mexicano	3,248,151	10.6	42.7	52,541	8.9	53.5
Principal	3,197,337	10.4	53.1	25,031	4.2	57.7
Profuturo GNP	3,063,825	10.0	63.1	60,128	10.2	67.9
Banorte Generali	2,738,938	8.9	72.0	35,546	6.0	73.9
ING	2,700,205	8.8	80.8	52,936	9.0	82.9
XXI	2,222,310	7.2	88.0	38,616	6.5	89.5
Inbursa	1,950,147	6.3	94.3	42,993	7.3	96.7
Allianz	1,239,449	4.0	98.4	18,447	3.1	99.9
Azteca	269,011	0.9	99.3	458	0.1	99.9
Actinver	230,115	0.7	100.0	357	0.1	100.0
<b>Total</b>	<b>30,743,849</b>	<b>100.0</b>	<b>N.A.</b>	<b>590,423</b>	<b>100.0</b>	<b>N.A.</b>
<b>Hischman-Herfindah Index</b>		<b>0.111</b>			<b>0.142</b>	

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---

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- Competition in the industry
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  - Consar Actions
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- Conclusions

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## Individual accounts systems must operate in competitive conditions to meet their social objective

---

Competition in the Afores industry can be approached from two perspectives:

- **Conditions from the Demand side:**
  - Lack of interest in retirement saving
  - Information Failures
- **Conditions from the Supply side:**
  - Friction in some operating processes
  - Services to affiliates

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## There are at least three elements that explain the low sensitivity of workers to changes in commissions

- **Nature of the product:** The product marketed in this market has different characteristics than those of a traditional product.

Management of Retirement Funds	Traditional Product
<ul style="list-style-type: none"><li>• Consumption of this product is compulsory.</li><li>• The price is not easily comparable, and its implications (in %) are not clearly understood.</li><li>• The benefit is obtained over the long run, when the pension is received.</li></ul>	<ul style="list-style-type: none"><li>• Consumption of the product depends on the interest of the consumer.</li><li>• The price is easily comparable.</li><li>• The benefits are received immediately or in the short term.</li></ul>

These special characteristics generate a low level of attention from workers regarding the net earnings of their individual account and of the services offered by the Afore.

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## There are at least three elements that explain the low sensitivity of workers to changes in commissions (Cont.)

- **Guaranteed Minimum Pension**
- **Pensions based on the benefits outlined in the Social Security Law of 1973**

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## **Another problem on the demand side is in the information available to workers**

---

**The system has great challenges to improve its information because:**

- **The system is relatively new.**
- **There is a limited culture of savings.**
- **In the past, CONSAR's dissemination efforts were limited.**

**In addition, information from Afores' customer service centers is neither neutral nor homogeneous.**

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## **On the supply side, the industry's cost structure must be taken into account**

---

**The complexity of some processes have a bearing on the entrance of new suppliers.**

- **For example, some frictions in the transfer process.**

**In summary, the combination of this (demand/supply) generates competition in advertising and brand, but to a lesser degree, in prices, which translates in an important degree to the dispersion of prices.**

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- Introduction
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To promote competition in prices, a demand aggregate figure has been used

CONSAR assigns the accounts of workers who do not elect an Afore to those Managers with the lowest commissions.

### Bimonthly Assignments to Afores

Date	Accounts	RCV Amount (millions of pesos)
Jun-02	1,132,836	765.3
Aug-02	289,015	127.0
Oct-02	441,411	188.9
Dic-02	404,012	98.0
<b>Subtotal 2002</b>	<b>2,267,274</b>	<b>1,179.2</b>
Apr-03	282,257	126.7
Jun-03	459,695	180.3
Aug-03	248,499	80.4
Oct-03	305,692	153.5
<b>Subtotal 2003</b>	<b>1,296,143</b>	<b>540.8</b>
<b>Total</b>	<b>3,563,417</b>	<b>1,720.0</b>

This is a powerful mechanism, since 77.6% of new accounts were assigned during 2003.

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The investment regime has also been adjusted to achieve better returns and thereby reduce the load of the Guaranteed Minimum Pension

Guideline	Before	After
Eliminate restrictions by issuer	Governmental (min. 65%) Private (max. 35%) Financial intermediaries (max. 10%)	Governmental, <b>Private, States, Municipalities and Public Sector</b> Financial intermediaries ( <b>unlimited</b> )
Regulate the risk of concentration in accordance with credit quality <i>In case of violation</i>	AAA and AA  <i>Immediate Sale</i>	AAA, AA y A  <i>No more purchases of this instrument, but can be held until expiration</i>
Increase investment opportunities in foreign currency	Dollars, only government bonds	Dollars, <b>Euros, and Yens</b> in government and <b>private</b> bonds
Allow the use of derivatives	Cash	Cash and <b>derivatives</b>
Efficiently control market risk	Min. 65% of bonds with Average Weighted Term of 182 days	<b>VaR</b>



In search of fostering Voluntary Savings as a complement to pensions

- If used for the purchase of a house, the probability of obtaining Infonavit credit increases
  - Allows better credit conditions with FONACOT
  - Fiscal deductability
- ➔ Increases workers' interest in the performance of their individual account, even if they are entitled to a Guaranteed Minimum Pension



Actions have also been taken that influence information to workers and optimization of operating processes

---

- Strengthening CONSAR´s Communication Program
- Launching of a broad publicity campaign
- Amplifying services for workers in consultation and information centers
- Regulatory changes relating to information provided by Afores
- Optimizing processes and preventing irregularities

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The budget for media dissemination increased and the publicity campaign was intensified

---

- **2003 Media Communication Program**
  - For 2003, the media budget for Consar increased by 100% relative to 2002.
  - The range of tools for dissemination was enhanced with a better segmentation of messages and publicity spaces.
- **Publicity Campaign**
  - Oriented towards creating public awareness of differences among pension administrators, in particular in their commission levels.
  - Implemented a campaign with three main messages:
    - ✓ Why it is important to know SAR
    - ✓ Not all Afores are the same. Commissions vary
    - ✓ Importance of voluntary contributions

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## Institutional Relationships

### State Tours with Union Organizations

Organization	States	Participants in Talks
CROC	20	2,200
CTM	12	1,000

- In addition, a program was started with CROM.

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## Institutional Relationships (cont.)

### Companies and PYMES

- During the last 4 months: 116 visits in 25 States and 102 in working centers.

Company Size (number of workers)	Number of Companies Visited	Number of Workers
0 – 1,500	40	44,000
1,500 – 3,000	32	73,600
3,000 – 10,000	14	98,000
10,000 or more	30	660,000
<b>Total</b>	<b>116</b>	<b>875,600</b>

- *Who's who in commissions? (PROFECO)*

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## Regarding information centers, services for workers are being expanded

- **Balance Calculator**
  - Simplify this instrument so as to make its use easier among workers
  - Was given greater visibility in Consar's webpage
  - This service was implemented via telephone (free)
- **Telephone Attention Centers (CAT): Agreement with Amafore**
  - Capacity and services supplied by CAT were expanded
- **Brochures**
  - 500,000 brochures have been distributed

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## Although Afores charge commissions on different bases...

Afore	Over Flow	Balance <sup>2</sup>
	% del SBČ	% Fijo anua
Banamex	1.70	-
Bancomer	1.68	-
ING	1.68	-
Actinver	1.05	0.24
Allianz Dresdner	1.60	0.50
Azteca	1.10	0.15
Banorte General <sup>3</sup>	1.40	0.70
Inbursa	0.50	0.50
Principal <sup>4</sup>	1.60	0.45
Profuturo GNP	1.67	0.70
Santander Mexican <sup>5</sup>	1.60	1.00
XXI	1.30	0.20

<sup>1</sup> BSC: Base Salary for Calculations. Amount obtained from dividing by 6.5 % worker/employer and state contributions of RCV (without social quota).

<sup>2</sup> Annual percentage.

<sup>3</sup> The commission on Banorte Generali's balance will be 0.60% in 2004, 0.50% in 2005, 0.40% in 2006, and 0.30% from 2007 onwards.

<sup>4</sup> The commission on Afore Principal's balance will decrease from 0.45% to 0.35% in 2005, to 0.30% in 2010, and to 0.20% from 2015 onwards.

<sup>5</sup> The commission on Santander Mexicano's balance will be 0.80% in 2004, 0.70% in 2005, 0.60% in 2006, 0.50% in 2007, 0.40% in 2008, 0.60% in 2007, 0.40% in 2008, 0.30% in 2009, 0.20% in 2010, and 0.15% from 2011 onwards.

Figures at the end of September 2009.



## ... Consar has devised the indicator "Equivalent Commissions" to allow comparison

### Equivalent Commissions over Balance at 25 years

Afore	Percentage of BSC
Profuturo GNP	1.37
Allianz Dresdner	1.16
Banorte Generali	1.00
Principal	0.82
Santander Mexicano	0.81
Bancomer	0.79
ING	0.77
XXI	0.72
Banamex	0.69
Inbursa	0.65
Actinver	0.62
Azteca	0.58
Average	0.81

Afore commissions maintain a certain equivalence at each term of comparison

BSC: Base Salary for Calculation. Amount obtained from dividing by 6.5 % worker/employer and government contribution to RCV (without social quota)  
Equivalent Commissions at the end of September 2003 for an average worker that earns a salary 3 times the minimum wage, has 6-year seniority with an initial balance of \$27,339.46, annual real profit rate of 5%, and a 25-year contribution term. Includes Allianz write-off.



## Changes in the regulation of Afores publicity

Guidelines were established to guarantee objectivity and uniformity of Afores publicity. The new publicity circular underscores, the following changes:

- A single comparison parameter is established regarding yield, commissions and balances, so indicators are not used according to convenience.
- It is valid to make comparisons with other Afores.
- Comparisons regarding yield and commissions must be made at least against the market average.
- Regarding voluntary and complementary contributions, they can be compared against other financial products.
- The source of information must always be quoted.

➔ These rules apply to all instruments in which Afores provide information to workers



## Changes to optimize processes and prevent irregular situations

These changes avoid registrations or transfers induced by biased information, and ensure that, when the worker decides to change, there are no obstacles for him/her to do so:

- The table on commissions charged by Afores was incorporated into the registration document that the worker signs and into his/her statement.
- Changes in the transfer process:
  - Reduction of the term in which the operation is performed, from three months to three weeks.
  - Receiving Afore performs the operation.
  - Digitized documentation for worker's safety.
  - Elimination of rejection causes regarding application.

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### Equivalent Commissions

### Projected Retirement Balance

**¡ATENCIÓN!** SI TÚ DECIDES CUÁL ES LA AFORE QUE MÁS TE CONVIENE, NO DAS COBRAN LAS MISMAS COMISIONES. REvisa con CUIDADO EL DOCUMENTO ANTES DE TRASPASAR O REGISTRAR TU CUENTA INDIVIDUAL.

Esta información es un cálculo basado en la estructura de comisiones vigente y rendimientos estimados. No se garantiza que estos resultados se mantendrán en el futuro. Las comisiones y los rendimientos de las AFORES pueden variar.

COMISIONES EQUIVALENTES		SALDO PROYECTADO PARA EL RETIRO	
AFORE	Porcentaje anual sobre el saldo (25 años)	AFORE	Saldo proyectado a 25 años
Azteca	0.59	Azteca	257,829
Actinver	0.62	Actinver	256,192
Inbursa	0.65	Inbursa	254,930
Banamex	0.71	Banamex	252,356
XXI	0.73	XXI	251,251
ING	0.78	ING	249,122
Bancomer	0.80	Bancomer	248,136
Santander Mexicano	0.81	Santander Mexicano	247,532
Principal	0.83	Principal	246,960
Banorte Generali	1.01	Banorte Generali	239,085
Allianz Dresdner	1.17	Allianz Dresdner	232,411
Profuturo GNP	1.38	Profuturo GNP	223,902
Promedio	0.84		

Firma o huella digital del Trabajador con la que manifiesta conocer el contenido del presente documento

Saldo estimado en la AFORE con la comisión más baja	\$ 257,829
Saldo estimado en la AFORE con la comisión más cara	\$ 223,902
Diferencia en Pesos	\$ 33,927
Diferencia en Porcentaje	15.15%

**Menores Comisiones, Mayor Saldo y Pensión**

**Mayores Comisiones, Menor Saldo y Pensión**

**Trabajador: sólo tienes que firmar este original. Si quieres suspender este traspaso o registro puedes hacerlo dejando de firmar este documento.**

Proyectado de la subcuenta de Retiro, Cesantía en Edad Avanzada y Vejez (RCV) con las comisiones vigentes de cada AFORE. Datos: Tasa de rentabilidad de 5% anual en términos reales, período de cotización de 25 años, un nivel de ingreso igual a 3 veces el salario mínimo, un saldo inicial de 0.00, crecimiento real del salario de 0% y 6 años cumplidos de permanencia. Los recursos acumulados no incluye la subcuenta de Vivienda administrada por el INFONAVIT. Cierre de agosto de 2003.

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## Services provided by the Specialized Unit of Attention to the Public of each Afore will be standardized

---

Soon, CONSAR will publish a new circular on the information services provided by the Afores's Specialized Units of Attention to the Public, so Afores can self-regulate services and quality of attention to their customers.

Afores will have a Manual that will:

- Define minimal information that Afores must provide.
- Establish minimal procedures that can be performed through telephone attention centers and webpage.
- Define auditing mechanisms through specialized companies that will monitor the quality of services.

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## In addition, improvements to the transfer process are being designed so that through self-regulation it becomes more efficient and secure for the worker

---

### • Efficiency and neutrality in the process

- Original assignor Afore document: is eliminated as a transfer requirement.
- Transfer application form: is standardized to make the review of digitized images easier.
- The verification process is centralized in Procesar.

### • Security for the worker

- Afores must create the Transfer Manual with a minimum standard of good practices:
  - Functionally separate the operation and commercialization areas in order to verify origin of transfer applications.
  - Use of methods that allow a worker to confirm his/her choice regarding transfer application (e.g., confirmation by phone).
  - Define corrective measures to be applied when irregular events are detected.

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## Several alternatives are being assessed to cut operational costs in the system and increase resource profitability

---

- Implement transfer modes through the Internet and automatic teller machines
- The Siefores investment regime will continue to be adjusted, so as to improve portfolio diversification and increase risk adjusted yields.

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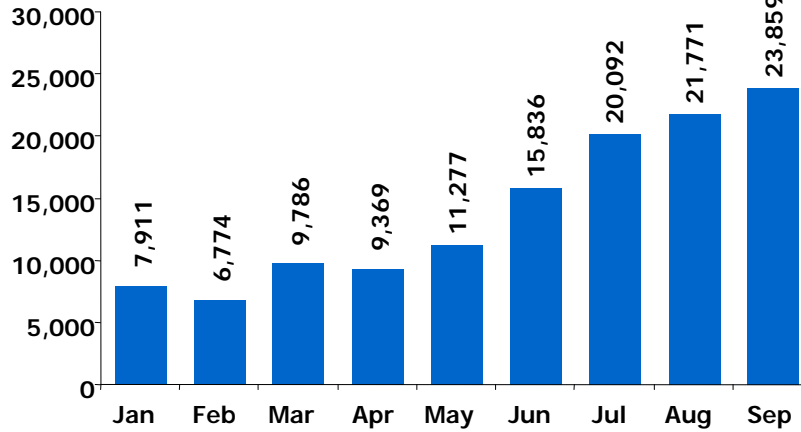
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The number of consultations using the Balance Calculator increased by 201.6% from January to September 2003

Monthly Consultations of the Balance Calculator in 2003

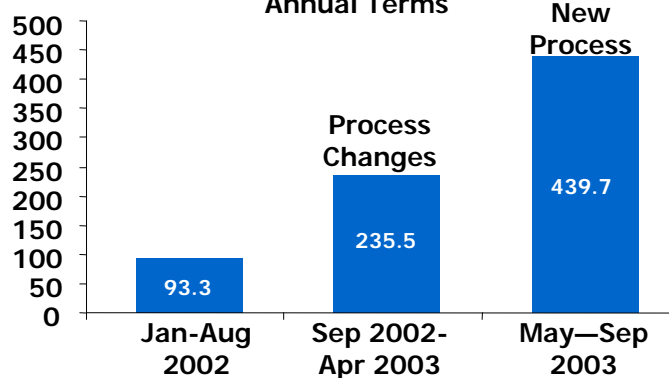


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The number of transfers has increased by 500%

Thousands of Affiliated Worker Transfers Annual Terms



Turnover (Transfers/Workers)	0.8%	2.0%	3.6%

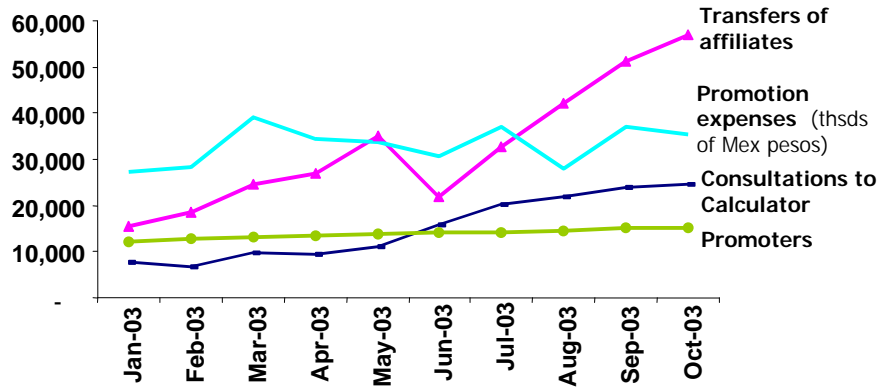
According to an exit survey, 61% of those who consult the calculator reveal their intention to change Afores.

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There is a high correlation between the number of transfers and the consultations to the Calculator

Affiliate Transfers, Promoters, Consultations to Calculator, and Promotion Expenses

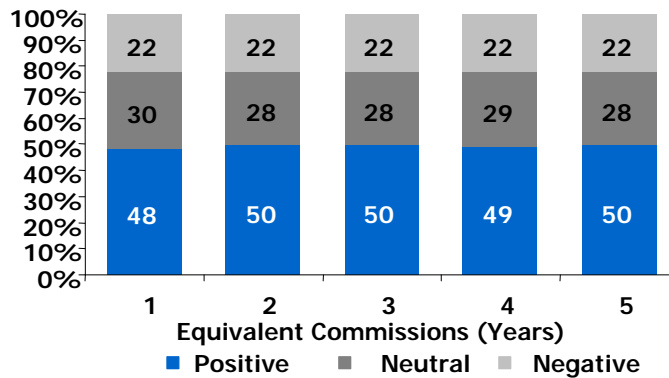


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Most workers have transferred to a less expensive Afore

Percentage of positive, neutral, and negative transfers Equivalent Commissions



Commissions as of September 2003

Note: Positive transfers are to a less expensive Afore, while negative ones are to a more expensive Afore.

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Complaints to CONDUSEF decreased by 18% in the first semester of 2003. Technical assistance increased by 80%.

CONSULTATIONS ATTENDED TO BY CONDUSEF ABOUT SAR

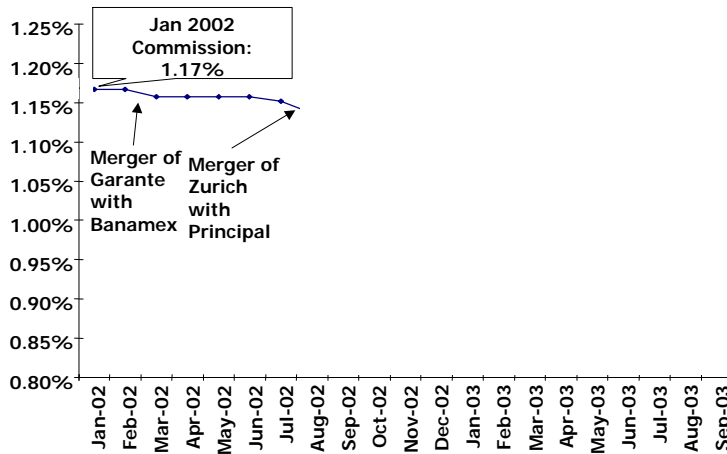
SAR	2002	%	2003	%	Difference	Decrease / Increase
Complaints	889	7.96	730	6.80	-159	-18%
Technical Assistance	40,884	52.07	73,547	62.94	32,663	80%

Source: CONDUSEF Semester Comparative Jan – June 2002 vs Jan – June 2003



Since January 2002 commissions have decreased by 31%, reaching a historic low

Historic Evolution of the Equivalent Commission Average



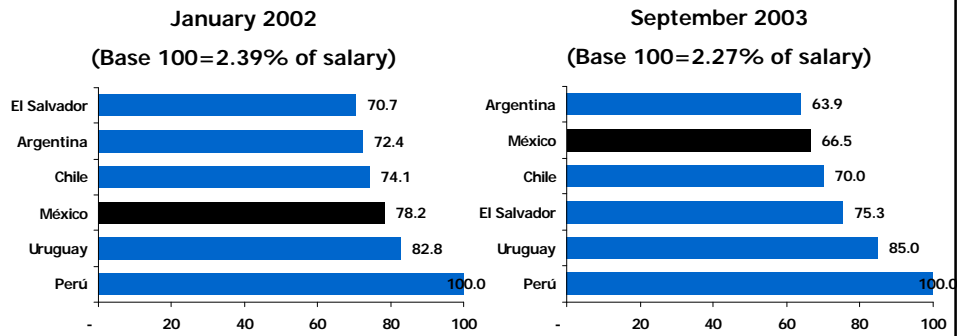
Projections to 25 years.

Based on a worker that earns 3 minimum wages, with an initial balance of MX\$27,339 pesos, a social fee of MX\$2.51249 pesos, and 6 years of contributions. By September 2003, it includes Allianz Write-Off.



Compared to other countries with similar schemes, the average commission in Mexico is among the lowest

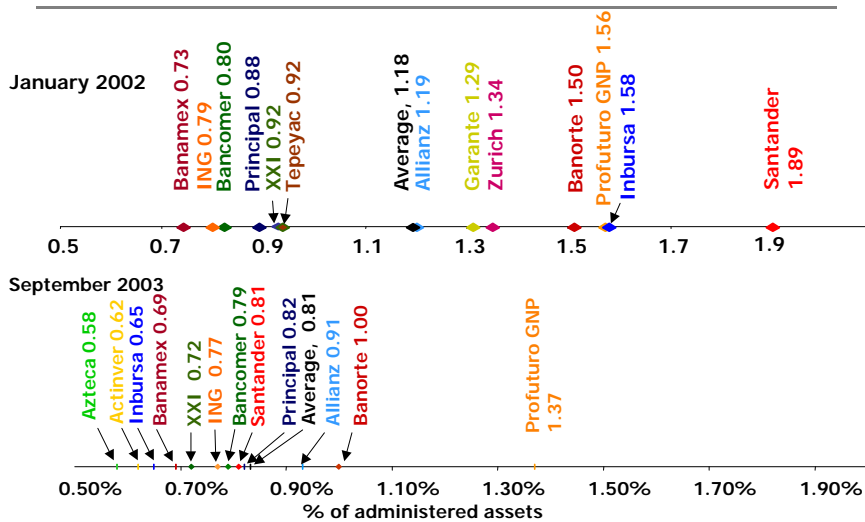
### Comparative of Commissions



Source: CONSAAR with data from the AIOS Bulletin as of December 2001 and June 2003. The figures for Mexico are January 2002 and September 2003 respectively; for this latter date, the Allianz write-off is considered.



### Dispersion of commissions has also decreased



Equivalent Commissions for a worker that earns 3 minimum wages, with a 3-year seniority, an initial balance of MX\$27,339.46, a real annual interest rate of 5%, and a 25 year projection. For September 2003, the Allianz write-off is included.

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## Conclusions

---

- **With the reform, a financially sustainable pension system was built, generating clear benefits for workers and the economy.**
- **There are supply and demand conditions that inhibit competition in the Afores industry in terms of prices: workers' lack of sensitivity, frictions in processes and in information services.**
- **The strategy followed by CONSAR to encourage competition consists in providing more and better information to workers and in optimizing processes.**
- **The objective of this strategy is for the industry to compete in elements that improve pensions.**
- **Among the results obtained, the decrease in commissions by more than 30% stands out.**

# **Pension System Contribution to Financial Markets Efficiency**

**Javier Beristain Iturbide**

## **1. Pension Investment: Current Situation**

## 1. Investment of retirement savings: Current Situation

- By the closing of September 2003 the retirement savings system (SAR) accumulated resources of 711 billion pesos, equivalent to 10,6% of the GDP:
  - ✓ 54%, equivalent to 381 billion pesos, corresponds to the resources of the workers directly managed by retirement funds managers (afores).
  - ✓ 29% of the resources are managed by the National Housing Fund for Workers.
  - ✓ 17% are resources that belong to the SAR 92 that also correspond to the pension subaccounts of workers affiliated to the ISSSTE, such as the Housing funds managed by Fovisste and Infonavit.

The retirement Fund subaccount (RCV), managed by afores, receives bimonthly installments near to 10 billion pesos. The SAR is the fastest growing segment of the financial market in our country:

- ✓ From 1998 to 2002 Siefores assets had an average growth of 43%, while the rest of the financial system grew just 8.5%.
- ✓ By the end of 2002, Siefores assets represented 10.6% of the financial savings of the country.
- ✓ In August of 2003 SAR funds already represented 26.5% of family savings and contributed 44.7% growth in the year. (Central Bank information Banco de México, July-September 2003)

## 1. Investment of Retirement Savings: Current Situation

- Investments of retirement savings by in charge of the afores have been made according to the investment regime authorized conformy the authorized by the Consar.
- Investments in siefores have proved their financial and structural efficiency by facing several episodes of the world financial instability, without detriment to the workers estate and allowing pension savings to grow at annual real rate of 8.2%

Graph 1. Evolution in time of the Gestion Price \* of the Afores Investment Funds

Spanish version



\* Refers to Siefores price index before commission on weighted balance by the asset value of each Siefore.

Fuente: CONSAR

## 2. Consequences of current investment regime

## 2. Consequences of current investment regime

### 2.1 Accelerated Fund growth with respect to investment instruments supply:

- **Workers have become one of the main demanders of public or private paper debt:**
  - 22% of the total of bonds that the Federal Government issues are held by Siefors. According to estimations of some analysts, if the internal debt rate, (GDP), persists in the following decade, pension funds could demand 100% of the government paper issued.
  - During 2002, 43% of the total amount of corporate bonds from private Mexican issuers with minimum AA qualification were acquired by Siefors. In spite of the growth in the supply of nongovernmental titles in the recent years, the total issued would only suffice the investment of 40% of the value of the Siefors portfolios.
- **Accelerated growth in the siefors resources in relation to financial market development makes clear the need to extend i investment alternatives in order to continue fulfilling the objective to invest workers savings in better security and yield conditions.**



## 2. Consequences of the current Investment Regimen

### 2.2 Excessive concentration in a few issuers and in a reduced number of sectors:

- By the end of September 2003, by economic sector distribution of siefores still shows a low degree of diversification: 83,9% of fund values were invested in governmental values, 4,1% in service sector, 3,8% in transformation, 3,8% in telecommunications, 2% in construction, 1,8% in infrastructure and 0,6% in states and municipalities.
- Also, the invested resources are invested highly concentrated in a single currency: 83,6% in pesos, 16,3% in udis and only the 0,1% in dollars.
- **Although funds have been invested in the highest quality issuers of the Mexican money market the observed level of concentration increases the general risk of portfolios.**
  - 10 issuers concentrate 70% of non governmental paper portfolios of siefores.
- **Also, although the investment regimen allows limited diversification in other currencies, it still limits investment in papers of Mexican issuers preventing the possibility of diversification of country risk.**

## 2. Investment Consequences of the Current Investment

### 2.3 Extension of terms and decreasing tendency of the real yield rate:

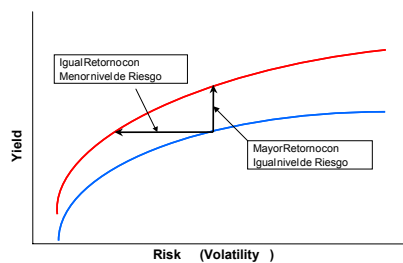
- **Recovery of economic stability in our country has provided investment with a better planning horizon investments.**
  - The maximum term of the yield curve of government bonds increased from one year in 1999 to 10 years in 2001 and up to 20 years in 2003.
  - The extension in the term of this curve has not only significantly contributed to the development of the equity, market also to the development of private securities markets and to that of derivatives of interest rates in pesos.
- **Investment yields must adjust, decreasing along with country risk and better reflecting economic agents productivity. Under the current investment regime and in face of decreasing real interest rates, the yield of retirement savings will come close to the long term growth rate, around 5% real rate.**
- **The convenience of increasing the retirement savings rate of growth becomes evident if their effects on the expected pension are analyzed.**
- **According to CONSAR calculations, increasing real yield rate of funds from 5% to 5,5%, could improve the expected pension up to 9,1%**

\* CONSAR, Informe al H.Congreso de la Unión, Agosto 2003.

### 3. Risk Management of Investments Diversification

### 3. Investment Diversification

- **Investment concentration in a single type of financial instrument - whichever this is - increases the level of risk exposure by favoring that investment portfolios are fully affected by events such as:**
  - ✓ Market Price and market rate changes, (market risk)
  - ✓ problems in the performance of the companies (issuer risk),
  - ✓ crisis in certain sectors of the economy (sector risks),
  - ✓ adjustments in the exchange rate (currency risks)
  - ✓ instability in a country is economy (country risk).
- **The diversification principle is part of the “golden rules” of the traditional investment funds and of the world pension funds.**



### 3. Investments Diversifications

#### Spanish version

- > In the OCDE countries the pension investment systems take place on a values basket extremely diversified, that they included in addition, the opportunity to make investments in no financial assets such as real estate and direct loans.
- > In the Latinamerican pensions systems of individual capitalization it is observed that the investments of the assets are diversified between the national and foreign financial and shareholding markets.

País	Inversión en Acciones	Inversiones en Bienes raíces	Inversiones en Bonos Corporativos	Inversión en Fondos de Inversión	Prestamos	Inversión en valores extranjeros
México	0	0	Hasta 100% en base a calidad crediticia	0	0	Hasta 20%, regulación pendiente
Canadá	Sin límite	25%	Sin límite	Sin límite	Sin límite	No permitida para el caso de inversiones en mercados accionarios de países no miembros de la OCDE
Rep. Checa	25%	Sin límite	Sin límite	25%	0	Sólo permitida para valores de países miembros de la OCDE
Hungría	50% fondos obligatorios 60% fondos voluntarios	0% fondos obligatorios 10% fondos voluntarios	50% fondos obligatorios 40% fondos voluntarios	50%	0% fondos obligatorios 5% fondos voluntarios	Hasta un 30% de los activos de los fondos obligatorios en papeles de países de la OCDE y hasta 5% en países no miembros
Italia	Sin límite	Sin límite	Sin límite	20%	Sin límite	Hasta en 50% en mercados de la OCDE no regulados y un máximo de 5% en valores de países no miembros
España	Sin límite	Sin límite	Sin límite	Sin límite	10%	No permitidos en países no miembros de la OCDE
EUA	Sin límite	Sin límite	Sin límite	Sin límite	Sin límite	Sin restricciones
Reino Unido	Sin límite	Sin límite	Sin límite	Sin límite	Sin límite	Sin restricciones

Limites máximos por tipo de instrumento y emisor en Junio de 2001  
(porcentaje del valor del fondo)

País	Deuda Pública	Deuda Privada	Acciones	Emisores Extranjeros	Fondos de Inversión
Chile	50	45	40	30	25
Argentina	65	40	35	10	14
Perú	40	40	35	7.5	15

Fuente: legislación vigente en los países considerados.

### 3. Risk Management

- A necessary condition for the efficiency of diversification is that it takes place under a strict risk management: identification, measurement, monitoring and risk control.
- A suitable risk diversification would imply the gradual disappearance of regulation based on quantitative restrictions, to approach a method that establishes limits to diverse investment risk indicators. This type of investment regime limits potential losses in the portfolios value, and allows an optimal diversification of assets.
- Afores have in operation a system and structure for risk management that consist of a Risk Integral Management Unit, Risk Committees that meet monthly that follow up on exposure to the different risk types, and maximum limits of tolerance to the risk established by the Councils of Administration.
- In addition, the investment regime has begun to adapt, allowing regulation to advance from a system of quantitative restrictions to one whose emphasis is integral risk management.

## 4. Regulation Investment Recent Changes

### 4. Investment Regime Evolution

In October of 2002 reforms to the Law of the SAR were published and during the last year important changes to the siefores investment regime took place, tending to:

1. **Extend the supply of values that can be acquired with workers the savings.**
  - The possibility is opened so that CONSAR authorizes investment in foreign values up to 20% of the assets of the Siefore, favoring risk diversification and reducing risk associated to a local portfolio. Regulation is still pending.
2. **Controlled of total, not only partial, portfolio risk.**
  - Limits to the Risk Value of the portfolio, was set, to the potential losses under the scenes of greater market volatility.
3. **Extend investment opportunities by issuer and currency.**
  - Investment titles issued by municipalities and government forms is allowed
  - The scope of limit of investment in titles in foreign currency issued by the Federal Government was extended, in order to also include titles issued by Mexican companies and not only in dollars but in euros and yens.
  - The investment limit in titles issued by Financial Institutions was eliminated, and prohibition for these investments applies in case of nexus with the Afore.
4. **Regulate based on credit quality and not on type of issuer.**
  - The generic limit of 35% for nongovernmental instruments was eliminated, and now the maximum limits are applied based on the credit qualification: 100% for AAA, 35% for AA and 5% for A.  
Concentration by issuer is also limited according to issuer (or counterpart) : 5% for AAA, 3% for AA and 1% stop A.
5. **Allow the operation of instruments that enable risk control.**
  - Once a series of strict operative requirements, are fulfilled Afores will be able to operate derivate instruments regarding underlying instruments permitted in the investment regime, to enable a more flexible portfolio administration and to cover against market risks.
6. **Allow the operation of a family of Siefores by Afore**
  - Operation of several investment societies with different composition portfolios, considering diverse degrees of risk, terms, origin and destiny of the resources invested in them. Requirements for workers to choose a given Siefore will be established. Regulation is still pending.

## 6. Siefores Contribution to the Stock Exchange Market Efficiency

### 6. Siefores Contribution to the Stock Exchange Market Efficiency

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#### 1. More players in the financial markets.

- Institutional investors such as investment societies, insuring firms and in greater measure Siefores, have gained share from the banking sector and generate competition in securities market.

#### 2. Yield as differentiating element for Afores.

- The pension of a worker depends to a great extent on the real yields that an Afore can generate. An efficient management along with an effective investment strategy, represent the two basic elements to differentiate among administrators to compete by a better yield.
- A wider definition of an investment regime access to new instruments and markets, and the possibility of offering a family of funds will contribute to large extent to greater a differentiation among administrators.
- A scheme of guaranteed minimum yields, like Chile's, inhibits competition for and foments the "herd" behavior, where differentiation between investment strategies and portfolio composition of the administrators is minimum.

#### 3. Greater deepening of bond market.

- In four years, the efficiency curve of governmental bonds increased its maximum term from one to twenty years, whereas the curve of real rates already includes 30 years expiration terms. The long investment term profile of the Siefores and the Insurers has motivated extensions.
- The purchase and sale price rate differential have decrease importantly, reflecting liquidity and the volume of operations that exist in the market, lowering the price of the intermediation cost.
- The suitable handling of the programs of governmental auctions values also has contributed to deepening, whereas the program of exchange and bond issues (CBIC's, SHF), contributes not only to more liquidity, but also to cover all the range of the efficiency curve with market observations.

## 6. Siefores Contribution to Financial Market Efficiency

### 4. Private Companies as demanders for funds

- The participation of nongovernmental financial papers in the portfolios of Siefores has grown constantly, and longer term papers are offered. During the last 12 months, the value of the nongovernmental portfolio titles has increased in 19.5 thousands of million pesos.
- The extension of the efficiency curve also has been a key element in the development of the fixed rate corporate bonds market, and it has also caused the sprouting of novel financing structures in the country such as securitization of mortgage portfolios that will contribute to a greater supply of house credit.
- The credit quality and double qualification requirements of private financial paper for the Siefores, have contributed to order the market, to build awareness of the risks that are assumed in these investments, and to foster more companies to disclosure information.
- The corporate bond market debt growth will allow in a future construction of efficiency yield curves differentiated by credit quality and transition studies and breach probability to enable a better analysis of credit risk.

### • Price and Value determination

- The growth of Institutional investors participation growth in the bond market has generated the necessities in terms of the determination of market prices for the investment valuation.
- Siefores, Investment Societies and Insurances portfolios valuation is made daily in market prices.
- In particular, in the last years have appeared two very relevant figures that had contributed in an important way to the development of a more disciplined exchange market.
  - The **market builder** who must analyse purchase selling prices for stock non-governmental values of fixed rate for different terms to enable the final investors find disposed intermediaries to buy or sell governmental values in case they need liquidity or require to invest.
  - The **Price provider** who must determine market prices of financial instruments for daily investment valuation.
- Both figures participate in an active way in order to determine the market price, and to give transparency and certainty to the investment values, promote competition, so that the investor could make resource allocation decisions.

## 6. Pending Tasks for the improvement of financial market efficiency

**In spite of the mentioned advances, the market continues displaying deficiencies and opportunities of improvement:**

- 1. Banks continue being the most important holders of governmental values.**
  - A high concentration of these values exist in a few banks.
- 2. The liquidity in the secondary market is concentrated basically in Bonds and Treasury Certificates.**
  - During 2003 the operation volume of treasury Certificates has decreased in an important way.
  - Long term bonds represent the most liquid paper in the secondary market, nevertheless, the liquidity is concentrated in very few issues. Liquidity in instruments small used.
- 3. A high concentration of certain issues exist making pricing difficult in the secondary market for private instruments.**

Eg. Some big banks, and even some Siefores can obtain the totality of government bonds auctioned
- 4. Lack of liquidity in the secondary market for private instruments.**

**Intermediaries hardly ever launch these papers. Often, these instruments must comprise a liquidity prime.**

## 7. Final Reflections

## 7. Final Reflections

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- The Pension System's objective is to achieve the best possible pension for workers. In the resource investment context, this means to take advantage of the opportunities of financial markets to obtain efficient risk-yield relation for workers savings.
- The importance of risk diversification and management in investments, is well documented by our country's experience and that of international markets. According to this experience, a prudent investment scheme avoids excessive risks from investment concentration in limited baskets instruments, through diversification.
- Modifications to the Retirement Saving System Law, was sensitive to the diversification needs and to establish a gradual fund opening process. Through this measures exposure of investments to exchange and country risks will decrease, in benefit of the security and profitability of funds. In turn, measures adopted to manage and control investment risks establish the framework for diversification to occur efficiently and in a controlled fashion.
- Siefores have become of one of the main institutional investors in the country. The expected portfolio growth together with an adequate regulation will be factors that contribute to develop and deepen capital markets.



GOBIERNO DE CHILE  
SUPERINTENDENCIA DE AFP

# Competition in the Chilean pension system

Guillermo Larraín  
AFP Superintendent

Mexico City, November 17th, 2003

The Chilean model

Little competition : why?

The Role of Multifunds

Ideas

## The main characteristics of the Chilean pension system's

- There are three pillars (following the World Bank)
  - Minimum Pension (20 years quotation)
  - *Mandatory* preventive saving, defined contribution
  - *Voluntary* preventive saving
- The mandatory component is aimed at all *dependent* workers. The preventive quotation is 10% of the taxed salary.
- The AFP collects the quotation, manages it in an individual account and makes the investments.
- **Except for solvency and integrity requirements, there are no *formal* barriers to entry to the industry. The minimum levels of capital to operate are low.**

The Chilean model

Little competition : why?

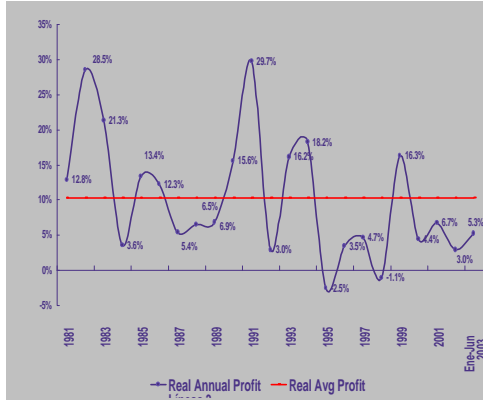
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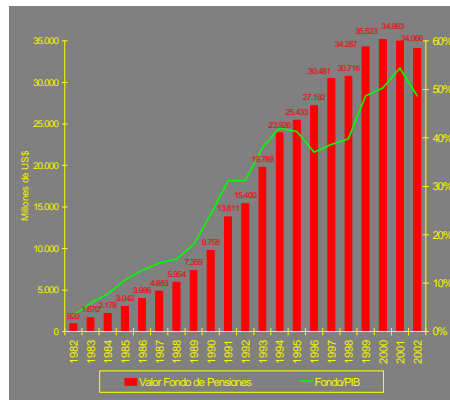


## The system has been succesful in its profitability and savings accumulation

Annual Average Real Profitability :  
10,4%



Great Asset Accumulation :  
USD42bn or 55% GDP



The Chilean Model

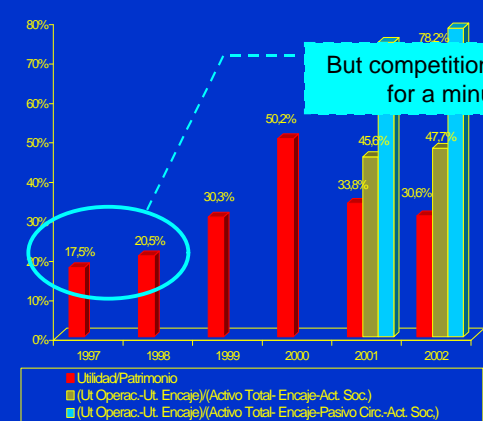
Little competition : why?

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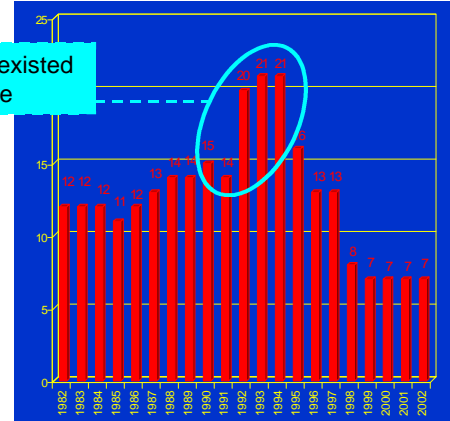
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## Nevertheless, the market needs competition (in other words, it can be better!)

ROE superior to other financial industries



The industry has concentrated



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## What happens is that not all competition is productive

- The concept of competition is very broad. In economics; what matters is that competition perfects the market (decrease costs, induce lower prices, improve service, increase transparency, etc...)
  - Competition in Chile between 1991 and 1997 had two characteristics:
    - Was actively promoted by the State. Union workers and Associations were persuaded to create their own AFP.
    - **Instead of competing on price, competition took place through commercial expenses: salespeople.**
- **Also promoted by the State, subsequently the sector “self-regulated”. See previous transparency.**

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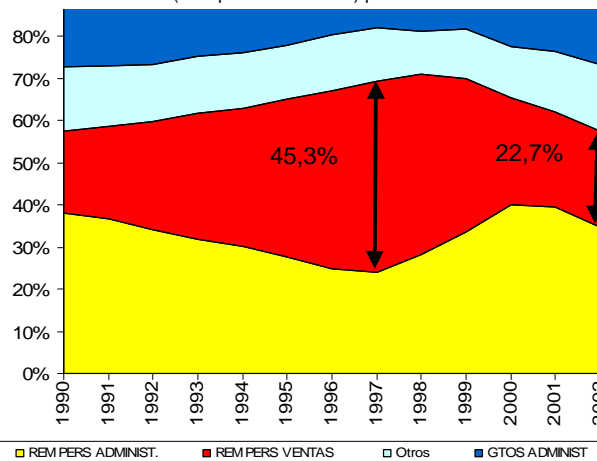
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## The expense adjustment associated with salespeople was brutal

Evolution of the (G. Operational- PSIS) per Affiliated Member



**But, What characteristics does the pension demand have, to make the market behave in this manner?**

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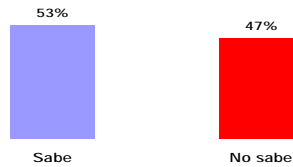
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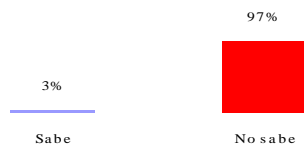
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## Outstanding demand characteristic: not knowledgeable, indifference

Half of the market participants do not know their monthly contribution:



Practically no one knows exactly how much the AFP pays:



Less than half knows how much they have accumulated on their fund:



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## Can there be healthy competition in this market?

### Supply Characteristics

- *Mono-producer* industry.
- Single commercial activity guaranteed by law. There is a possibility of integrating cost areas with banks and insurance companies.
- Important scale economies. Apparently, they are found in the collection function.

Entry barrier : Minimum critical mass is hard to obtain due to a captive demand

### Quasi-natural monopoly

### Demand Characteristics

- Obligation to consume. Until 2002, the consumer had no influence on investment decisions, and just opted to change AFP.
- Time passed between investing and deriving benefits varies with age. For the young, it is similar to a tax. Product value grows with age.
- Indifference for the product leads to lack of demand for information. Deficient quality of the latter.

### Inelastic demand

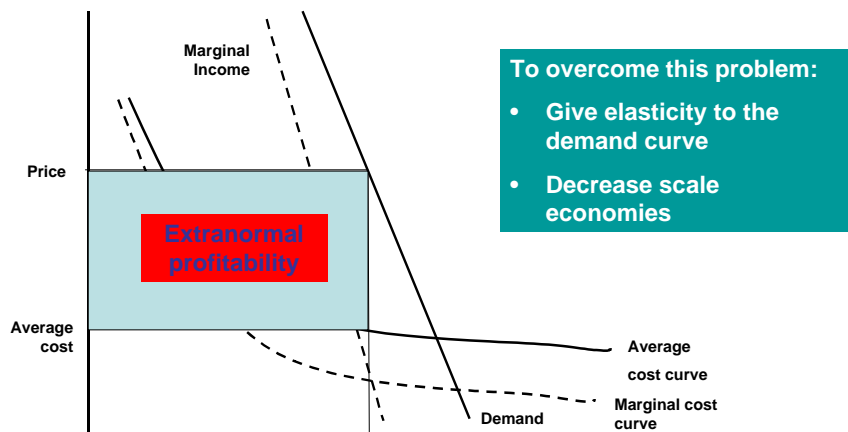
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## Can there be a healthy competition in this market?



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## Elasticity of the demand curve

There are many aspects where progress has been made, those that have increased the preferences of investors to the pension system:

- More and better information  
Internet, brochures, bulletins, customer service office.
- Voluntary Preventive Savings
- In the future: consider the individual's "existencial" problem, his life cycle. Explore optimizing the complementarities between the preventive system and retirement insurance (which in Chile also operates with an individual capitalization scheme)
- Multifunds

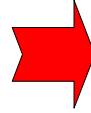
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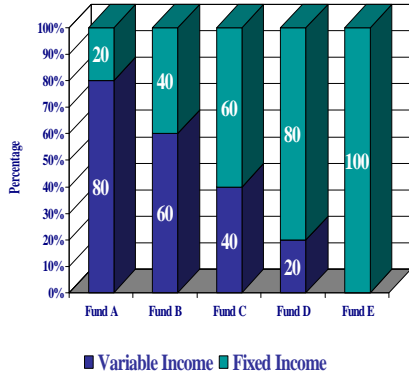
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Multifunds imply limited information



Restricted portfolios with freedom to choose according to life cycle

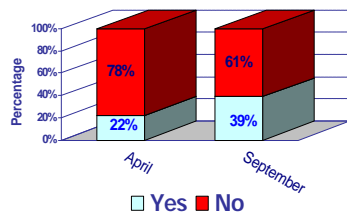


Men up to 35 years	Men from 36 to 55 years	Men from 56 years
Women up to 35 years	Women from 36 to 50 years	Women from 51 years

Fund A		
Fund B		
Fund C		
Fund D		
Fund E		

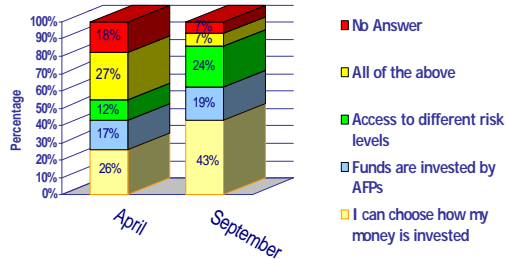
### Multifunds have generated expectations and stimulated demand for information

¿Have you heard about Multiple Portfolios?



**CERC Survey, 2002**

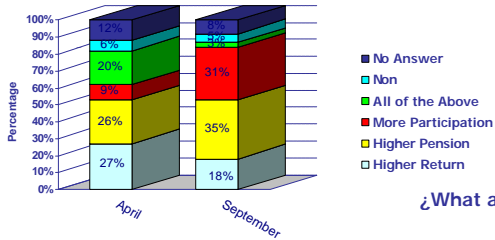
¿What do you know about multiple portfolios? (\*)



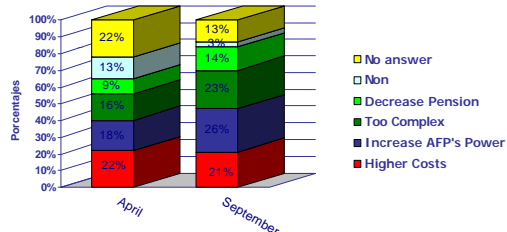
(\*) Only people who answer yes to the first question.

## Multifunds have generated expectations and stimulated demand for information

¿What are the Benefits of Multiple Portfolios?



¿What are the Disadvantages of Multiple Funds?



**CERC Survey, 2002**

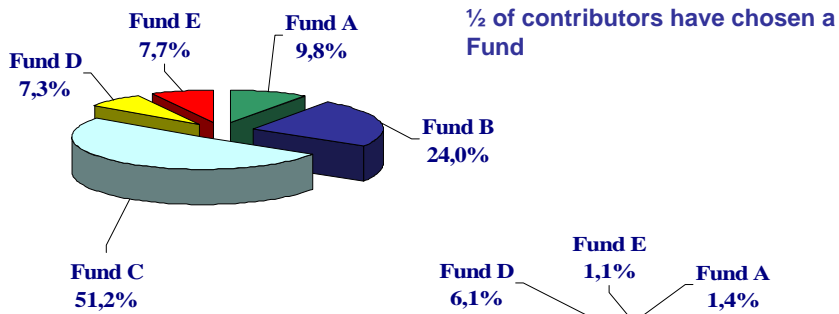
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## In such a way that 50% of investors have chosen a fund



(\*) August 2003.

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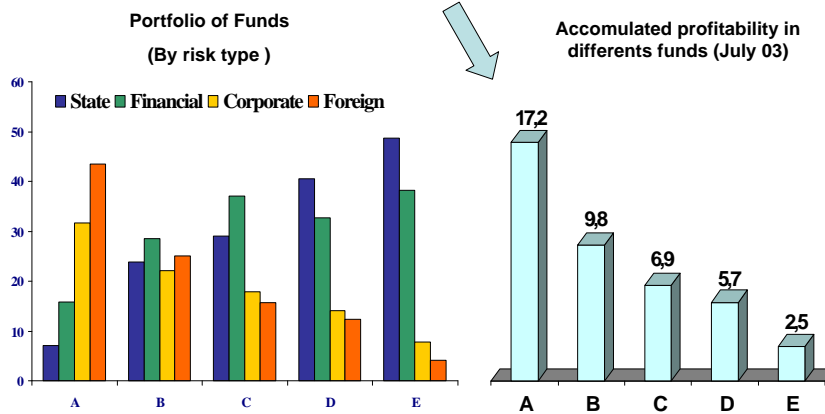
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## Why this reaction from the people?

It looks like it is the dirty money...



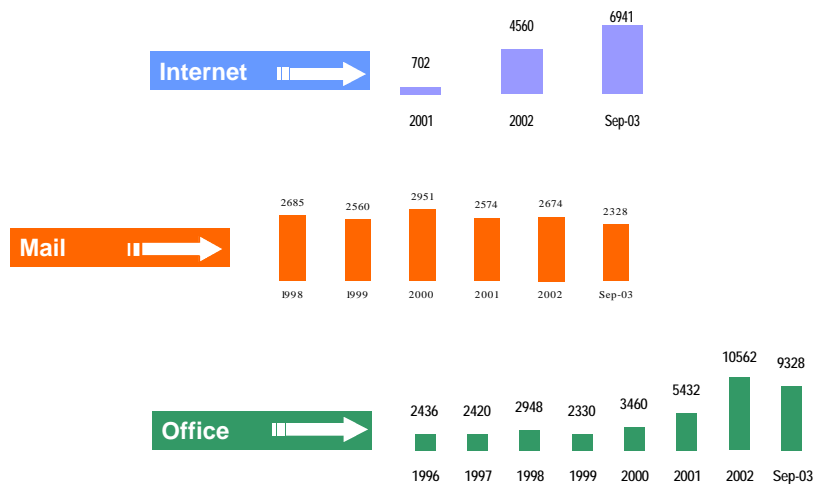
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## It looks like demand is awakening...



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There are many other proposals to improve competition conditions: some of them:

**Arrau – Valdes : Progress towards more voluntary behavior and reduce mandatory quality of the system. Professionalize demand advancing towards group pension plans, linked to a company ( as in 401-k) What to do with the informal sector or small and medium companies?**

**Tarziján : The problem lies in the price of service, which is identical for all (distributive reasons). Allow price differentiation.**

**Separate account management functions from fund administration (because of scale economies)**

**Generate bidding mechanisms as in Bolivia, where the extranormal rent is erased.**

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Three final considerations: (1) it is not rare that regulation inhibits competition

Investment limits

The Chilean network is so complicated that regulation has a large influence on portfolio. For the same reason, responsibility is delegated to the authority which is harmful: it reduces incentives for risk-taking, for the exhaustive analysis of investment opportunities, for financial innovation.

Minimum profitability

To oversees the integrity of funds, AFPs must guarantee a minimum level of profitability as a function of the industry. This induces excessive runs (“herd effect”).

Sanctions

To keep a balance between the nature and seriousness of a violation and a sanction

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## (2) And that the industry protects the *status quo*

Regulation for the lobby is deficient

Regulation that protects competition recently changed

Consumer protection law is on its way to approval, with the significant problem of “class action” initiatives

The industry has contacts and resources

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## (3) Self-regulation is crucial, but not everything is self-regulation

Self-regulation: agreement about conduct in the market taking into account the legal framework (competition, labor rights, environment, etc...).  
Therefore,

Must complement the spirit of the law.



Not every agreement is self-regulation

Requirements for an agreement to be considered self-regulation

Must be public: content, participants

Has verifiable sanctions for “free riders”: the agreement must add value to participants.

“Ethical” control

The name of other types of agreements is cartelization

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# **Afores' industry: analysis of its structure and recommendations on competition and regulation policy**

**Jorge Meléndez**

Inter-American Conference on Social Safety

Seminar on competition and regulation in the financial services sector  
November 17th and 18th, 2003, Mexico City



## **Contents**

- **Objectives.**
- **Competition and regulation in the afores' market: advance.**
- **Scale economies and market regulation.**
- **Cost functions of afores: estimations.**
- **Cost curves of afores.**
- **Market power and competition.**
- **Possible competition and regulation policies.**



# Objectives



- 1. To know cost structure in the afores' industry.**
- 2. To identify scale economies and cost advantages creation sources.**
- 3. To estimate market power measures (mark-up) and revenues by afore.**
- 4. To propose public policies for this industry in order to improve its performance in benefit of affiliates.**



## **Competition and regulation in the afores' market: advance**



### **Regulation alternatives:**

- **Allow market share to exceed 20%.**
- **But, establish a price cap on fees.**
- **Reduce payment options for affiliates in order to simplify fee structure.**
- **Only one regulator body for afores and banks.**
- **Bid large amounts of new accounts.**



## **Scale economies and market regulation**



- 1. There are scale economies when the average cost per offered service decreases with the number of services.**
- 2. Taking advantage of low costs is beneficial for society.**
- 3. But that requires few afores operating at large scale.**
- 4. It would give them monopolistic power.**
- 5. Regulation dilemma: take advantage of scale economies but at competitive prices.**



**Table 1**  
**Quarterly average by afore**  
**first quarter of 1998 to last of 2002**

•Afore	•Affiliates•Funds (1)		•Equivalent fee		•Yield		•Bank	•Importance of advertising expenses (4)		•Net	•# of transfers •quarters
	•flow	•balance	•on (2):	•gross	•net (3)	•1998		•After			
•Allianz	•1,275,242	•15,370.0	•1.87	•2.84	•8.96	•6.12	•No	•6.6%	•-35,393	•5	
•Banamex Aegon	•2,617,177	•48,790.0	•1.67	•4.49	•9.51	•5.02	•Yes	•1.5%	•4.1%	•52,181	•19
•Bancomer	•2,964,504	•58,900.0	•1.65	•4.44	•9.52	•5.08	•Yes	•7.1%	•2.8%	•10,826	•19
•Bancreer Dresdner	•728,105	•7,059.0	•1.74	•5.26	•8.85	•3.59	•Yes	•0.3%	•11.4%	•-3,530	•15
•Sólida Banorte Generali	•1,722,978	•13,580.0	•1.77	•4.60	•9.96	•5.36	•Yes	•10.3%	•14.4%	•9,099	•19
•Bital	•1,701,542	•17,280.0	•1.67	•5.12	•9.92	•4.79	•Yes	•45.0%	•20.8%	•-2,566	•15
•Capitaliza	•60,883	•182.6			•3.68		•No	•6.0%			•2
•Confía Principal	•736,045	•2,394.0					•Yes	•7.2%			•1
•Profuturo GNP	•2,254,028	•24,820.0	•1.96	•5.16	•10.25	•5.09	•No	•19.8%	•7.0%	•-3,075	•19
•Garante	•1,699,726	•19,180.0	•1.78	•5.12	•9.59	•4.47	•No	•41.2%	•28.6%	•4,072	•16
•Genesis	•174,769	•1,710.0	•1.65	•5.55	•6.29	•0.74	•No	•7.7%	•4.8%	•-417	•5
•ING	•2,718,941	•37,120.0	•1.64	•2.48	•9.69	•7.22	•No	•2.6%		•-20,336	•5
•Inbursa	•684,359	•19,460.0	•0.98	•2.42	•9.29	•6.86	•Yes	•3.2%	•0.8%	•-18,433	•19
•Previnter	•559,917	•1,119.0					•No	•36.3%			•2
•Principal	•891,335	•6,619.0	•1.60	•4.14	•9.66	•5.52	•No	•18.9%	•5.7%	•-15,965	•18
•Promex	•187,369	•784.6			•5.86		•Yes	•4.7%			•2
•Santander Mexicano	•2,489,277	•22,490.0	•2.09	•5.48	•8.99	•3.50	•Yes	•32.7%	•25.1%	•3,792	•19
•Tepeyac	•464,122	•2,154.0	•1.62	•4.32	•8.51	•4.20	•No	•9.3%	•2.6%	•-9,485	•19
•XXI	•813,453	•15,740.0	•1.55	•4.13	•9.09	•4.96	•No	•20.6%	•25.0%	•-5,401	•19
•Zurich	•330,364	•1,334.0	•1.72	•4.72	•9.37	•4.64	•No	•34.7%	•17.3%	•-3,715	•17

- (1) Millions pesos of 1998.  
•(2) To five years  
•(3) Net yield minus equivalent fee on balance.  
•(4) Expenses include: administrative, operative, advertising, depreciation, repayment and others.  
• It shows the median of advertising expenses importance.  
•Source: own calculations with information published by Consar in [www.consar.gob.mx](http://www.consar.gob.mx).



**Cuadro 2**  
**Indicadores de las afores existentes**  
**en el último trimestre de 2002**

Afore	Afilados Fondos (1)		Comisión equivalente sobre (2):		Rendimiento		Banco	Importancia de gasto en promoción (4)	Trasposos netos
	flujo	saldo	flujo	saldo	bruto	neto (3)			
Allianz	1,262,229	10,930.0	1.88	2.62	8.47	5.85	No	6.6%	-54,255
Banamex Aegon	5,170,982	74,810.0	1.62	2.25	9.02	6.77	Sí	2.1%	238,866
Bancomer	4,357,716	68,820.0	1.63	2.26	8.92	6.66	Sí	1.9%	30,175
Sólida Banorte Generali	2,597,323	18,250.0	1.78	2.48	9.22	6.74	Sí	5.8%	62,797
Profuturo GNP	2,913,638	31,100.0	2.09	2.93	9.49	6.57	No	1.1%	45,314
ING	2,710,146	27,030.0	1.62	2.25	9.10	6.85	No	4.3%	-33,586
Inbursa	1,838,856	23,140.0	1.15	1.58	8.50	6.92	Sí	8.8%	-119,386
Principal	2,196,407	10,220.0	1.73	2.41	8.97	6.56	No	5.7%	-93,194
Santander Mexicano	3,235,950	28,830.0	2.30	3.24	8.65	5.41	Sí	23.1%	16,588
Tepeyac	941,594	3,497.0	1.67	2.32	8.22	5.91	No	0.1%	-40,799
XXI	1,899,473	20,490.0	1.43	1.97	8.85	6.87	No	36.6%	-52,518

- (1) Millones de pesos de 1998.  
(2) A cinco años.  
(3) Rendimiento bruto menos comisión equivalente sobre saldo.  
(4) Los gastos incluyen: de administración, de operación, de promoción, depreciaciones y amortizaciones, otros.  
Fuente: cálculos propios, con información publicada por la Consar en [www.consar.gob.mx](http://www.consar.gob.mx).



## Cost function of afores: estimations



$$\ln C = \alpha_0 + \sum_i \alpha_i \ln z_i + (1/2) \sum_i \sum_j \alpha_{ij} \ln z_i \ln z_j$$

where, vector  $Z = (Q, W, X)$ , and

**Q** = output vector with four elements: total funds managed by afore, total affiliates, transfers received (new affiliates) and net fee yield rate.

**W** = input rent price vector with two elements: real wage (labor price) and real interest rate (capital price).

**X** = vector of inputs whose quantity may not be changed by offering a higher use price, it has two elements: relationship between afore and a bank, and proportion of afore's advertising costs.



**Cuadro 3**  
**Función estimada del logaritmo del costo total**  
**incluyendo sólo términos lineales**  
**promedios trimestrales, 1998-2002**

• Scale economies in affiliates, funds and transfers.

• Yield is an input.

• Cost advantage because of relationship with bank.

• Advertising lowers other costs.

Logaritmo natural de:	(A)	(B)	(C)
Afiliados totales	0.496	0.623	0.042 **
Fondos administrados	0.078 *	0.072 **	0.080 **
Trasposos a favor	0.040 **	0.034 **	0.049 **
Rendimiento neto de comisiones	-0.150	-0.114	-0.102
Salario real	-0.713 **	-1.246	0.045 **
Tasa de interés real	1.053	1.091	0.770
Importancia de promoción	-1.345	-1.336	-1.135
Relación con banco	-0.254	-0.263	(dropped)
Constante	15.619	18.584	17.022
R cuadrado	0.699	0.699	0.833
R cuadrado ajustado	0.685	0.685	0.812
# de observaciones	187	187	187
Prob > F, prueba que suman uno			
coeficientes de salario e interés	0.148	0.003	0.617

\* significativo al 10%.

\*\* no significativo ni al 10%.

(A) Regresión simple, con variables originales.

(B) Para Fondos administrados y Trasposos a favor se introduce el residuo de una regresión de esas variables sobre el resto de los productos.

(C) Efectos fijos, factor categórico = atore, con estimador de Huber-White para calcular errores estándar consistentes.



**Table 2**  
**Estimated function of total cost logarithm**  
**Including quadratic terms and intersections**  
**Quarterly averages, 1998-2002**

Natural Logarithm of:	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
Total affiliated	-13.507 **	-10.375 **	-13.538	-6.838	-7.580	-6.758	-9.965	-11.213
Square of total affiliated	+0.683	+1.053	+0.407	+0.687	+0.452	+0.536		
Managed funds	+9.374	+8.275	+7.613	+3.581 **	+2.180	+3.928	+4.154	+8.722
Square of managed funds	+0.134 **	+0.010 **	+0.132 **	+0.072 **			+0.228	+0.357
Transfers in favor	+0.869 **	+2.823 **						
Square of transfers in favor	+0.014 **	+0.011 **						
Net yield of fees	+5.337 **	+8.119	+1.724 ***	+3.730 ***	+0.501 ***	+0.110 ***	+0.319 ***	+0.188 ***
Square of net yield	+0.105	+0.066 **	+0.045 ***	+0.015 **				
Affiliated funds	+0.229 **	+0.696	+0.075 ***	+0.465	+0.169	+0.307	+0.458	+0.534
Affiliated yield	+0.369	+0.305	+0.311	+0.155	+0.125 ***	+0.214	+0.300	+0.363
Affiliated transfers	+0.111 **	+0.049 **						
Fund yield	+0.218	+0.150 **	+0.205	+0.060 **	+0.051 **	+0.122	+0.167	+0.226
Funds/transfers	+0.062 **	+0.051 **						
Yield/transfers	+0.038 **	+0.044 **						
Real wage	+95.775 **	+142.576	+16.511 ***	+57.637 **	+0.939	+0.921	+0.865	+0.750
Square of wage	+9.980 **	+14.752	+2.182 ***	+8.098 **				
Real interest rate	+8.177 **	+0.881 **	+5.587 ***	+0.665 ***	+0.951 ***	+1.491	+0.276 ***	+0.508 **
Square of interest	+0.606	+0.210 **	+0.368	+0.128 **				
Wage/interest	+0.368 **	+0.714 **	+1.376 ***	+0.173 **				
Affiliated wage	+0.303 **	+0.431 **	+1.024 ***	+0.515 **				
Affiliated interest	+0.876	+1.183	+0.015 ***	+0.216 **				
Funds wage	+0.361 **	+0.294 **	+0.232 ***	+0.208 **				
Funds interest	+0.270 **	+0.404	+0.093 ***	+0.123 **	+0.002 ***	+0.025 **	+0.048 **	+0.015 **
Yield/wage	+1.430 ***	+1.972	+0.293 ***	+0.920 **				
Yield/interest	+0.659	+0.434 **	+0.003 **	+0.049 **				
Transfers/wage	+0.067 **	+0.254 **						
Transfers/interest	+0.363	+0.416						
Advertising importance	+1.687	+0.685 **	+1.607	+0.862 **	+1.009	+2.139 ***	+1.586	+26.114
Bank relationship	+0.304	(dropped)	+0.320	+0.070 **	+0.944	+0.298	+7.180	+0.251
Affiliated bank							+0.368	
Affiliated advertising							+0.238 **	
Funds bank							+0.318	
Funds advertising							+0.318	
Constant	+242.920 ***	+346.136	+25.938 ***	+99.492 ***	+47.194	+23.352	+36.447	+1.176
R square	+0.815	+0.890	+0.814	+0.884	+0.795	+0.775	+0.784	+0.776
Adjusted R square	+0.785	+0.858	+0.790	+0.857	+0.760	+0.750	+0.759	+0.770
# of observations	187	187	188	198	198	198	198	198
Prob > F, test they add one								
Wage and interest coefficient	+0.293	+0.050	+0.862	+0.187	+0.318	+0.676	+0.048	+0.242
Prob > F, test they add zero								
Interactions between wage and interest coefficient	+0.347	+0.077	+0.971	+0.263	+0.972	+0.589	+0.312	+0.746

\*\* significant at 10%.

\*\*\* not significant even at 10%.

(A), (C), (E)-(H) Simple regression with original variables

(B) and (D) Fixed effects, categorical factor = atore, with Huber-White estimator to calculating consistent standard errors



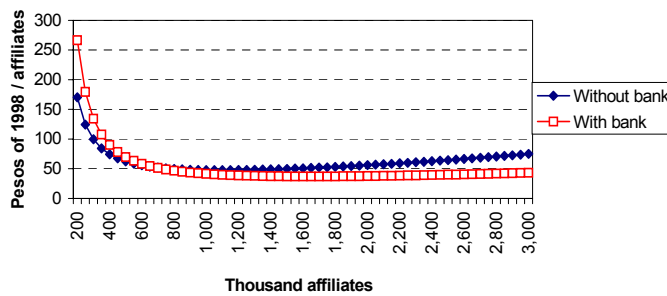


# Cost curves of afores



## There are scale economies in the number of affiliates

Figure 2  
Quarterly average cost per afores affiliate (1998-2002)  
As function of number of affiliates  
According to relationship with bank

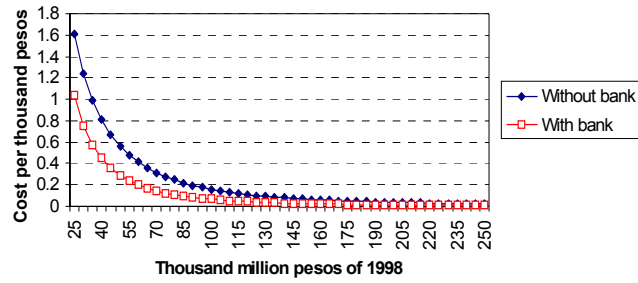


Source: own estimations with information published by Consar.



## There are scale economies in managed funds

Figure 3  
Average cost per 1,000 pesos of managed funds (1998-2002)  
as function of fund amount  
according to relationship with bank

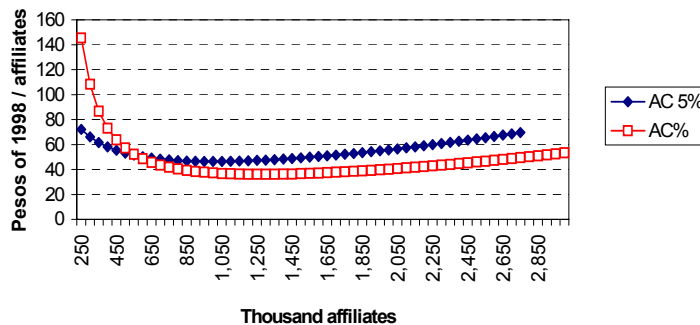


Source: own estimations with information published by Consar.



## Investing in advertising is a way of obtaining cost advantages

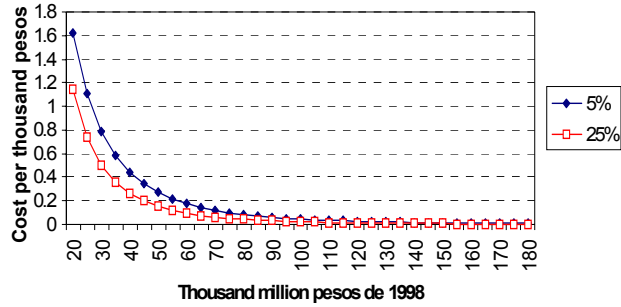
Figure 4  
Quarterly average cost per afore affiliate (1998-2002)  
as function of number of affiliates  
according to importance of advertising expenditure in total cost



Source: own estimations with information published by Consar.



**Figure 5**  
**Average cost per 1,000 pesos of managed funds (1998-2002)**  
**As function of funds**  
**According to the importance of advertising expenditure in total cost**

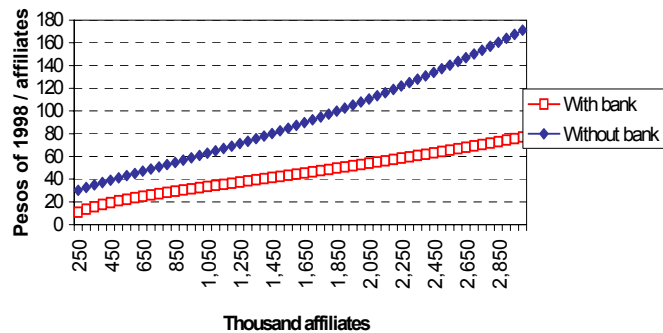


Source: own estimations with information published by Consar.



## Wining new affiliates is more expensive for afores unrelated to banks

**Figure 6**  
**Marginal cost per afore affiliate (1998-2002)**  
**as function of number of affiliates**  
**according to relationship with banks**

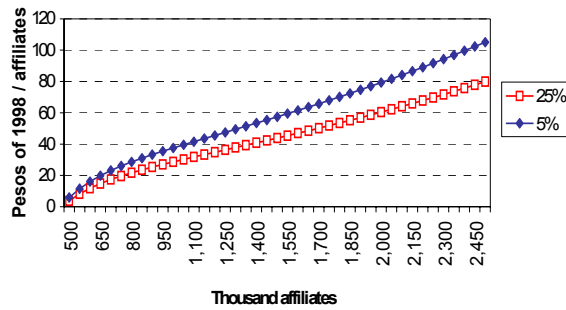


Source: own calculations with information published by Consar.



## Wining new affiliates is more expensive for those with low advertising investements

Figure 7  
Marginal cost per afore affiliate (1998-2002)  
as a function of affiliates number  
according to importance of advertising expenditure in total cost



Source: own estimations with information published by Consar.



## Factors that affect the level of competition among afores

- Largest afores have cost advantages.
- Also those that are related to banks and spend more in advertising.
- Advertising creates advantages at early stages of the system.
- It is not possible to compete when operating at small scale, without relationship with a bank, when advertising is not so profitable.



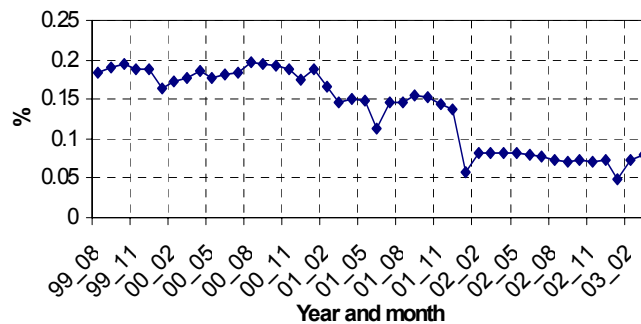
# Market power and competition indexes



## Important advertising expenditures at the beginning of the industry

Figure 2

Proportion of advertising expenditures in the afores' total cost\*

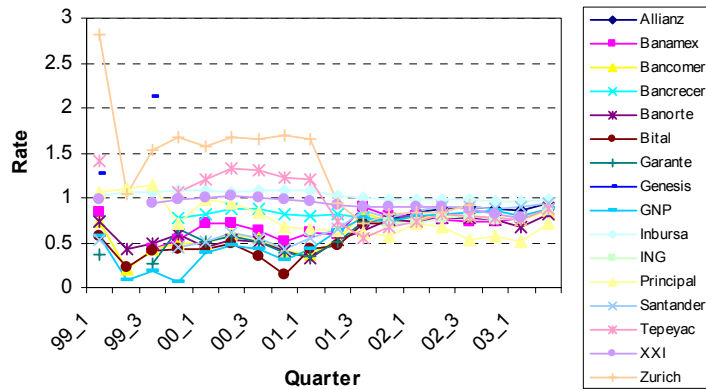


\* Advertising expenditures include: compensations and benefits to advertising personnel.

Source: Official information from Consar.



## Mark-up ( $P-MC/P$ ) averages 0.7 (price is 3.3 times the marginal cost), convergence in time



## Mark-up ( $P-MC/P$ ) shows upward trend in time

• Figure 5  
• Mark-up pattern  
• Price regarding MC and AC

	• Marginal cost		• Average cost*	
	• Coef.	• P-value	• Coef.	• P-value
• Market share	• -4.574	• 0.000	• 0.716	• 0.139
• Relationship with bank index	• 0.199	• 0.019	• 0.028	• 0.000
• Trend in time	• 0.061	• 0.000	• 0.089	• 0.031
• Constant	• 0.064	• 0.634	• 0.256	• 0.000
• R square	• 0.310		• 0.257	
• Adjusted R square	• 0.302		• 0.249	
• # observations	• 261		• 271	

• \* Operative average cost.

• Minimum squares weighted by number of affiliates



## Market shares are notably steady

•Figure 6  
•Market share patterns

	•(A)		•(B)	
	•Coef.	•P-value	•Coef.	•P-value
•Relationship with bank index			•0.038	•0.000
•Importance of commercial capital			•-0.001	•0.186
•Trend in time	•0.000	•0.606	•0.000	•0.974
•Constant	•0.109	•0.000	•0.086	•0.000
•R square	•0.001		•0.210	
•Adjusted R square	•-0.003		•0.201	
•# observations	•286		•272	

•Market share in terms of total affiliates.

•Minimum squares weighted by number of affiliates.



- **Convergence in Mark-up may result from two causes:**

**(a) Demand elasticities tend to be similar among afores.**

**(b) Collusion?**

- **Mark-up's upward trend and market share stability must also be taken into account.**
- **There is no evidence that market is becoming more competitive.**



## **Possible competition and regulation policies**



### **Dilemma for the Regulator**

- **Scale economies and lower costs could be achieved with less afores.**
- **But still lower competition.**
- **Low average costs would not mean less fees.**
- **How to take advantage of scale economies and transfer benefits to affiliates?**





## **Regulation alternatives:**

- **Allow a market share above 20%.**
- **But, establish a price cap in fees.**
- **Reduce payment options for affiliates in order to simplify the fee structure.**
- **Only one regulator body for afores and banks.**
- **Bid large amounts of new accounts.**

**Federal  
Competition  
Commission**

**APEC**

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## **Seminar on Competition and Regulation in Financial Services**

November, 2003

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## **Regulation in Insurance Markets**

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Basic Principles and  
International Standards

Manuel A. Calderón de las Heras  
Institutional Operation Vice president  
National Insurance and Securities Commission  
CNSF-Mexico

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---

- 1 Regulation and Supervision of Insurance
  - 2 New IAIS basic principles for insurance
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  - 4 Final Remarks
- 

## Regulation

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- Financial activities are considered to be of public interest:
    - Financial intermediaries manage third party assets.
    - Insolvent intermediaries can lead to high economic and social costs.
  - Thus, regulation attempts to influence individual firm choices, in an effort to prevent private decision-making process from affecting public interest.
-

# Regulation Issues

## Market Imperfections



Asymmetric Information



Market Power



Negative Externalities

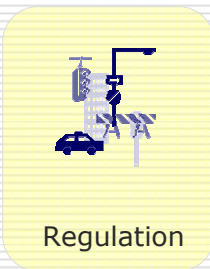


Preventive Regulation

Market conduct

Competition Policy

# Regulation: Why Is It Justified?



Regulation



Asymmetric Information

Minimize the negative impact due to:

- The insolvency of an insurer
- Lack of information



Market power

To encourage a pro-competitive solvency regulation



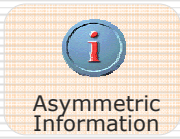
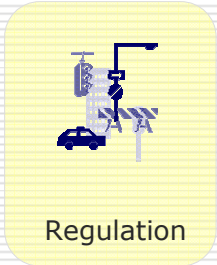
Negative externalities

To lessen the negative impact due to:

- Systemic risk

# Regulation: Important issues

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Inflicts costs upon consumers



Affects market conduct



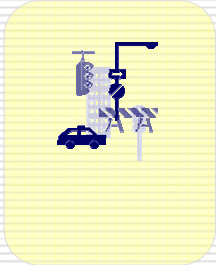
Involves a time dimension

---

# Regulation

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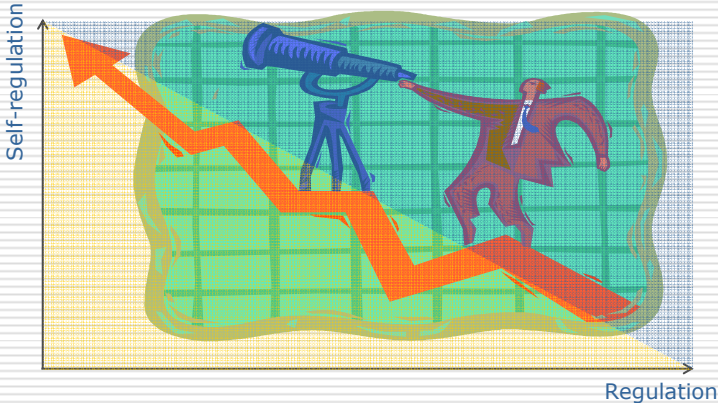
Provided by the government  
Regulation



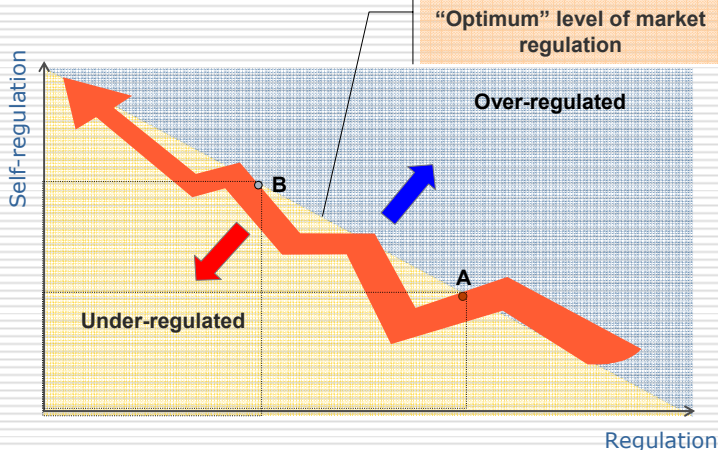
Self-Imposed  
Self-regulation



# Regulation

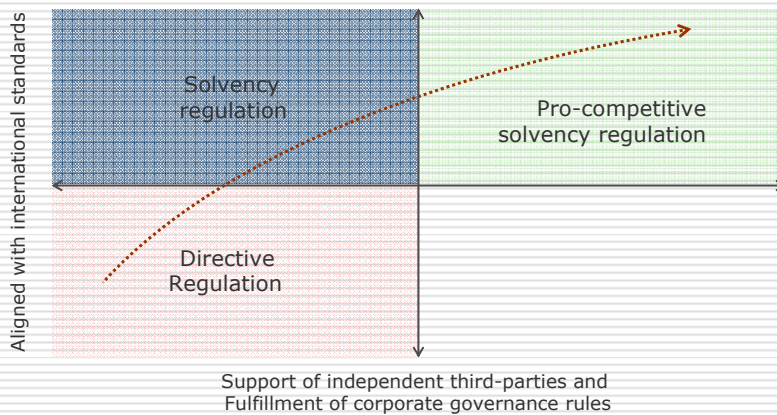


# Regulation:



## Regulation Trends

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## Regulation Trends

---

- As financial services undergo substantive changes, regulation and supervision must adapt to the new circumstances of markets.
  - Under these changing circumstances, the effectiveness of supervision will mostly rely on:
    - A stronger coordination and collaboration among supervisors (local and from other jurisdictions).
    - Adequate implementation of standards and internationally accepted practices.
-

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## Standards for Regulation and Supervision of Insurance

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- In 1994, the International Association of Insurance Supervisors (IAIS) was created.
  - It gathers authorities that supervise the insurance industry in more than 115 jurisdictions around the world, and more than 70 overseers.
  - Its main purpose is to contribute to international financial stability.
    - By preparing and implementing principles and standards in regulation and supervision matters.
-



## Standards for Regulation and Insurance Supervision

---

- Regarding this issue, the IAIS activities rely on 3 pillars:

Development of Basic Principles for Insurance



Development of General Standards and Guidelines

Development of Text Books and Case Studies

---

## Review: Basic Principles for Insurance

---

- The IAIS has defined fundamental principles for an effective supervision of the insurance market.

Basic Principles for Insurance, 1997.

1



Basic Principles for Insurance, revised and approved, 2000.

2



Basic Principles for Insurance revised, 2003

3



## Basic Principles of Insurance:

### 2003 proposed structure

---



Conditions for an  
Effective regulation (1)



Ongoing supervision  
(11-17)



Supervision system (2-5)



Prudential requirements  
(18-23)



Supervised  
entity (6-10)



Market and  
consumers (24-27)



Against money laundering  
(28)

---

## Basic Principles of Insurance: Methodology

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- The basic principles of insurance provide a general framework that can be applied in a variety of supervisory regimes.
  - However, it recognises that an evaluation of these principles by different supervisors, without a uniform guideline, can lead to different interpretations of the results.
-

## Basic Principles of Insurance: Methodology

---

- As a result, the IAIS prepared a methodology to evaluate the basic principles of insurance and to monitor their implementation.
  
  - This methodology provides the process for evaluating regulation and supervision schemes, regarding the basic principles.
- 

## Basic Principles of Insurance: Methodology

---

- The methodology can be applied in different evaluation scenarios.
    1. Self-evaluations performed by supervisors, to determine if they comply with the Basic Principles of Insurance.
    2. Reviews in which other supervisors assist.
    3. Reviews undertaken by a third-party specialist, including the evaluation programmes of the IMF and the World Bank (FSAP).
-

## Basic Principles of Insurance: Methodology

---

### Criteria to evaluate compliance with principles:

- Two kinds of criteria are used to evaluate each principle: essential criteria and additional criteria.
  - Essential criteria are those that must be applied with the aim of proving full compliance with the principles.
  - Additional criteria are those that must be applied to improve financial stability and effective supervision.
- 

## Basic Principles For Insurances: Evaluation

---

NA = not applicable to the evaluated jurisdiction

🚫 NO = not observed.  
An action plan should be prepared for full compliance

🚧 MNO = Mostly Not observed.  
Clear limitations for adequate compliance

🟡 AO = Widely observed.  
Minimum limitations to attain compliance

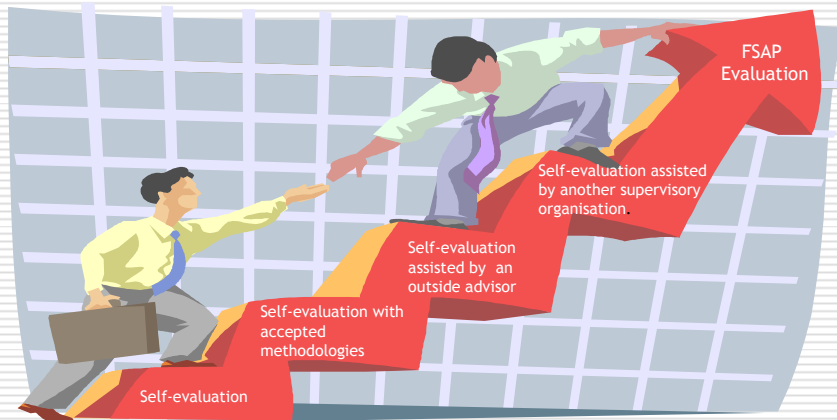
🟢 O = Observed.  
All the essential criteria are accomplished without deficiencies.

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# Evaluation Mechanisms of International Standards

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## Spectrum of Possible Evaluation Mechanism



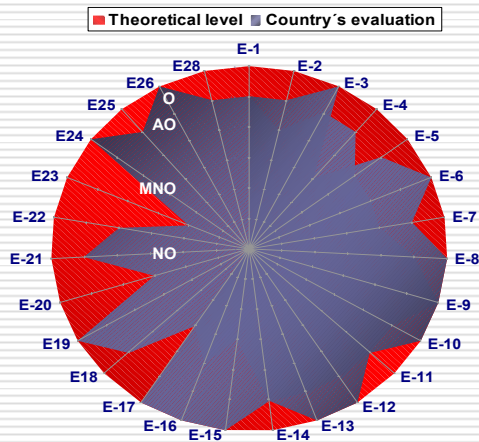
## FSAP General Issues

---

- In May 1999, the International Monetary Fund (IMF) and the World Bank created the Financial Sector Assessment Program (FSAP):
    - Its purpose consists in evaluating the vulnerabilities of the national financial systems, and
    - Identifying the priorities for the development of reforms.
  - This implies, among other aspects, evaluating compliance with the applicable standards.
-

# Supervisory Organism

## Evaluation of the New BPI

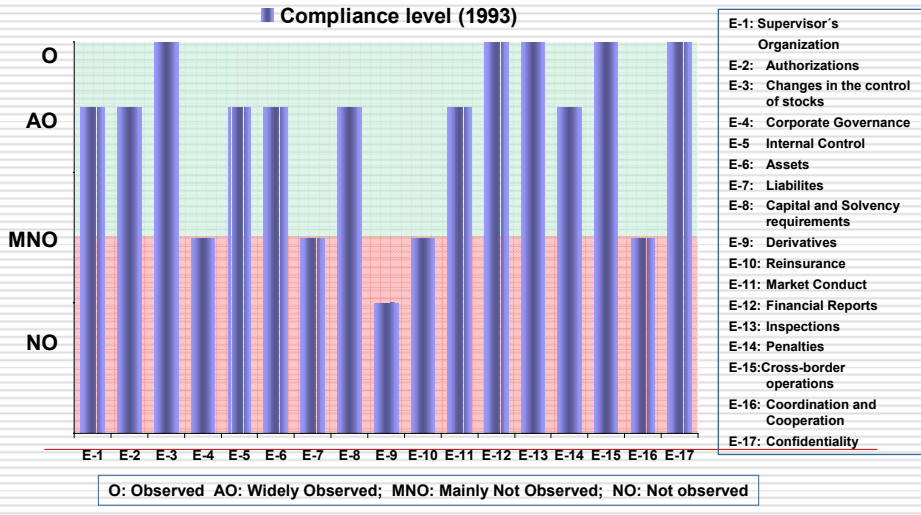
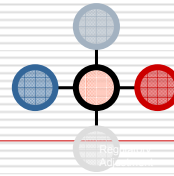


O: Observed AO: Widely observed MNO: Mostly not Observed NO: Not observed

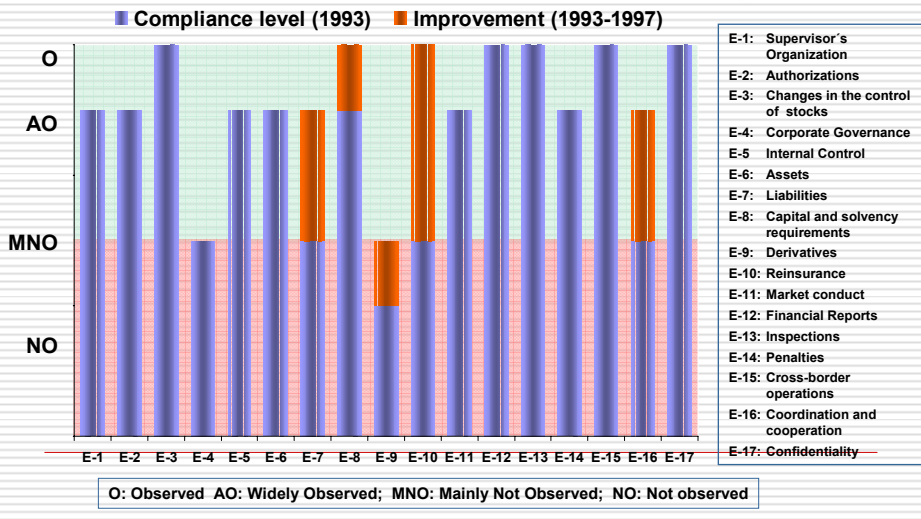
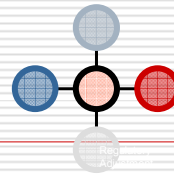
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# Regulatory Adjustment ICP 1993 Self-evaluation

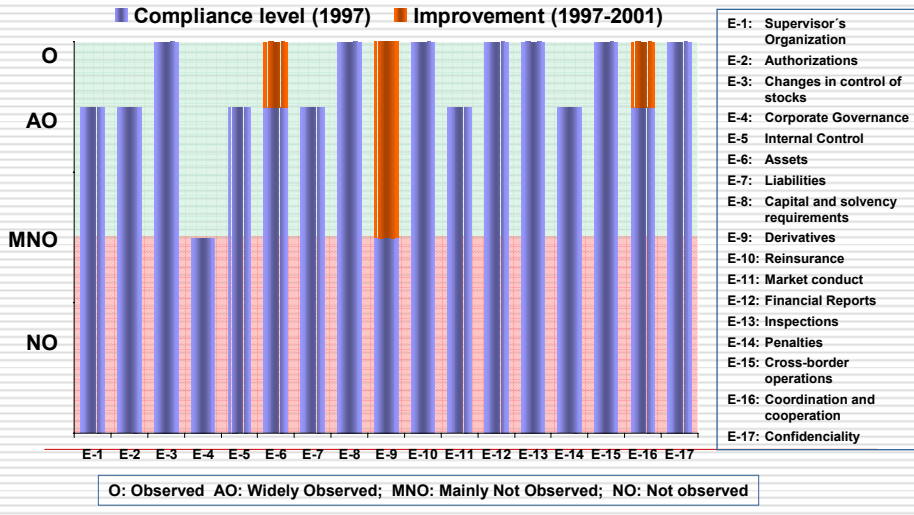
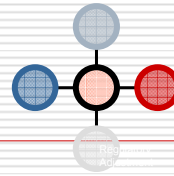


# Regulatory Adjustment ICP 1997 Self-evaluation



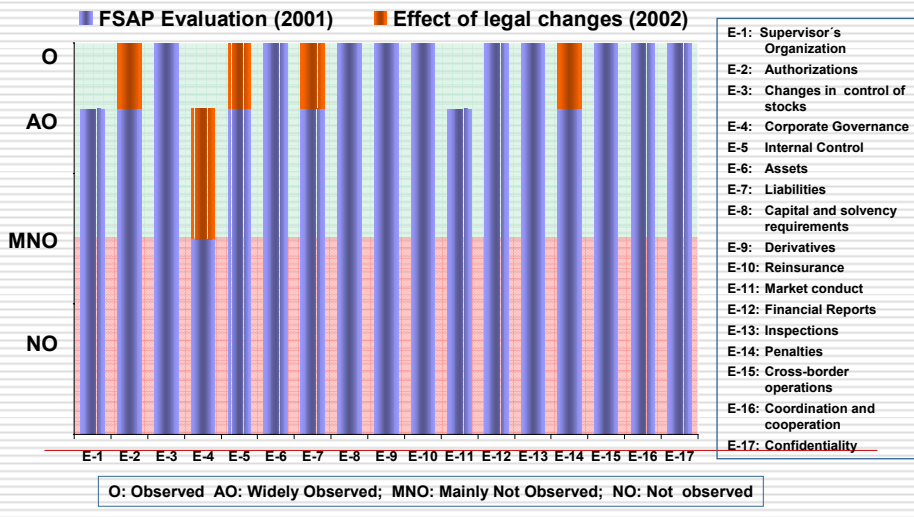
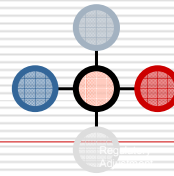
# Regulatory Adjustment

## FSAP evaluation of ICP, 2001



# Regulatory Adjustment

## 2002 ICP Self-evaluation





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- 

## Final Remarks

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- Development and evolution of financial markets require the instrumentation of processes to evaluate compliance with the international standards that:
    - Facilitate the identification of financial and economics vulnerabilities.
    - Detect holes in the regulatory structures and practices.
    - Provide important elements to develop regulatory reforms.
    - Contribute to the sector's development within a solvency regulatory framework that is pro-competitive.
-

# COMPETITION AND REGULATION IN THE INSURANCE MARKET



## Agenda

- Competition problems in the insurance sector
- Some possible solutions.

## Problems of Competition

- The institutional purchasers of insurance (including the Federal Government) face a difficult situation:
  - Adverse selection while contracting insurance.
  - Moral hazard of the companies, ex post
  - Complexity in insurance products

3

## Problems of Competition (cont.)

- There is no way to compare two products that cover the same risk, among insurance companies, since:
  - Each institution handles its own clauses and conditions in their policies.
  - The exclusions are different, in such a way that the risk is absorbed by the insured.
  - The agreements are of differing quality, which can be reflected in a low price, but poor quality in service.

4

## Price Dispersion

### Example of quotation for a state-owned entity:

VEHICLE POLICY			AIRPLANE POLICY		
Insurer	Quotation (in pesos)	Percentage relative to the lowest quotation	Insurer	Quotation (in dollars)	Percentage relative to the lowest quotation
1	13,504,932	24%	1	1,014,816.35	118%
2	18,825,370	73%	2	<b>466,131.16</b>	0%
3	13,487,327	24%	3	573,850.00	23%
4	19,750,000	82%	4	887,697.59	90%
5	12,415,442	14%			
6	<b>10,864,050</b>	0%			
7	20,556,971	89%			

5

## Review of Files

During 2002, savings of 251 million pesos were achieved:

Entity	Cost 2002	Budget	Cost 2003	Saving vs Budget	Percentage
CNA	240	300	220	- 80	-26.7%
TELECOMM	108	112	101	-11	-10.2%
Damages	37	40	34	- 6	-14.2%
Autos	4	5	3	- 2	-46.6%
Satellite	67	67	64	-3	-5.1%
SEMARNAT	26	40	29	-11	-27.8%
SSP	66	210	85	-125	-59.4%
IMSS	164	219	207	-12	-5.5%
<b>TOTAL</b>	<b>712</b>	<b>993</b>	<b>742</b>	<b>-251</b>	<b>-25.3%</b>

\* Amount in Millions of pesos

\*\*Even though there is an increase in the policies of IMSS, the insurance companies had notified to this entity an increase in their policy price of 65%.

6

## Review of Files (cont.)

During this year, savings of 357 million pesos were achieved:

Entity	Cost 2002	Cost 2003	Budget 2003	Saving vs. Cost 2002	Percentage
SAGARPA	35.99	25.01		- 10.98	-30.50%
CNDH	9.86	13.43		3.58	36.29%
SEPOMEX***	5.32	6.35	6.91	1.03	19.32%
FARAC	** 184.29	105.00	184.29	- 79.29	-43.03%
CFE	986.97	715.52		- 271.45	-27.50%
CNA	289.71	177.78		- 111.93	-38.63%
<b>TOTAL</b>	<b>1,512.14</b>	<b>1,043.09</b>		<b>- 357.11</b>	<b>-31.02%</b>

\*Amount in Millions of pesos.

\*\* The previous year there was no insurance, however the amount included was proposed by re-insurers.

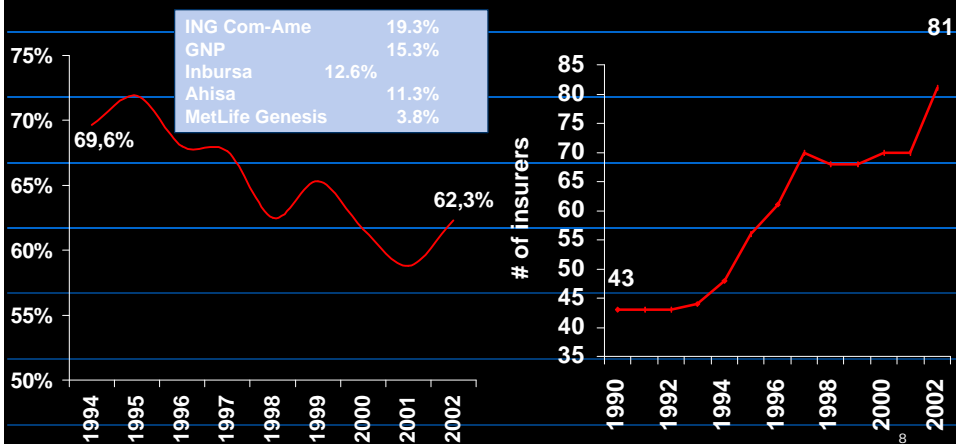
\*\*\* The increase in SEPOMEX was because last year the insurance for Motorcycles did not exist, and it was included this year.

7

## However, the problem is not the lack of participants in the market ...

Market share of the top 5 firms

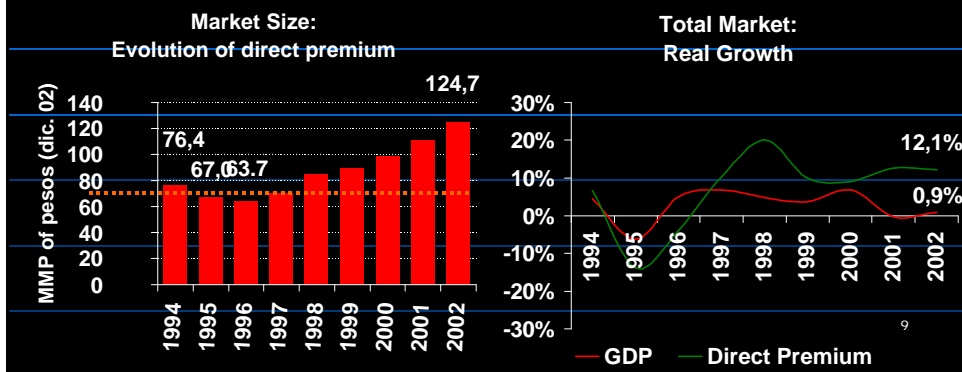
Participants in the market



8

## ... or due to a lack of sector growth

- While the growth of the economy during the nineties reached a real average growth rate of 3.4%, between 1990 and 2000 the insurance sector's premiums grew at an average annual real rate of 8.6%.



## Possible Solutions

- Improving information:
  - Create data bases that describe the characteristics of the goods and the type of accident.
- Simplifying insurance contracts :
  - Offering standardized products.
  - Possibility of purchasing insurance online.
- Increasing the penalties for breaching the contract.

## One example: competition in the life - annuity market

- Competition was not oriented towards a better price; in this case, a bigger pension award.
- By contrast, it sought to gain customers by offering products that did not belong to the service it wanted to sell.
- This type of competition caused confusion among the consumers

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## *PERSPECTIVES OF THE INSURANCE SECTOR AND ITS INVESTMENT REGIME*



Ministry of  
Finance and  
Public Credit

November 14, 2003

12

# Federal Competition Commission

## REGULATION AND INFORMATION IN THE INSURANCE SECTOR

NOVEMBER 2003

### What is an insurance company?

- Risk.
- Mutuality.
- Technical capacity.
- Honorability.
- Financial aspects.
- Administration.



## Regulation

**“In insurance markets regulation must guarantee that the system accepts the probability of firms’ collapse.”**

## Regulation II.

- **Regulation must procure healthy competition at the same time that it protects public interest when the free market cannot do this.**

## Critical Factors of Regulation

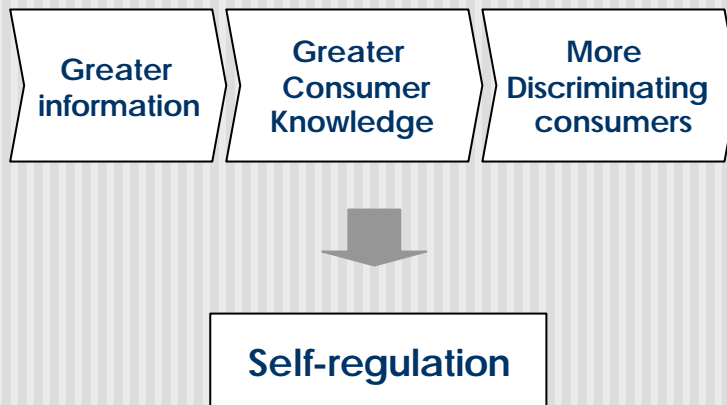
### SOLVENCY.

- Technical reserves.
- Investments.
- Capital for deviations.
- Re-insurance.

## Impact of Regulation.

- Sector Development.
- Growth.
  - Profitability.
  - Permanence.
  - Competition and competitiveness.

## Information to ensure a functioning market



## Two very important elements

- **JUDICIAL CERTAINTY.**
  - Not only prudential regulation matters.
  - Other regulatory entities.
- **Responsibilities of the regulator.**
  - What is his fault and what is not?
  - Costs and benefits.

## The cost of regulation

Regulation is in many occasions determined by an average of the companies with a given factor

This can benefit some firms to the detriment of others

## WHERE SHOULD WE GO.

- NEED TO MOVE TOWARD A MORE EFFICIENT REGULATION, THAT PROTECTS CONSUMERS AND ALLOWS THE DEVELOPMENT OF FIRMS AT THE SAME TIME .
- PROMOTE THE DEVELOPMENT OF MARKET MECHANISMS THAT CONTRIBUTE WITH REGULATION.

## **CONCLUSIONS**

- **Need to foster insurance intermediaries.**
- **Regulation and growth in one entity only.**
- **Efficiency of regulation.**
- **Complementary Agents.**
- **Globalization.**

■ **THANK YOU VERY MUCH FOR  
YOUR ATTENTION**



# **THE CHILEAN EXPERIENCE IN THE INSURANCE MARKET**

**OSVALDO MACIAS M.  
INSURANCE INTENDENT  
CHILE  
November 2003**

## **INDEX**



- INSURANCE MARKET DEVELOPMENT**
  - STATISTICS
  - DEVELOPMENT FACTORS
- PRACTICES RELATED TO SECTOR COMPETITION**
- MAIN RECENT REGULATORY CHANGES**
- PENDING CHALLENGES**

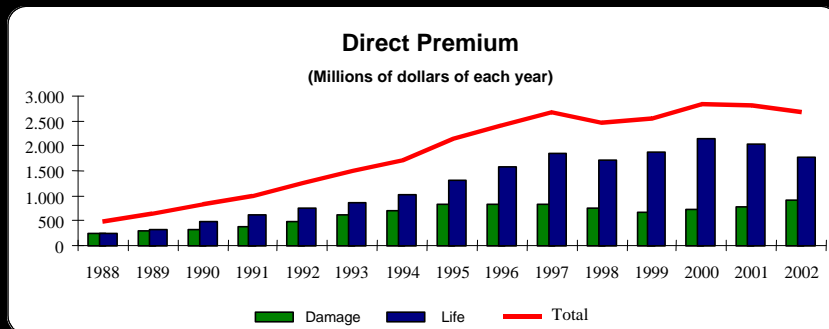
# I INSURANCE MARKET DEVELOPMENT



## STATISTICS Evolution of Direct Premium

(millions of dollars per year)

1988 485 USD millions      2002 2.686 USD millions

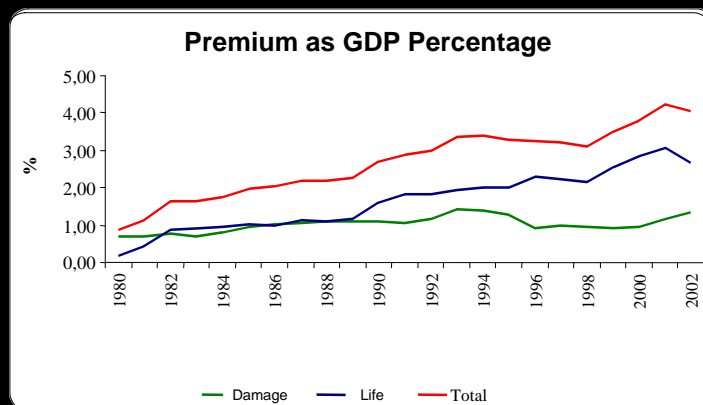


## Evolution of Premium as GDP Percentage

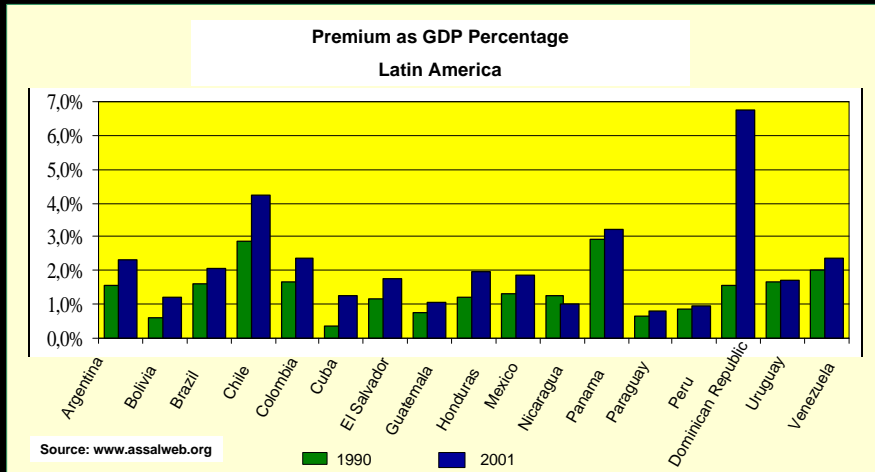


1980 0,89% (0,7% D and 0,19% L)

2002 4,04% (1,36% D and 2,68% L)



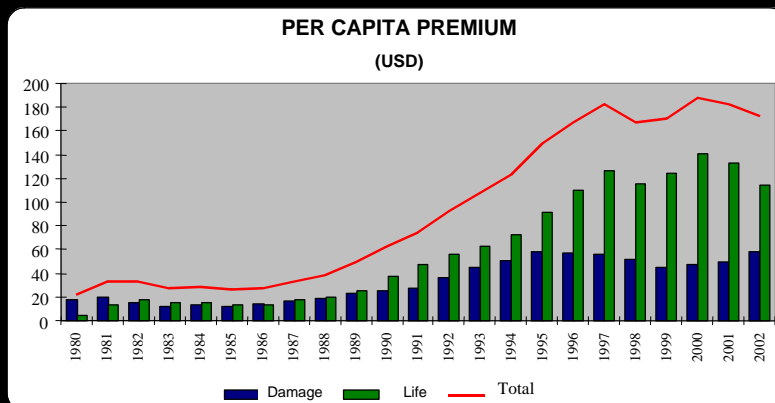
## Premium as Percentage of Latin America GDP



## Evolution of Per Capita Expenditure

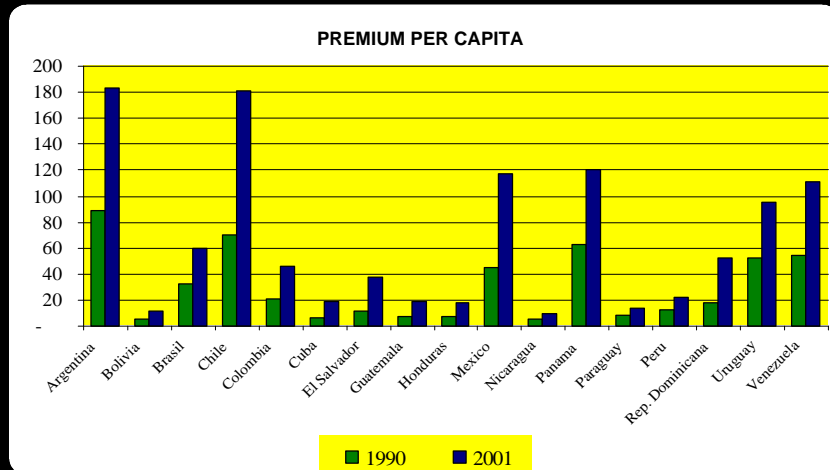


1980 USD 22 (17D and 5 L)  
2002 USD 172 (58D and 114 L)





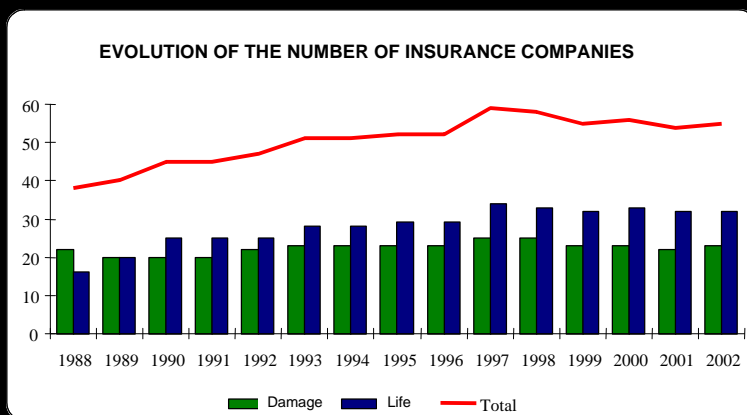
## Evolution of Per Capita Expenditure in Latin America



## Evolution of the number of companies



1988                      38 companies    22D and 16L  
 2002                      55 companies    23D and 32L



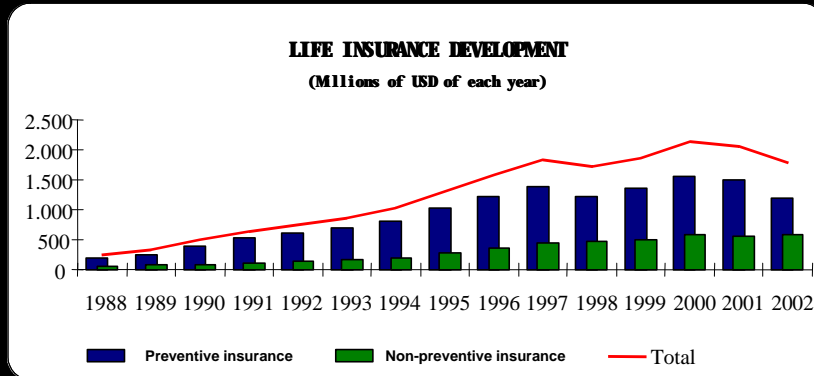


## DEVELOPMENT OF LIFE INSURANCE

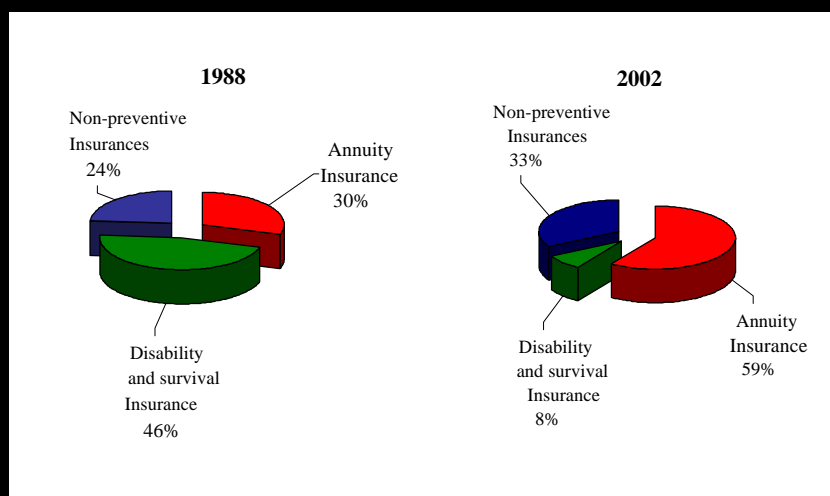


### Evolution of Direct Premium

1988 US\$ 246 millions      58 NP and 188 P  
 2002 US\$ 1.780 millions      590NP and 1.190 P



## Composition of Life Insurance Portfolio

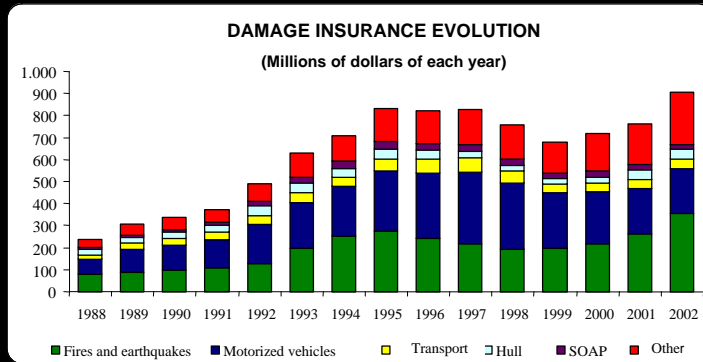


▪ **DEVELOPMENT OF DAMAGE INSURANCE**

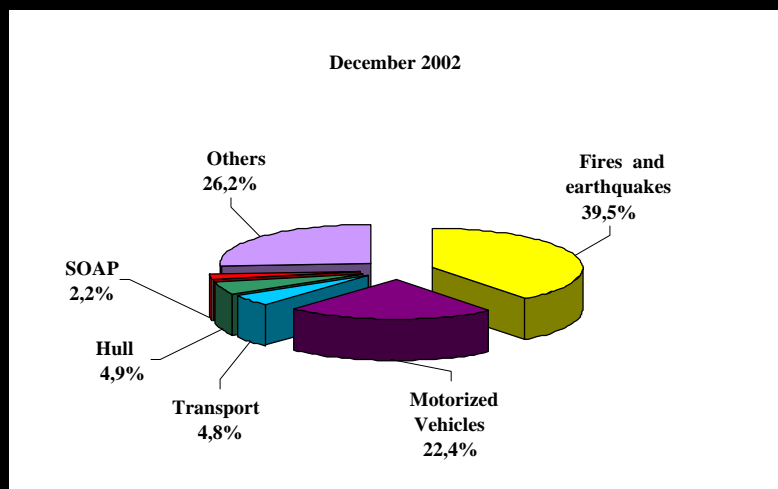


**Evolution of Direct Premium**

1988 239 USD millions  
 2002 905 USD millions



**Composition of Damage Insurance Portfolio**



## 2. FACTORS THAT EXPLAIN THE DEVELOPMENT OF THE CHILEAN INSURANCE MARKET



- ❑ REFORM TO THE 1980 INSURANCE ACT
- ❑ REFORM TO THE 1980 PREVENTIVE SYSTEM ACT

### ▪ BASIS OF THE 1980 INSURANCE ACT REFORM



- **Requirement of Patrimonial Risk Fund**
  - Previously, companies were not requested to keep a risk-estate fund, which protects them against excess of disaster.
- **Freedom regarding commissions and tariffs**
  - SVS approved the tariffs that companies settled for different kinds of risks.

## ▪ **BASIS OF THE 1980 INSURANCE ACT REFORM**



### • **Regulation of Investment**

- They could only invest in national assets
- Companies had limits to invest only by kind of instrument, not by issuer, issue, economic group and risk classification.

### • **Application of antimonopolistic principles**

- Reinsurance of the contracts effectuated in Chile was only allowed among the companies established within the country.

## **Factors Fostering the Preventive Life Insurance Market**



•Since 1980, the development of the insurance market in Chile has been closely linked to the preventive system.

•In 1981, with the introduction of disability and survival insurance contracted by pensions funds, premiums in life insurance reached almost US\$ 150 millions, duplicating the market share of life insurance sector regarding the totality of the market.

•In 1988, when commercializing of life annuity began, the life insurance industry was already slightly superior to damages insurance, with a 51% share. That year, 76% of insurance market sales corresponded to preventive insurances.

## Factors Fostering the Non-Preventive Life Insurance Market



- INCREASE OF PER CAPITA INCOME
- DEVELOPMENT OF NEW INSURANCE COVERS:
  - Insurance with savings (universals and APV), health insurance (complementary to ISAPRE)
- GROWTH OF TAX RELIEVED INSURANCE ASSOCIATED TO MORTGAGE CREDITS

## Factors Fostering the Non-Preventive Insurance Market



- STRONG MARKET COMPETITION:
  - New products and services
  - Intense marketing campaigns
  - Increase of insured population
- NEW COMMERCIALIZATION AND DISTRIBUTION SYSTEMS:
  - Direct mailing commercialization
  - Bank-insurance
  - Distribution in commercial houses

## ▪ BASIS FOR THE REFORM OF THE PREVENTIVE CHILEAN SYSTEM



- INDIVIDUAL CAPITALIZACION
- PRIVATE FUNDS MANAGING
- FREE CHOICE OF THE MANAGER
- ROLE OF THE STATE:
  - GUARANTEES BENEFITS
  - REGULATES AND SUPERVISES

## IMPACT OF PENSION SYSTEM ON INSURANCE INDUSTRY



- ❑ MODALITY OF ANNUITY PENSION.
- ❑ INSURANCE OF DISABILITY AND SURVIVAL.





## **ANNUITY**

### **MAIN CHARACTERISTICS:**

- THE AFFILIATE CONTRACTS PENSION PAYMENT WITH A LIFE INSURANCE COMPANY.**
- PAYMENT OF A MONTHLY RENT CONSTANT FOR LIFE.**
- CSV ASSUMES FINANCIAL RISK AND RISK OF PENSIONER AND HIS FAMILY OVERLIFE.**
- IRREVOCABLE DECISION, SINCE THE AFFILIATE LOSSES RESOURCES PROPERTY.**
- STATE GUARANTEE.**



## **DISABILITY AND SURVIVAL INSURANCE**

### **PRINCIPAL CHARACTERISTICS:**

- AFP MUST CONTRACT AN INSURANCE THAT COVERS DISABILITY AND AFFILIATE DECEASE RISKS.**
- THIS INSURANCE IS FINANCED BY THE AFFILIATES THEMSELVES DURING THEIR ACTIVE LABOR LIFE WITH A FRACTION OF ADDITIONAL QUOTATION.**



## **IMPACT ON INSURANCE**

**THE EFFECT OF PENSIONS FUND ON LIFE INSURANCE MARKET IS REFLECTED ON:**

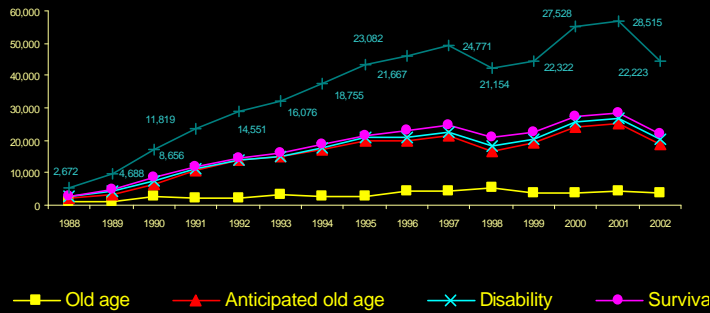
- ❑ INCREASING COMPETITION.**
  
- ❑ SIGNIFICATIVE INCREASE IN THE VOLUME OF RESOURCES MANAGED BY THE SECTOR.**



## **IMPACT ON INSURANCE**

- ❑ DIRECT PREMIUM FOR ANNUITY:**
  - IN 2002, 59% OF DIRECT PREMIUMS OBTAINED BY LIFE INSURANCE COMPANIES CORRESPONDED TO LIFE ANNUITIES**
  
  - IN THE PAST TEN YEARS AN AVERAGE OF 67% OF DIRECT PREMIUMS CORRESPOND TO LIFE ANNUITIES.**
  
- ❑ NUMBER OF ANNUITY POLICIES:**
  - HAVE GROW AT AN ANNUAL AVERAGE RATE OF 53% IN THE PAST TEN YEARS.**

## EVOLUTION NUMBER OF ANNUITY POLICIES



## II PRACTICES RELATED TO SECTOR COMPETITION



### □ PRACTICES RELATED TO TARIFFS

#### • EFFECT OF INTERNATIONAL REINSURANCE:

- The national insurance industry strongly depends of external reinsurance cycles: In 2002 56% of direct damages premiums at market level, was ceded to foreign companies.

## II PRACTICES RELATED TO SECTOR COMPETITION



### □ PRACTICES RELATED TO TARIFFS

- **STRONG SHARE IN THE PROPERTY OF COMPANIES OWNED BY LARGE INTERNATIONAL INSURANCE GROUPS:**

- **Freedom of tariffs:** the strong presence of european and american capitals in the property of national insurance companies makes the insurance market very competitive in prices and products.

The two former points translate into tariffs being set according to technical parameters such as the expected accidents of the insured risks as well as the requirements imposed by foreign reinsurers participating in covers.

## II PRACTICES RELATED TO SECTOR COMPETITION



### □ PRACTICES RELATED TO SHARING USERS' INFORMATION

- **THE INSURANCE INDUSTRY REACHED AN AGREEMENT REGARDING THE CREATION OF A COMMON DATABASE OF ACCIDENTS IN ALL SECTORS:**

- The mechanism works through the monthly register of each firm's accident in the chamber's WEBSITE. This WEBSITE can be consulted by all the associated companies, by the RUT (Unique Tributary Role) of the insurer and by patent (vehicle circulation number plate) in the case of automotive sector.

## II PRACTICES RELATED TO SECTOR COMPETITION



### □ PRACTICES RELATED TO SHARING USERS' INFORMATION

- Improvement in retained accident occurrence is of crucial importance in the results of insurance industry damages, specially automobile covers, sector which represented 22% of all premiums in 2002 and where retention was 92% of all premiums.
- This mechanism, in case of fire and the majority of sectors is used to generate accidents statistics for large firms and customers, but regarding automobile insurance it allowed the application of differentiated tariffs.

## II PRACTICES RELATED TO SECTOR COMPETITION



### □ PRACTICES RELATED TO SHARING USERS' INFORMATION

- This agreement at industrial level on sharing users' information of insured vehicle accidents results in a better risk identification and premiums are adjusted to the particular historic accidents rather than to market average.
- This agreement regarding maintaining a common insured data base is also valid for life insurance, but in this kind of insurance it is used to share a rejected customers database, without incorporating greater information about the reasons for such rejection.

### **III PRINCIPAL RECENT REGULATORY CHANGES**



- **THE INVESTMENT REGIME BECOMES FLEXIBLE.**
- **THE CALCULATION VAR (VALUE AT RISK) SYSTEM IS ESTABLISHED BY INSURANCE FIRMS REGARDING THEIR INVESTMENT PORTFOLIO.**
- **IT IS ALLOWED TO ACQUIRE MUTUAL MORTGAGE THAT FINANCE NATURAL AND JURIDIC PERSONS, ALL KINDS OF REAL ESTATES AND FOR GENERAL AIMS.**

### **III PRINCIPAL RECENT REGULATORY CHANGES**



- **PREVENTIVE VOLUNTARY SAVING IS FOSTERED ALLOWING INSURANCE COMPANIES TO PARTICIPATE IN TWO MODALITIES , THIS IS THROUGH INSURANCES AND BY SUBSIDIARIES MANAGING GENERAL FUNDS.**
- **PERMIT TO DISCOUNT REINSURANCE CONTRACTED WITH FOREIGN ENTITIES (UP TO 40%) FROM TECHNICAL RESERVES OF PREVENTIVE INSURANCE.**

### **III PRINCIPAL RECENT REGULATORY CHANGES**



- **ALLOCATING RESOURCES THROUGH PERSONAL LOANS AND PARTICIPATING IN CREDIT CARD ISSUES ARE AUTHORIZED AS COMPLEMENTARY ACTIVITIES.**
- **SVS AUTHORIZED CREDIT INSURERS TO PROVIDE THEIR CUSTOMERS IN THIS SECTOR WITH LOANS FOR WORKING CAPITAL. THESE RESOURCES WILL COME FROM FREE ESTATE.**

### **IV PENDING CHALLENGES**



- ❑ **ANNUITY LAW PROJECT**
- ❑ **DEVELOPMENT AND IMPLEMENTATION OF NEW MORTALITY SCALES FOR ANNUITY RENTS.**
- ❑ **PREVENTIVE COLLECTIVE VOLUNTARY SAVINGS PROJECT**

## **ANNUITY LAW PROJECT**



### **MARKET IMPERFECTIONS:**

- **CONFLICT OF INTERESTS**
- **HISTORIC HIGH LEVEL OF COMMISSIONS**
- **MARKET OF INFORMAL INFORMATION**
- **DIFFICULT ACCESS TO THE TOTALITY OF SUPPLY**
- **UNEQUAL REQUIREMENTS AND LIQUIDITY PREFERENCES.**

## **ANNUITY PROJECT LAW**



### **CONSULTATION SYSTEM AND PENSIONS SUPPLIES:**

- **CONSULTATION AND SUPPLIES OF PENSION AMMOUNTS, WILL BE DONE THROUGH ELECTRONIC INFORMATION SYSTEMS.**
- **AFFILIATES MUST CONSULT THE SYSTEM TO OPT FOR A PENSION MODALITY.**
- **CSV, AFP, AUTHORIZED LIFE ANNUITIES INSURANCE AGENTS AND BANKING SUBSIDIARIES THAT PERFORM INSURANCE BROKERAGE COULD PARTICIPATE IN THE SYSTEM.**
- **AFFILIATES WILL BE INFORMED ABOUT THE PENSIONS SUPPLIES FROM LIFE INSURANCE COMPANIES AND AFP.**





## **ANNUITY PROJECT LAW**

- **THE MAXIMUM COMMISSION THAT COMPANIES WILL BE ABLE TO PAY EITHER DIRECTY OR INDIRECTLY TO INTERMEDIARIES OR SALES AGENTS IS ESTABLISHED.**
- **PUBLIC INFORMATION ISSUANCE OF POTENTIAL PENSIONERS (AFFILIATES CAN EXPRESS THEIR WILL NOT TO BE INCLUDED).**
- **LIFE INSURANCE COMPANIES WITH A RISK CLASSIFICATION EQUAL OR GREATER THAN "BB" WILL NOT BE ABLE TO OFFER NOR CONTRACT LIFE ANNUITY INSURANCES.**

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# Strategic Map of the Stock Exchange

Outlook from the perspective of the Mexican Stock Exchange



November, 2003

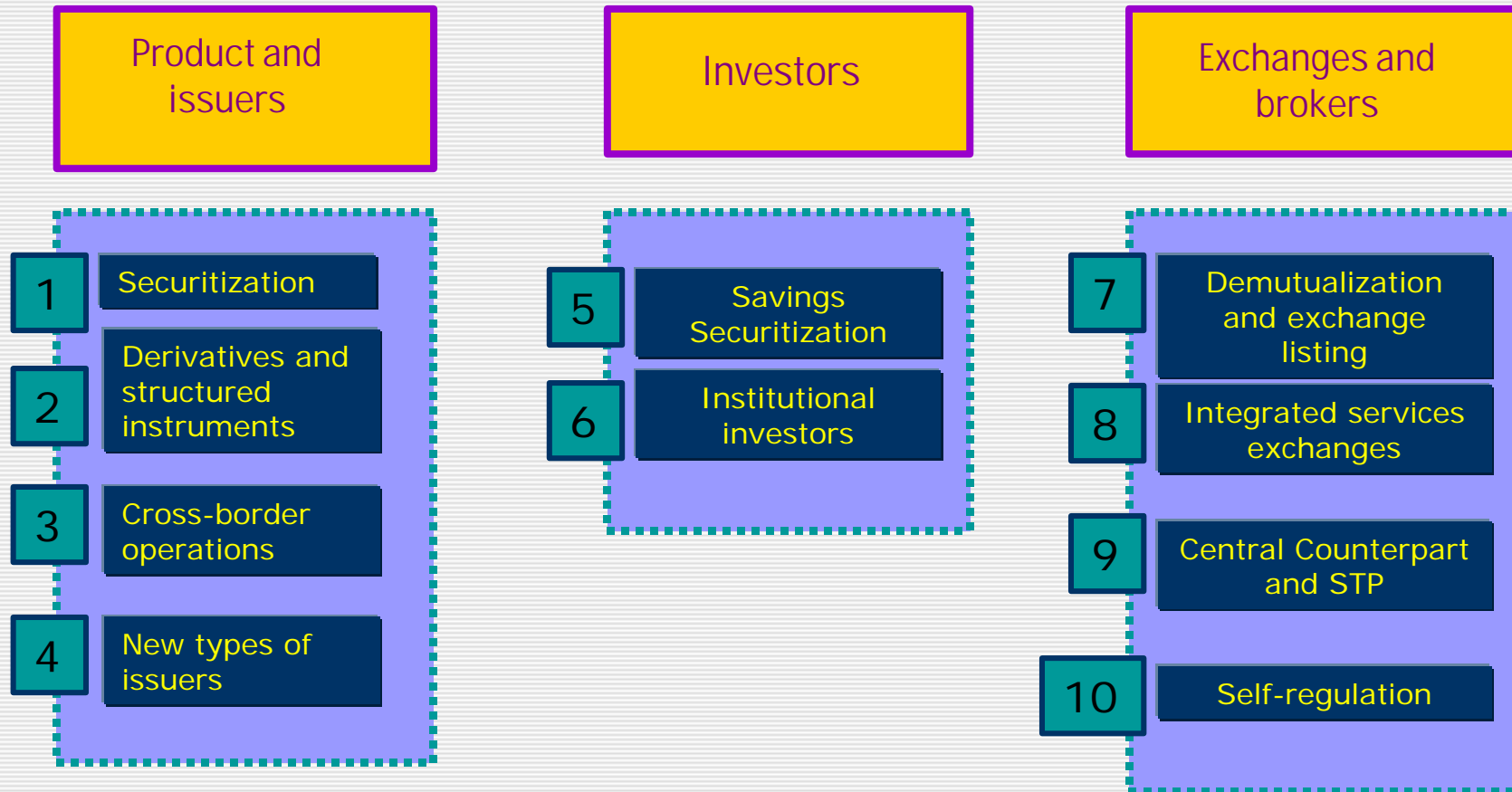
# Index

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- Reference framework
- Megatendencies
- A strategy for the future
- Thinking of unpredictables
- Conclusions

# Reference framework in 10 concepts...

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# Index

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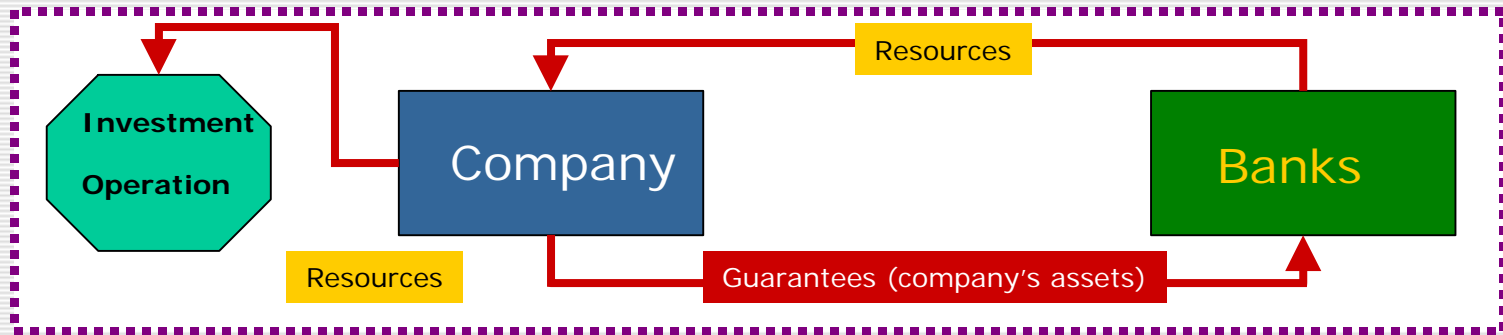
- Reference framework
- Megatendencies
- A strategy for the future
- Thinking of unpredictables
- Conclusions

# 1

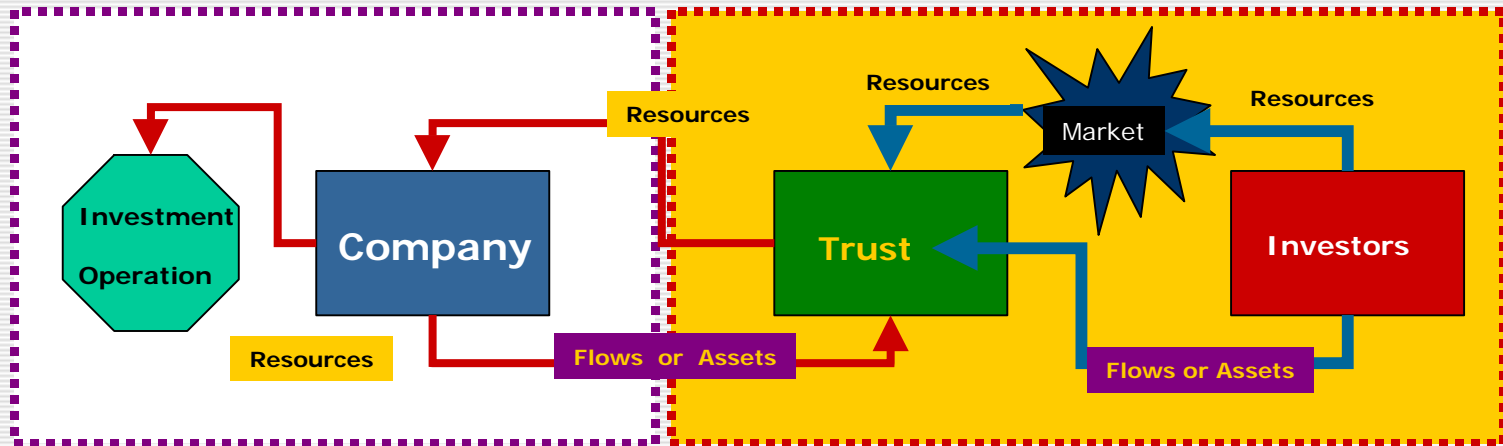
# Securitization

## Concept

### Traditional Model



### Securitization



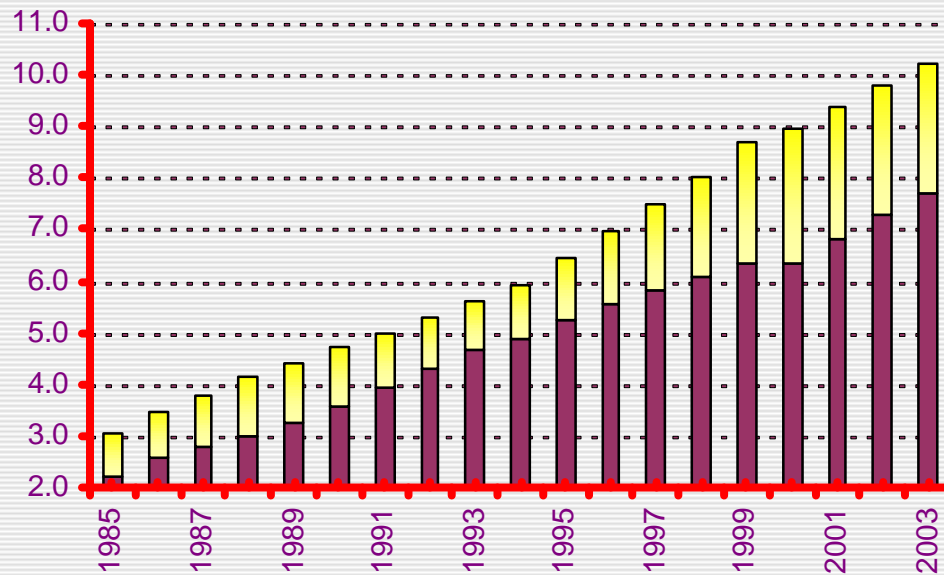
# 1

# Securitization

## In the United States

- Residential Mortgage Backed Securities (MBS)
- Commercial Mortgage backed securities (CMBS)
- Federal Agencies asset backed securities
- Asset Backed Securities (ABS)
- Securitization of credit cards
- Other securitizations

**Securitized Instruments in the United States  
(trillions of dollars)**



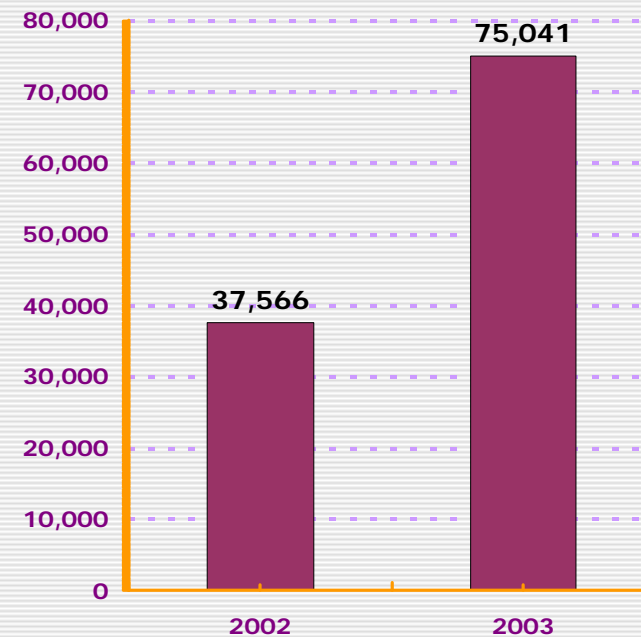
# 1

# Securitization

## Securitization in Mexico

### Long and medium term debt allocation (total in millions of pesos)

Figures up to November 14th	2002	2003
OBLIGATIONS	0	420
BANK BONDS	0	0
OPC'S*	3,926	2,839
MEDIUM TERM PROMISSORY NOTE	2,597	761
STOCK CERTIFICATE	31,043	71,021
<b>TOTAL:</b>	<b>37,566</b>	<b>75,041</b>



Source: Mexican Stock Exchange (BMV)

\*Ordinary participation certificate

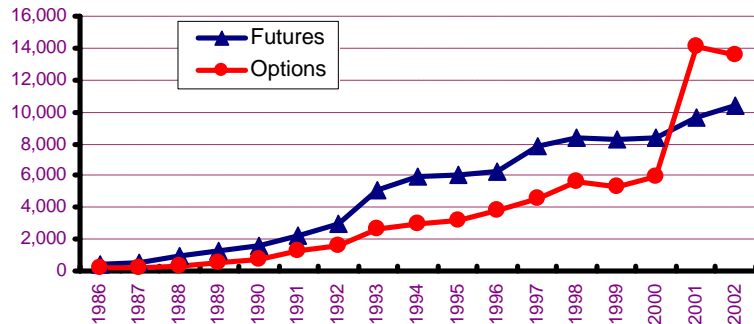


# 2

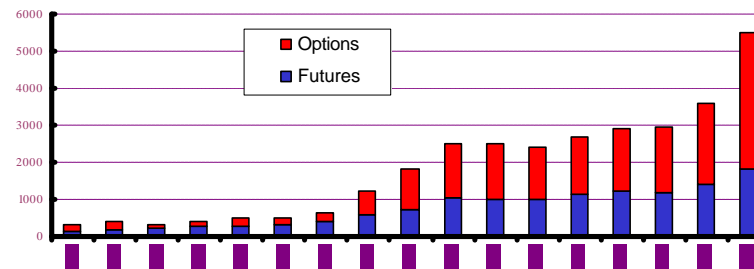
# Derivatives

## Listed derivatives in the world

**Notional Value in Listed Markets**  
(thousand million dollars)



**Number of negotiated contracts**  
(millions)



**Notional value of listed futures and options surpasses 24 trillion dollars, with more than 5,000 millions of negotiated contracts during 2002**

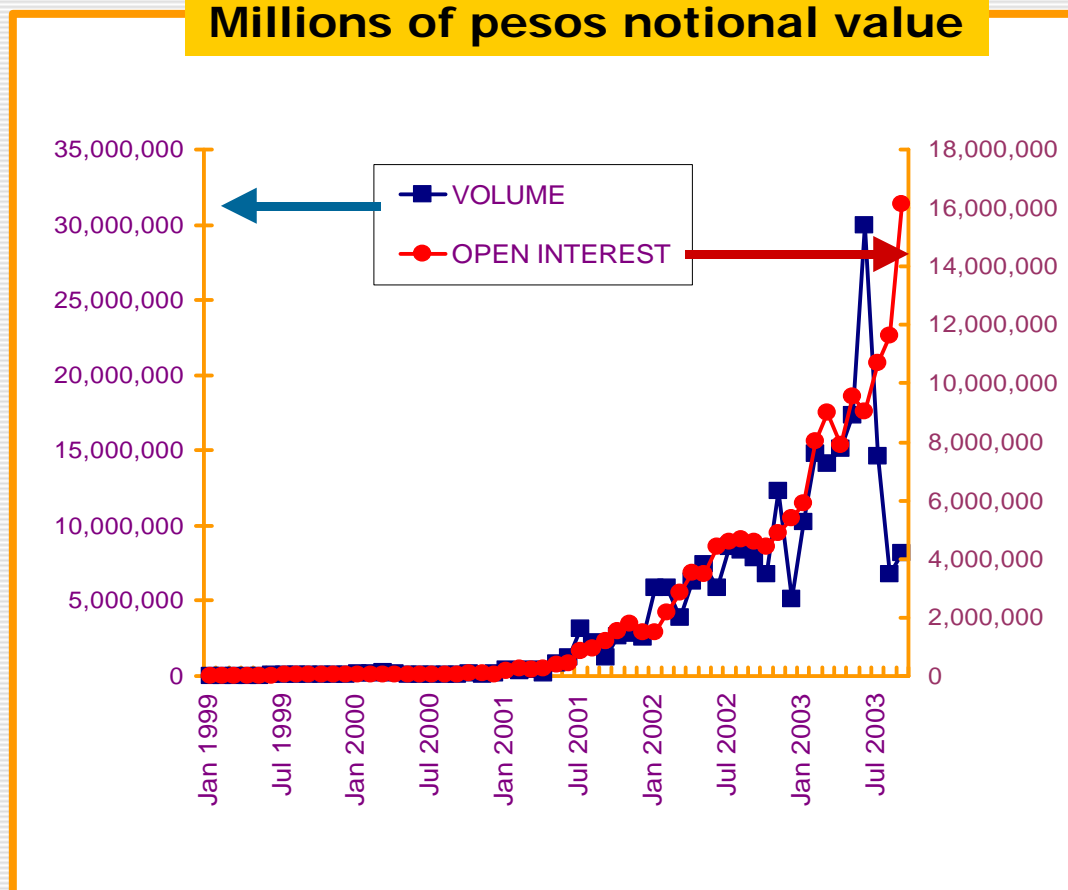
# 2

## Derivatives

### Derivatives in Mexico

- As reference, during the year 1999, 619 thousand contracts were negotiated. The accumulated amount during that year surpassed 134 million pesos.
- The operativity growth rate during the first nine months of 2003 was 123.3% compared to the same period of the previous year.
- MexDer\* is the fastest growing market in the world, regarding operations derived from interest rates.

Number of negotiated contracts  
Millions of pesos notional value

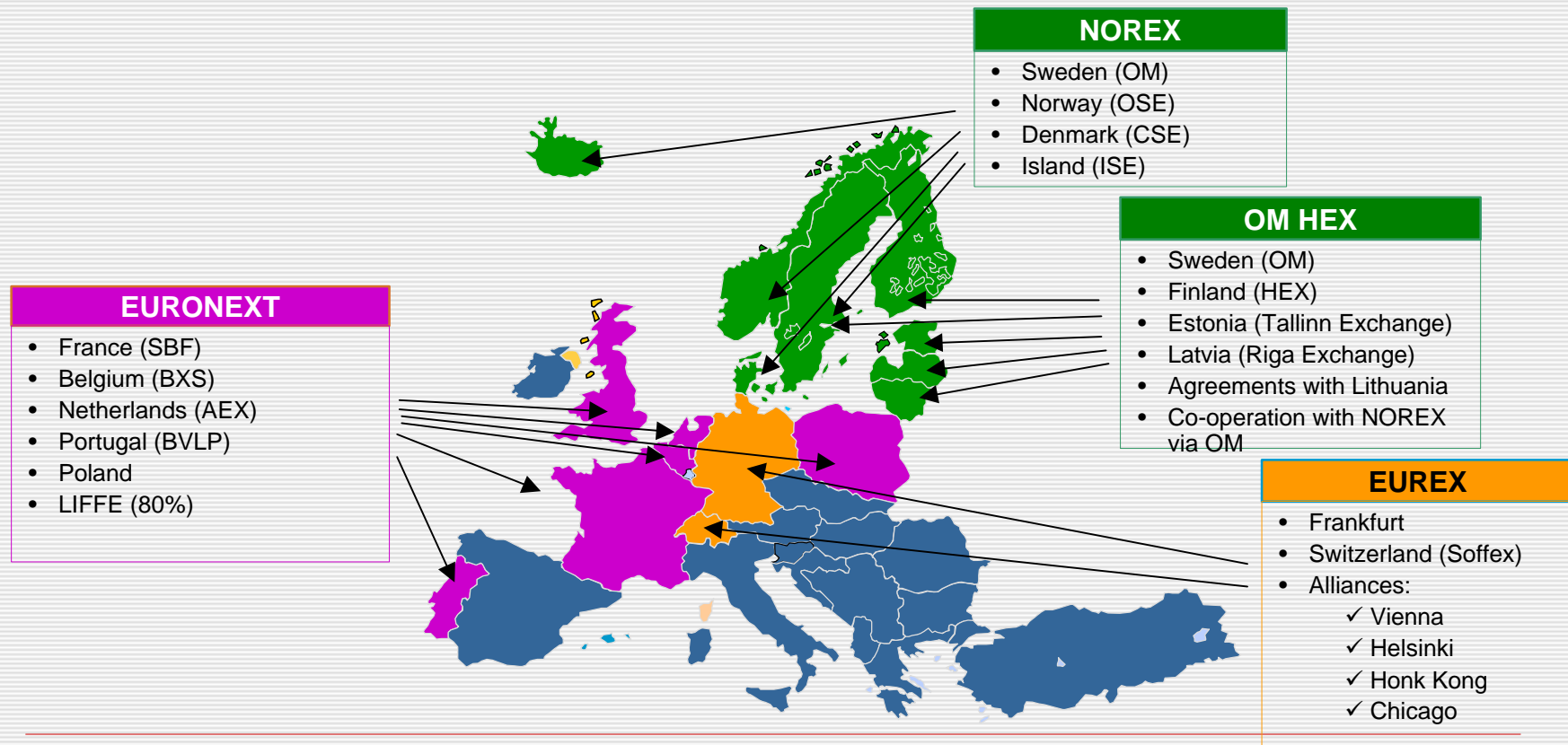


\* Mexican derivatives exchange

# 3

## Cross-border operations

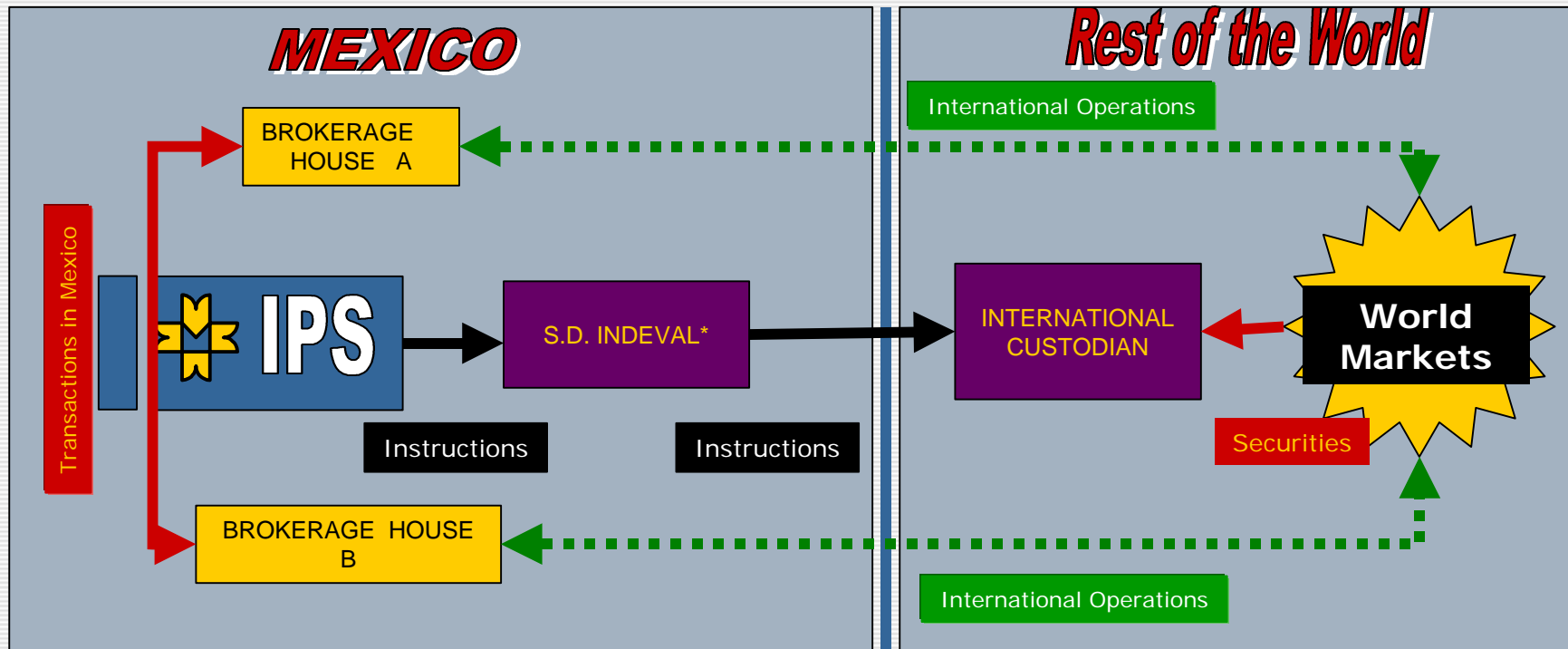
European Model: markets' consolidation



# 3

## Cross-border operations

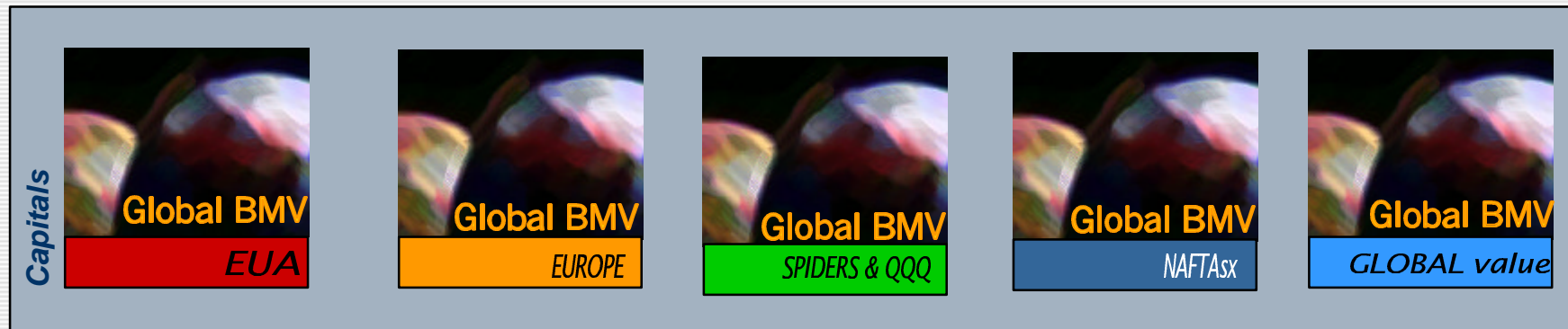
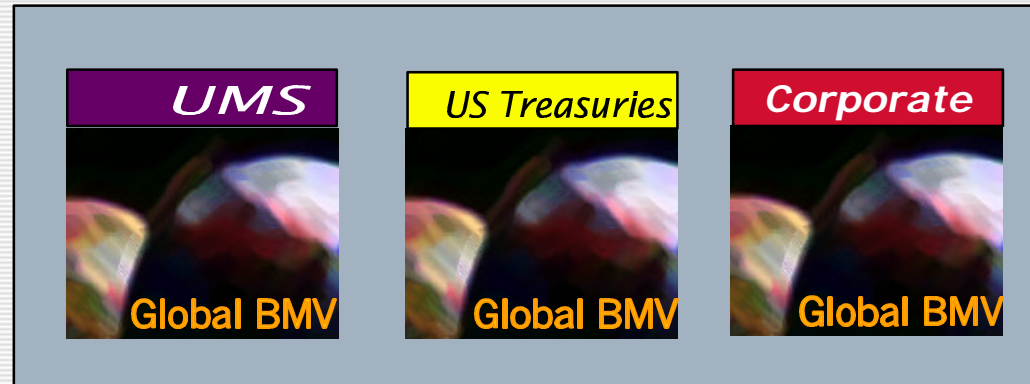
The Mexican model: Global Market BMV



\* Institute for Securities Deposit

# 3

## Cross-border operations



# 4

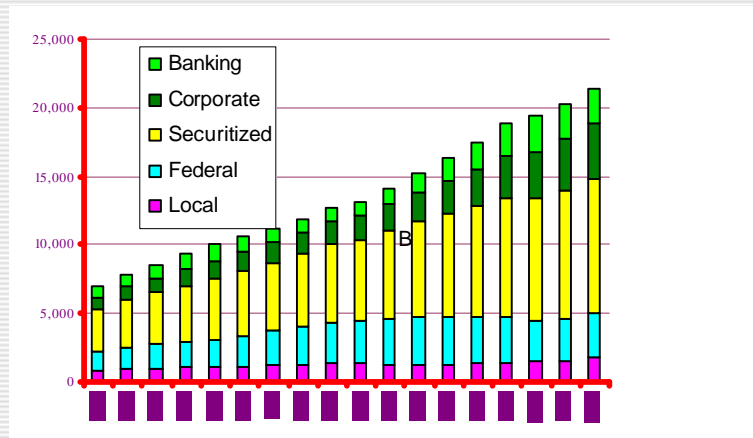
## New types of issuing companies

In the United States

**Securitized debt balance in the United States**  
(trillions of dollars)

<i>Local Governments</i>	1.8
<i>Federal Government</i>	3.3
<i>State-owned firms</i>	2.4
<i>Mortgages</i>	4.9
<i>Other</i>	1.6
<i>Banking</i>	2.5
<i>Corporate</i>	4.1
<b>Total</b>	<b>20.6</b>

**Path and composition of securitized debt**  
(thousands million dollars)



# 4

## New types of issuing companies

In Mexico

### Allocation in the Stock Market (amount in millions of pesos)

SOFOLIS (Limited objective financial societies)	2002	Jan-Nov 2003	TOTAL
MORTGAGES	1,413	3,490	4,903
AUTOMOTIVE	6,445	6,200	12,645
CONSUMPTION	150	50	200
<b>TOTAL:</b>	<b>8,008</b>	<b>9,740</b>	<b>17,748</b>

### Authorized Programs (amount in millions of pesos)

GOVERNMENT COMPANIES AND AGENCIES	2003
PEMEX	20,000
CFE (Federal Electricity Commission)	6,000
Federal Mortgages Society	9,500
Fonacot (Fund to promote and guarantee workers' consumption)	1,000
<b>TOTAL:</b>	<b>36,500</b>

Source: BMV

# 4

## New types of issuing companies

### In Mexico

- Since December 2001 until now, **7 States and 6 Municipalities** have issued **10,884 millions of pesos**.
- Market resources have served to finance projects with social impact and of infrastructure.
- The 13 local governments have been highly rated and used diverse mechanisms to guarantee their emissions (participations, rights for water usage, local taxes and toll fees)

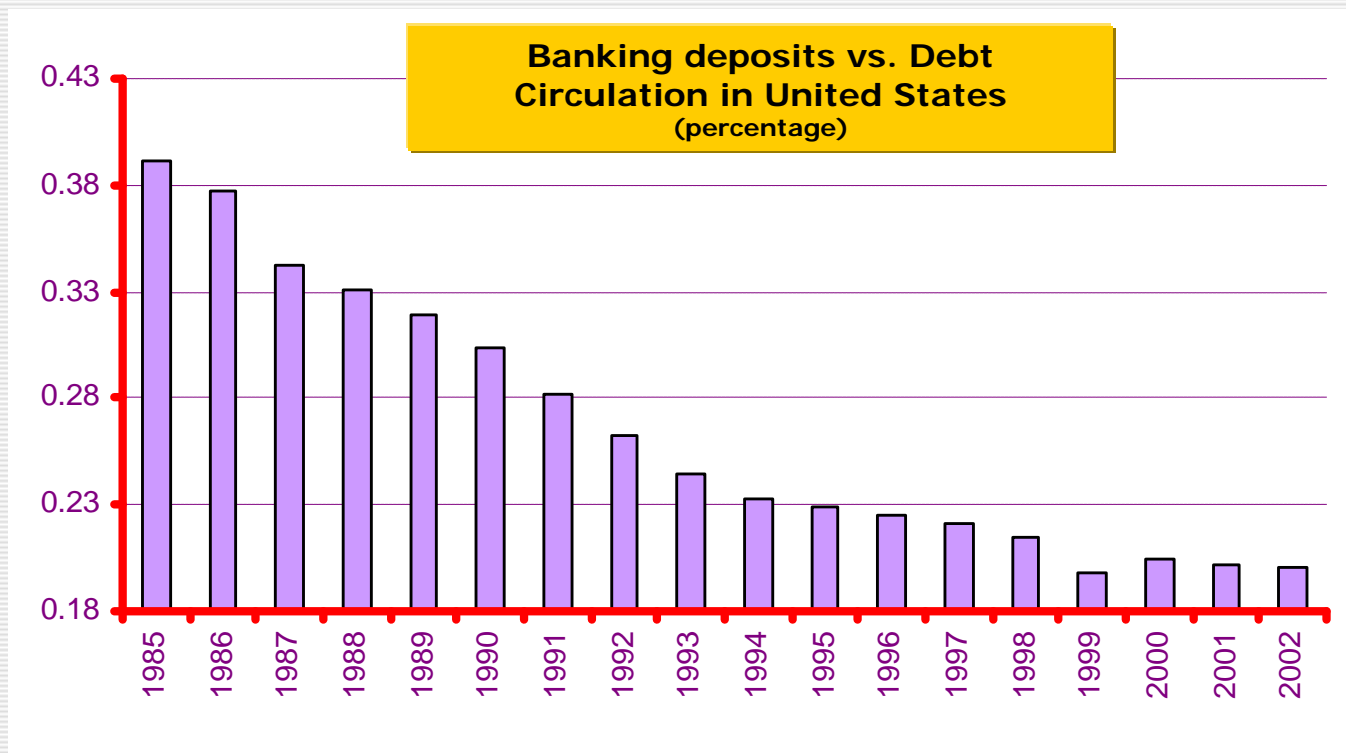
Allocations in the Stock Market 2002-2003 (amounts in millions of pesos)	
<b>States</b>	<b>9,383</b>
Morelos Chihuahua Mexico Guerrero Veracruz Hidalgo	
<b>Municipalities</b>	<b>1,460</b>
Aguascalientes, Ags. Garza Garcea, N.L. Zapopan, Jal. Monterrey, N.L. Guadalajara, Jal. Tlalnepantla, Mexico	
<b>TOTAL:</b>	<b>10,844</b>



## 5

# Savings Securitization

In the United States



Source: generated with data from FDIC and SEC

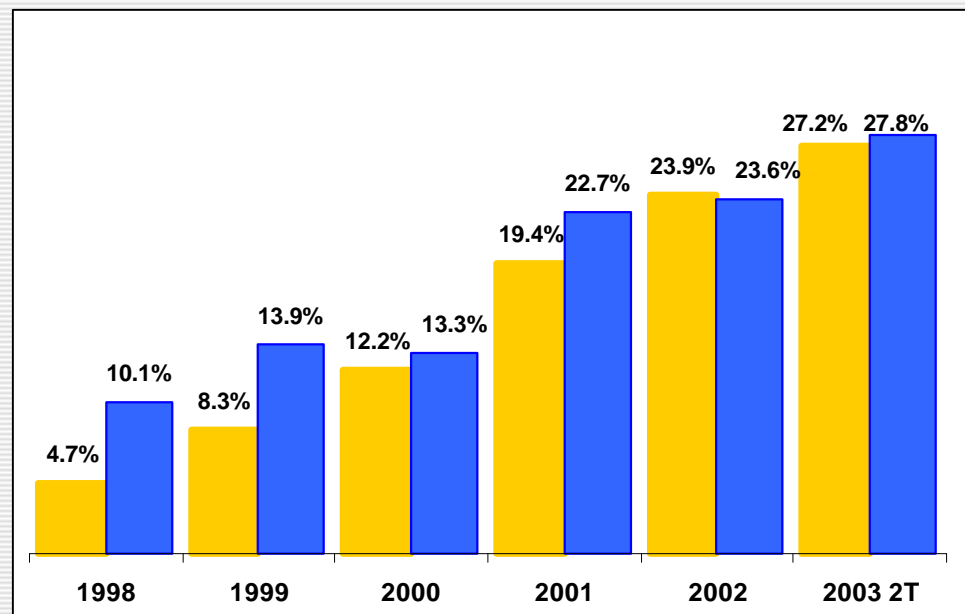
# 5

## Savings Securitization

### In Mexico

- In 1998, assets from both kinds of mutual funds represented less than 15% of traditional banking deposits
- In 2002, said proportion reached close to 48%, and for the first semester of 2003 it has reached 55%.

### MUTUAL FUNDS ASSETS AND SIEFORES\* VS. BANKING DEPOSITS



■ SIEFORES
 ■ MUTUAL FUNDS

Source: Bank of Mexico

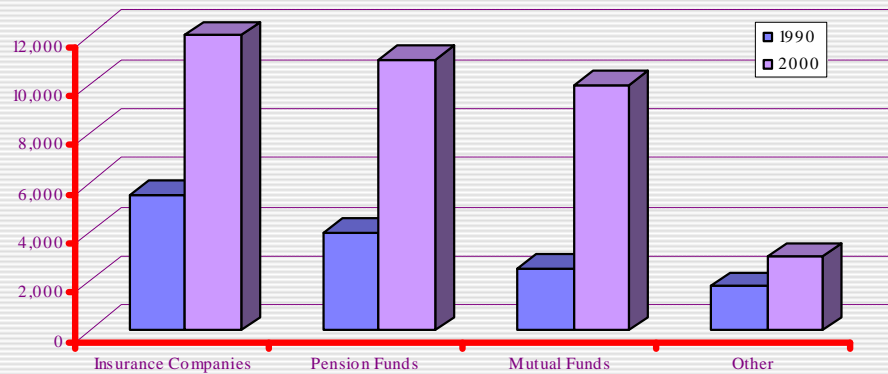
\*Mutual funds for retirement

# 6

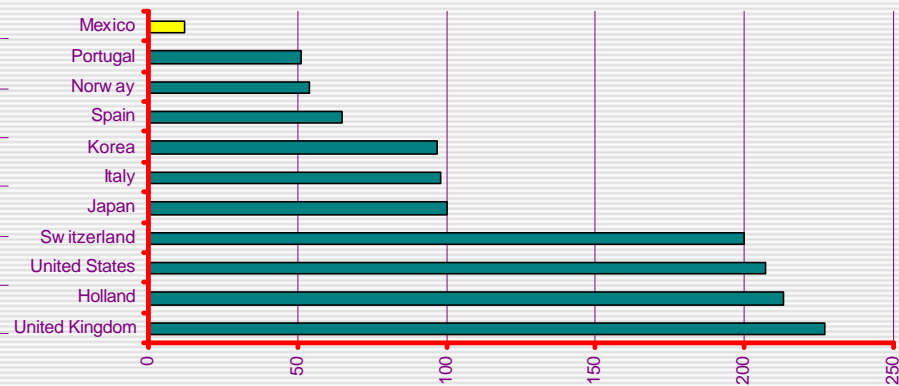
# Institutional Investors

## In the World

**ASSETS IN THE ADMINISTRATION OF INSTITUTIONAL INVESTORS (thousand million dollars)**



**ASSETS IN THE ADMINISTRATION OF INSTITUTIONAL INVESTORS (% of the GDP)**



Institutional Investors administer resources that exceed 35 trillion dollars

Source: OECD

# 6

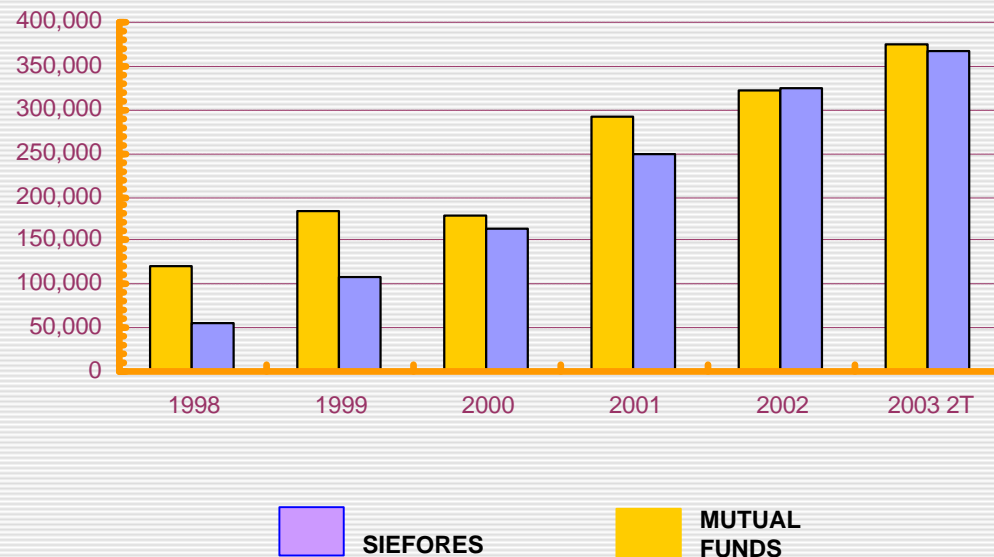
## Institutional Investors

### In Mexico

- Siefores and Mutual Funds administer resources that by the end of the second trimester of the year surpassed 700 thousand million pesos.
- Although a substantial portion of resources are governmental paper, the proportion of private paper from states and municipalities has grown substantially. These now represent close to 15% of SIEFORES holdings.

### Assets MF and SIEFORES

Millions of pesos



# 7

## Demutualization

### Concept

Before

- Only Exchange members were able to operate in it.
- Exchanges were not allowed to have more partners than their members.

Effect

- Complicates mergers and strategic alliances.
- Reduces corporate transparency.
- Reduces flexibility to compete against negotiation systems "outside exchanges"

Solution

- Exchanges transformed into commercial societies, where partners may or may not be members.
- Some exchanges are even listed in the stock exchange market.

# 7

# Demutualization

In the World

Exchanges "listed in stocks"



Demutualized



1998

2002

# 8

# Integrated Services Exchanges

In the World

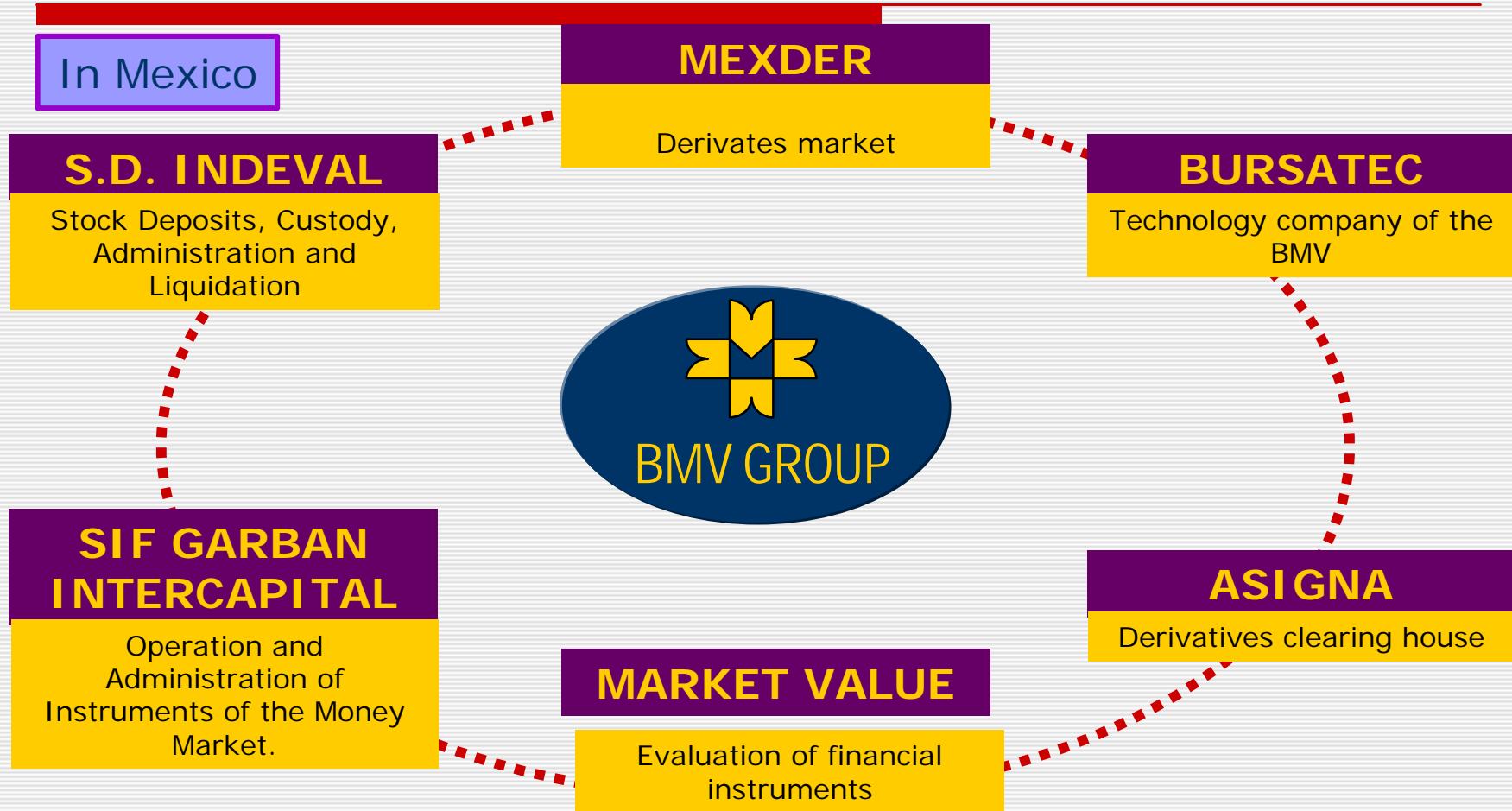
Revenue composition of listed stocks in 2002  
(percentage)

	Europe				USA				Asia		
	Deutsche Börse	Euronext	London Stock Exchange	OM		NASDAQ	NYSE	TSX	SINGAPORE EXCHANGE	HKE	ASX
Operation: capital	13%	22%	38%	22%	---	48%	16%	38%	21%	12%	43%
Operation: derivatives	16	22	---	---	80% <sup>(1)</sup>	---	---	---	8	5	18
Information	7	9	44	5	12	27	18	14	5	17	14
Others	---	---	---	---	---	---	17	5	---	---	---
Issuers fee	---	6	12	6	---	20	35	40	7	16	18
<b>Subtotal</b>	<b>36</b>	<b>58</b>	<b>94</b>	<b>33</b>	<b>92</b>	<b>95</b>	<b>86</b>	<b>97</b>	<b>40</b>	<b>50</b>	<b>93</b>
Cust. and liquidation	31	25	---	---	---	---	---	---	47	22	---
Technology	9	15	---	61	---	---	---	---	2	---	---
Other	24	2	6	6	8	5	14	3	10	28	7
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b> <sup>(3)</sup>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: Salomon Smith Barney

# 8

## Integrated Services Exchanges

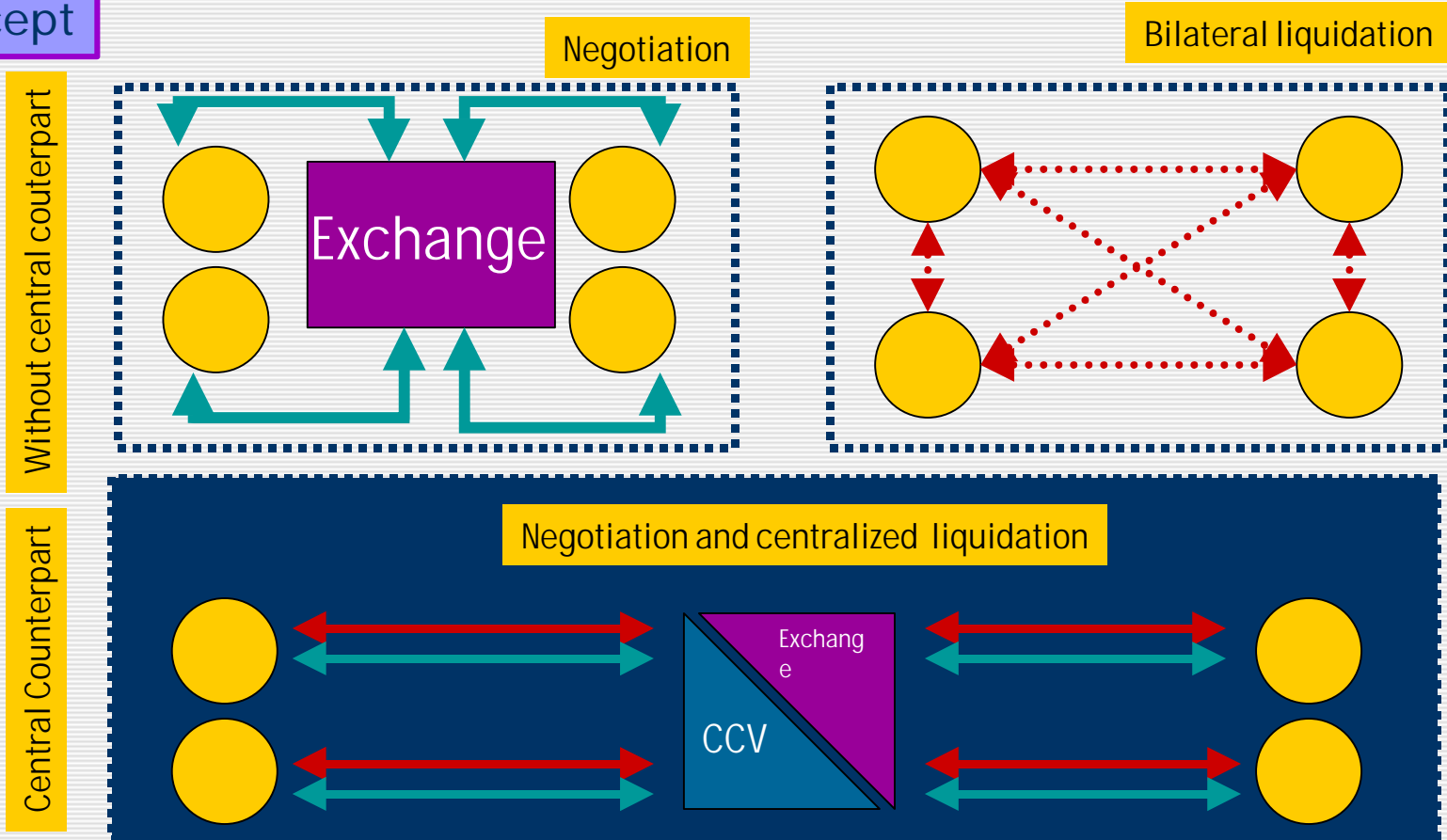




# 9

# Central counterpart

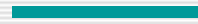
## Concept



Brokerage house



Stocks and cash






Orders and confirmations

# 9

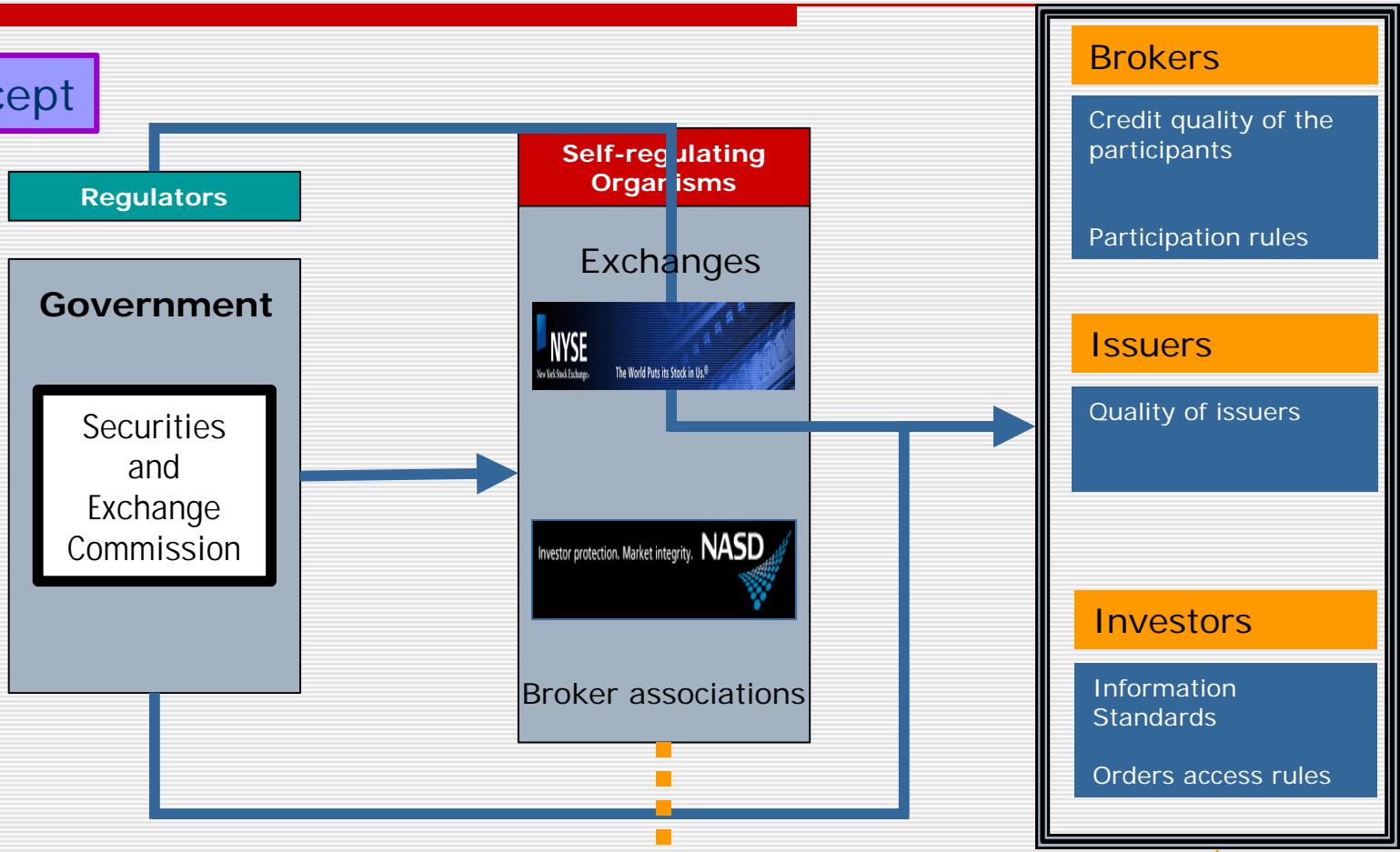
# Central counterparts

## Mexico in the world

		Securities	Derivatives	Debt
 <p><b>EUROPE</b></p>	FRANCE	CLEARNET CLEARNET CLEARNET CLEARNET LCH EUREX CLEARING * CCG *	CLEARNET CLEARNET CLEARNET LISBON CLEARING HOUSE LCH EUREX CLEARING CCG MEFF WIENNER BÖRSE	CLEARNET CLEARNET CLEARNET
	BELGIUM			
	<b>NETHERLANDS</b>			
	PORTUGAL			
	UK			
 <p><b>AMERICA</b></p>	GERMANY	DTCC CSD CBLC Merval	OCH CSD	DTCC CBLC
	ITALY			
	SPAIN			
	AUSTRIA			
	US			
 <p><b>ASIA</b></p>	<b>MEXICO</b>	<b>CCV</b>	<b>ASIGNA</b>	
	VENEZUELA		MEFF	
	JAPAN	TSE	TSE	
	HONG KONG	HKSCC		
	AUSTRALIA	CHES	SFE / OCH	
SINGAPORE	CDP			

# 10 Self-regulation

Concept

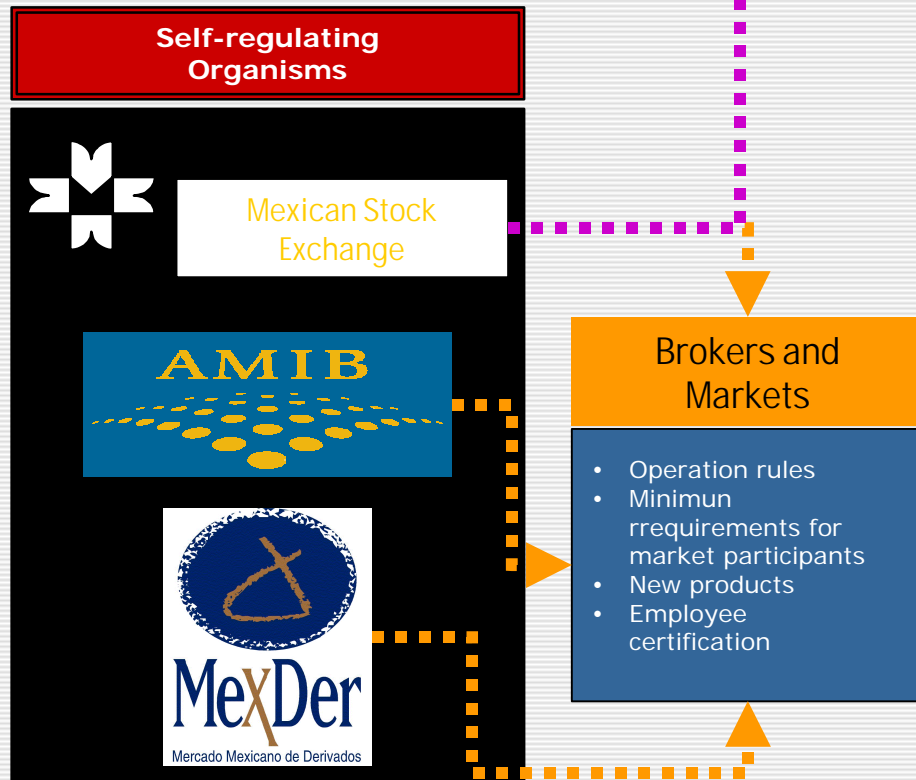


Main concurrence areas

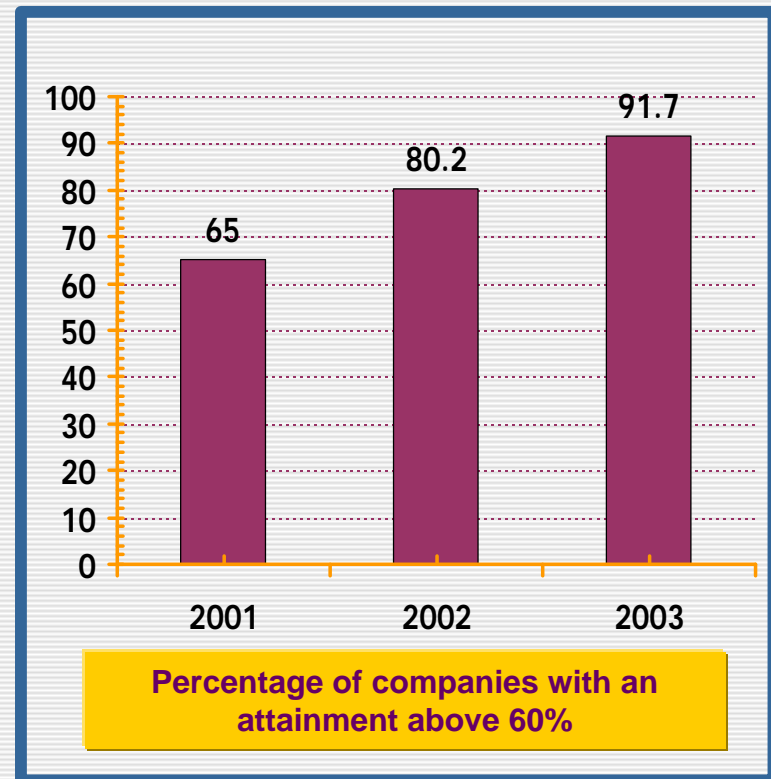
# 10

# Self-regulation

In Mexico: an example



Issuers: best practices code

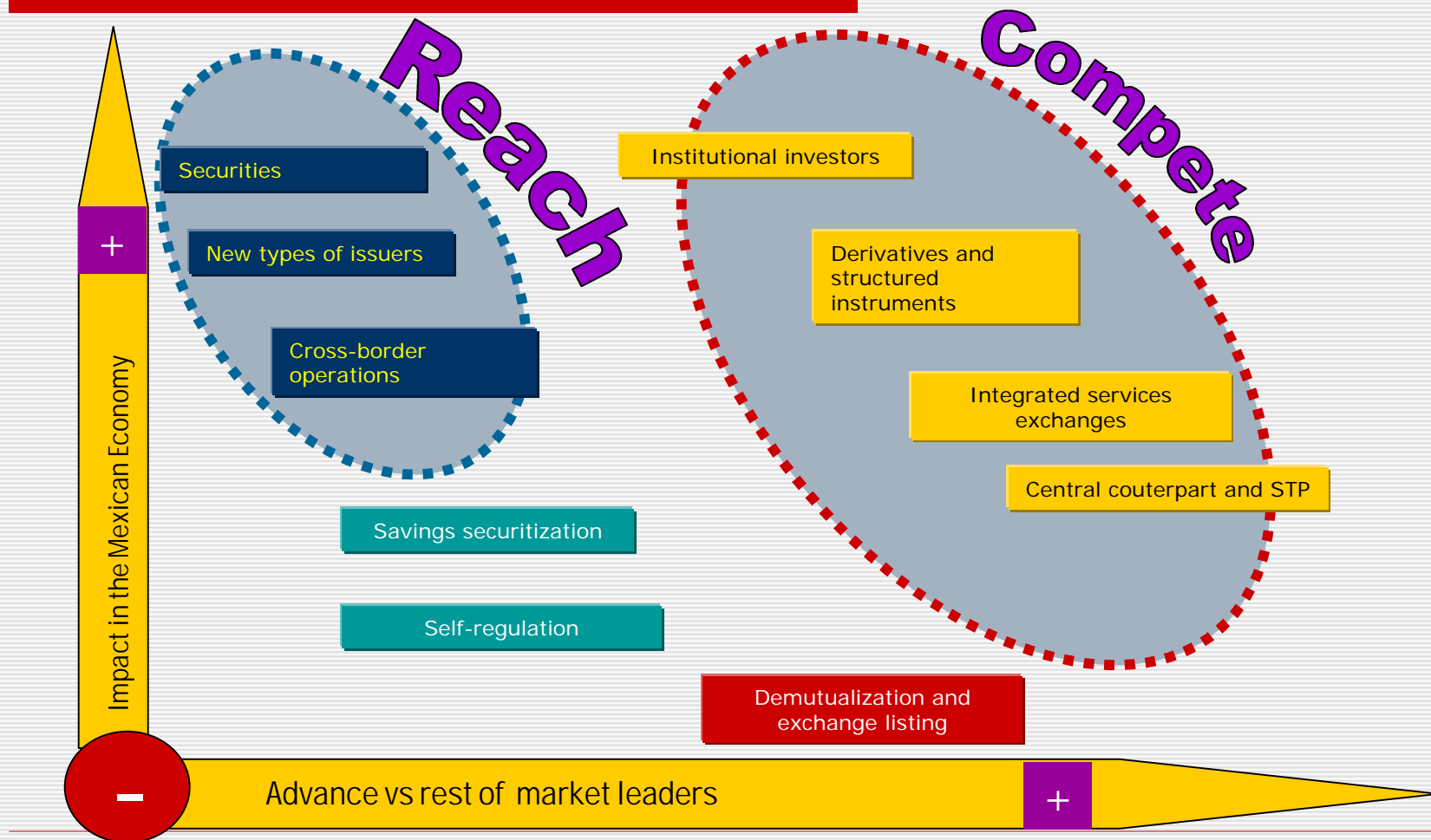


# Index

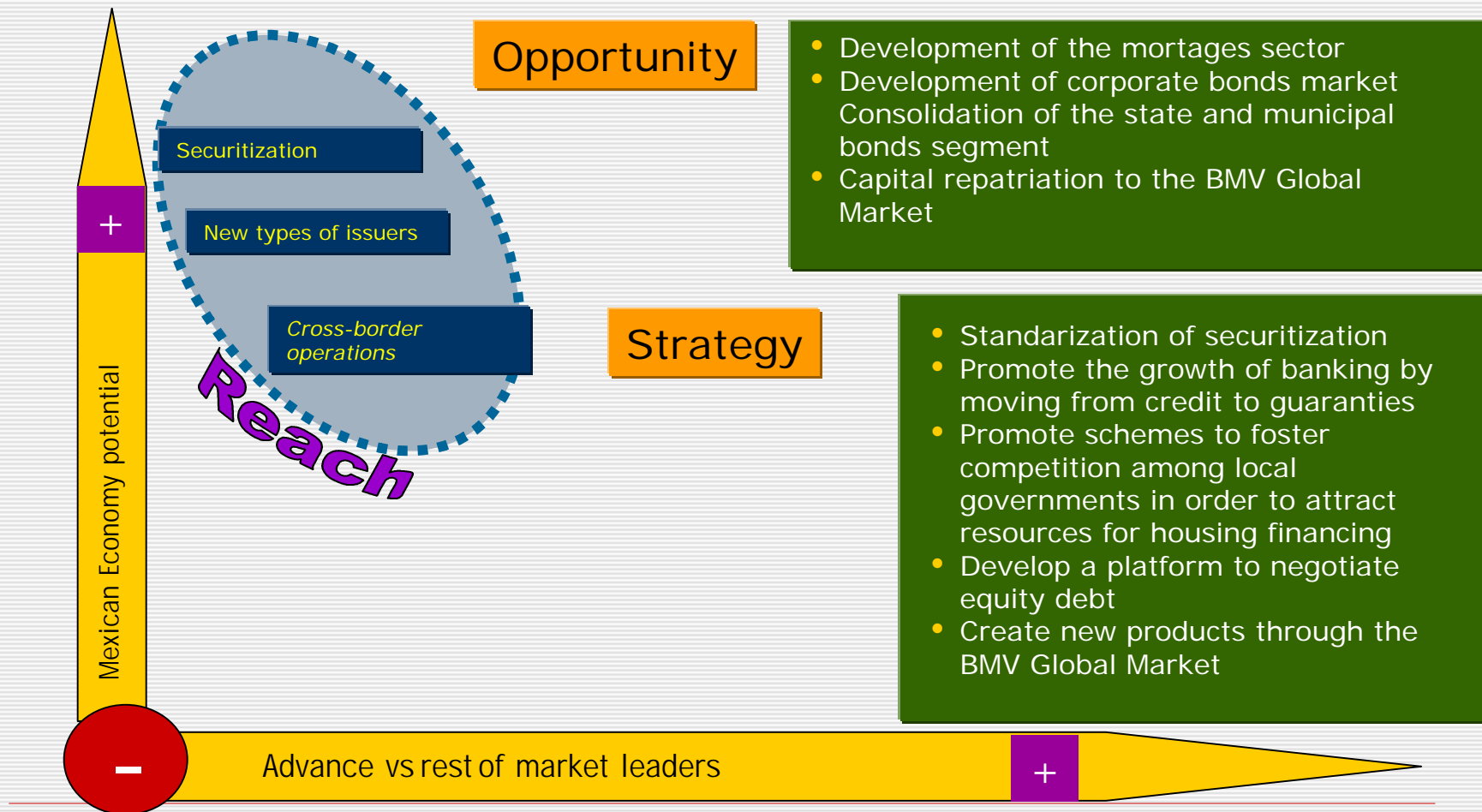
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- Reference framework
- Megatendencies
- A strategy for the future
- Thinking of unpredictable
- Conclusions

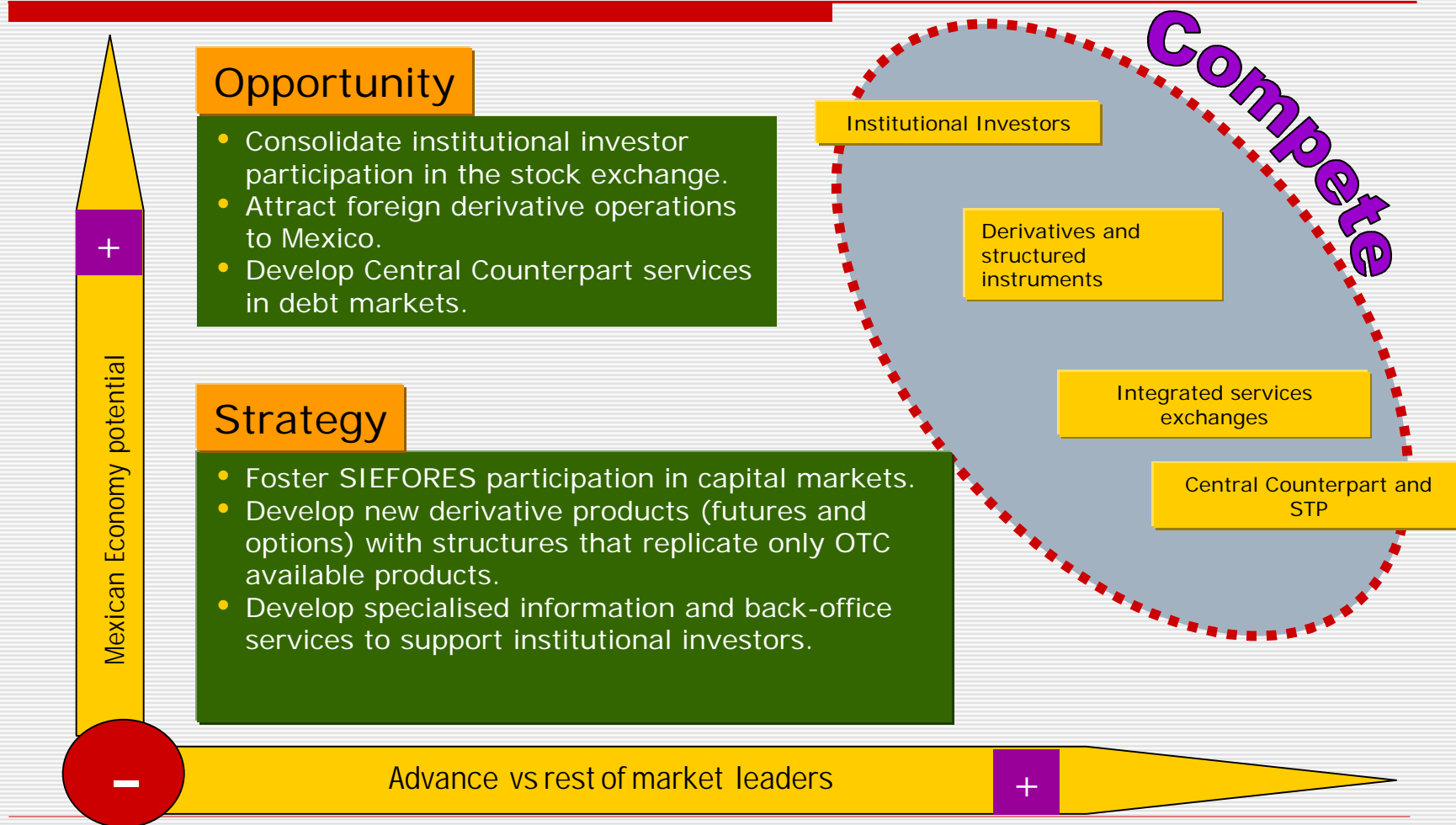
# A strategic map with 10 ideas



# A strategic map with 10 ideas



# A strategic map with 10 ideas





# Index

---

- Reference framework
- Megatendencies
- A strategy for the future
- Thinking of unpredictables
- Conclusions

# What can go wrong?

---



**A**

Macroeconomic or financial crisis in Mexico and abroad.

**B**

Financial scandals and violations that seriously affect interests of the general investment community.

**C**

Uncertainty caused by events similar to terrorism or war.

**D**

Disasters or serious failures of the market infrastructure that jeopardize its operation.

# What can go wrong?

Problem: uncertainty and distrust

Answer: liquidity, solvency and trust

**A**

Macroeconomic or financial crisis in Mexico and abroad.

- Central Counterpart risk administration to ensure solvency and liquidity in the market.
- Mechanisms to guarantee the opportunity and quality of market information.

**B**

Financial scandals and violations that seriously affect interests of the general investment community.

- Strengthening credibility and trust in stock market institutions.
- **Oversight** of self-regulation.

**C**

Uncertainty caused by events similar to terrorism or war.

- Operational Contingency Plans
- **Co-ordination schemes** with authorities and other international markets.

**D**

Disasters or serious failures of the market infrastructure that jeopardize its operation.

- **Operative back-up center** in Pachuca
- **Contingency plans**
- Constant **capacity building**

# Index

---

- Reference framework
- Megatendencies
- A strategy for the future
- Thinking of unpredictables
- Conclusions

# Conclusions

---

- Although **all future events are not predictable, most are.**
- **Stock markets tendencies are very clear** in fact, the challenge of positioning ourselves as a competitive market is the most important issue in our agenda.
- Our strategy lies in **seizing opportunities** brought by securitization, the development of market of instruments for institutional investors, repatriation of capital and attraction of markets of Mexican instruments that are now abroad.
- By being exposed to negative unpredictable events, the market should administer and prevent impacts. Central Counterparts solvency, systems backups and trust building, are key.

# Regulation in the Stock Market

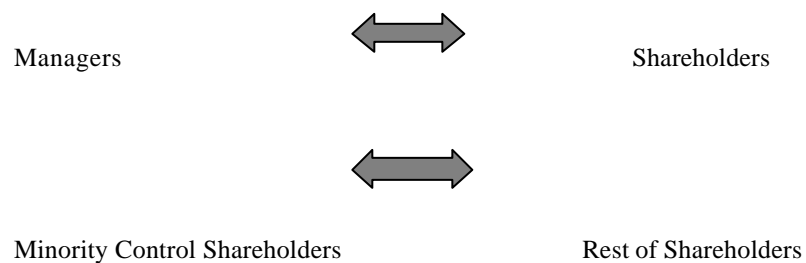
**Jorge Familiar Calderón**

November 2003

1

## Background

International Regulation has been taken into account, however, reforms have been designed considering specific risk factors in our country.



2

## History

- 1997 **Secondary Regulation**
  - Disclosure of Information (prospects)
  - Principle of Relevance
  - Certification of Information
  - Relevant Events
- 1998 **Issuing Criteria**
  - Different shares from common ones**Secondary Regulation**
  - Emisnet
- 1999 **Code of Better Corporate Practices**
  - Disclosure of degree of adhesion

3

## History

- 2000 **Secondary Regulation**
  - Periodic information of issuers, quarterly and annual reports.
- 2001 **Reform to the Exchange Market Law**
  - Disclosure of information
  - Corporate Governance
  - Minority Rights
- 2002 **Rule of IPOs**
- 2003 **Circular for Issuers**
  - Corporate Governance
  - Disclosure of information

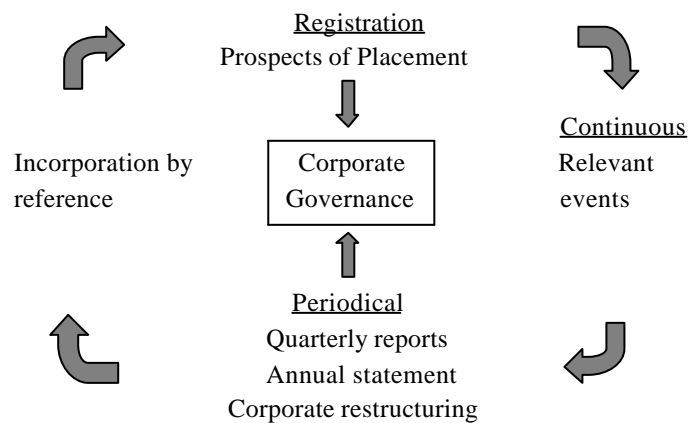
4

## Disclosure of Information Relevance Principle

- Law. Issuers must reveal all relevant information that contributes to an adequate decision-making process by public investors.
- Circular for Issuers. Relevant Information: All qualitative or quantitative information from an Issuer, its assets and, if it applies, the business group it belongs to, regardless of the position it holds within it, necessary to know the true financial situation, administrative, economic and judicial of the Issuer as an economic entity, as well its activities and risks, whose publication or omission affects the valuation, price estimation and investment decisions that according to common analysis, a common investor would carry out.

5

## Disclosure of Information



6



## Exchange Market Law

- Corporate Governance

Size: Between 5 and 20 councillors, 25% independent. Each proprietor councillor will have only one substitute.

Frequency of Meetings: Each quarter, also 25% of councillors or any of the commissioners can summon a session.

- Faculties: The council must approve operations that are different from the ordinary course of affairs of the business, among others.
- Auditing committee: with majority and presided by independent councillors

- Rights of Minority Shareholders

- Right to name a commissioner with 10% of social capital,
- Right to demand responsibility of councillors and commissioners by civil means with 15% of social capital.
- Right to judicially oppose resolutions of the assembly and promote the suspension of agreements with 20% of the voting shares or restricted vote.

7

## Rule of IPOs

Current Investment (votes)	Expected Investment (votes)	% of capital to be acquired
< 30%	=30% = 50%	10% or a percentage of the capital equal to the percentage of the votes to be acquired, whatever is higher.
	= 50%	100%

- Public offering must extend to all series of shares at the same price.
- If as a result of the offer, the capital of the enterprise placed in the market is less than 15%, the offer will have to be made extensive to 100% of the capital.

8

## Code of Best Corporate Practices

See graph in Spanish version .

Enterprises that presented the Code in:

2000: 178

2001: 170

2002: 175

9

## Code of Best Corporate Practices

### Total

	<u>2000</u>	<u>2001</u>	<u>2002</u>
> 91%	5	8	15
> 81%	12	27	40
> 71%	37	49	66
> 61%	61	74	82

### Shares

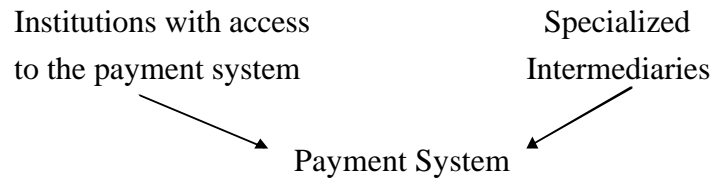
	<u>2000</u>	<u>2001</u>	<u>2002</u>
> 91%	6	9	19
> 81%	13	29	48
> 71%	37	52	75
> 61%	62	78	90

### Debt

	<u>2000</u>	<u>2001</u>	<u>2002</u>
>91%	3	3	7
>81%	11	20	20
>71%	37	40	42
>61%	58	60	62

10

## Competition among Intermediaries



- Access to the payment system must not be used as an instrument of competition among financial institutions.
- The existence of specialized intermediaries is indispensable for the development of the market.

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# ***The Stock Market: Progress and Challenges***

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**Seminar on Competition and Regulation  
in the Financial Services Sector**

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**Lorenza Martínez Trigueros  
Bank of Mexico**

**November 18th, 2003**

1

## **CONTENTS**

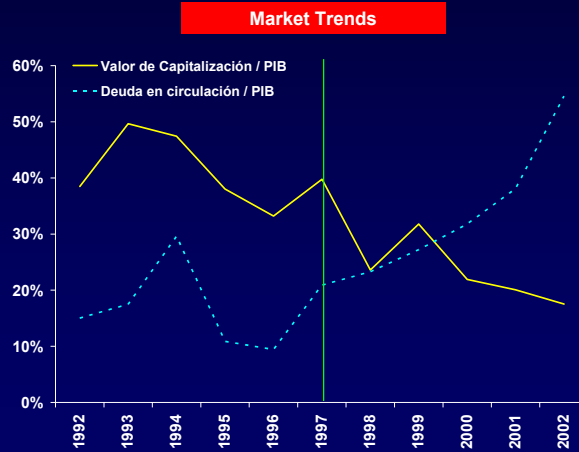
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- ✓ ***MOTIVATION***
- ***DEBT MARKET***
- ***SHARES / CAPITAL MARKET***
- ***GENERAL ASPECTS***
- ***CLOSING REMARKS***

2

## Market Trends

- ➔ *Debt and shares markets showed a relatively similar behavior from 1992 to 1997.*
- ➔ *However, from 1997 the exchange market has declined, while the debt market has followed a dynamic development. (Graphs have been translated wherever possible)*



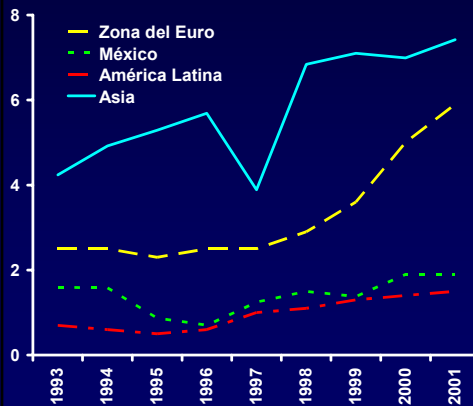
Source: MSE and Bank of Mexico.  
The 1994 capitalization value is at the end of November.

3

## However...

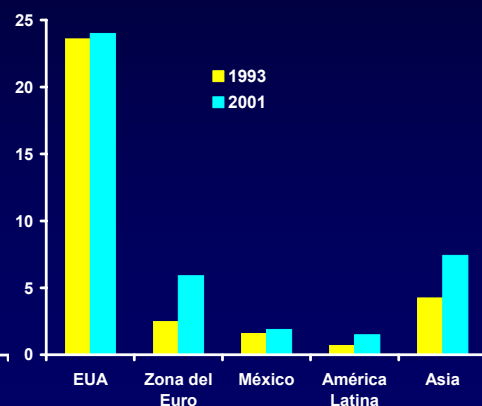
- The corporate debt market is still small by international standards. (Graphs have been translated wherever possible)*

**Evolution of Corporate Debt in Circulation (% of GDP)**



Fuente: BMV y "Trends in Developing Countries' Capital Markets Around the World" Häusler.

**Corporate Debt in Circulation (% of GDP)**

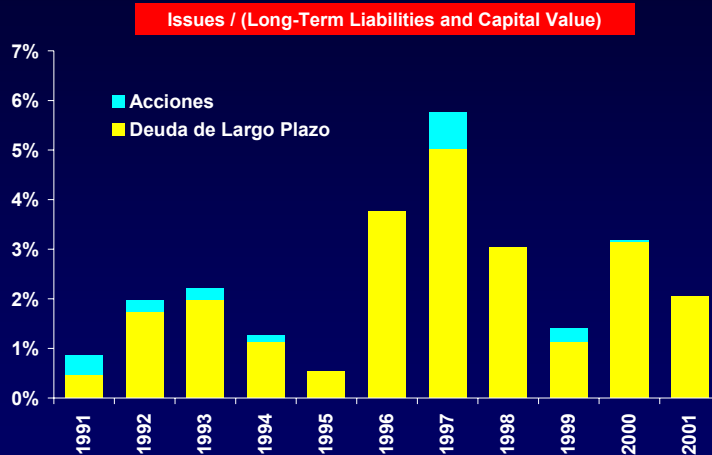


Fuente: BMV y "Trends in Developing Countries' Capital Markets Around the World" Häusler.

4

## However...

2. *During 1996-1998 the exchange market partially substituted bank credit as a source of financing. (Graphs have been translated wherever possible)*



Nota: Emisión bruta de bonos corporativos de largo plazo (maduración igual o mayor a un año) y de acciones sobre pasivos de largo plazo más el valor del capital. Promedios de todas las empresas no financieras listadas en la BMV durante el período 1990-2000 y para las que además existe disponibilidad de datos de los estados de resultados. 50 empresas cumplen con estas condiciones.

Fuente: Martínez, Tornell and Westermann, 2003

5

## However...

3. *The exchange market lag relative to the debt market turns out to be normal considering:*

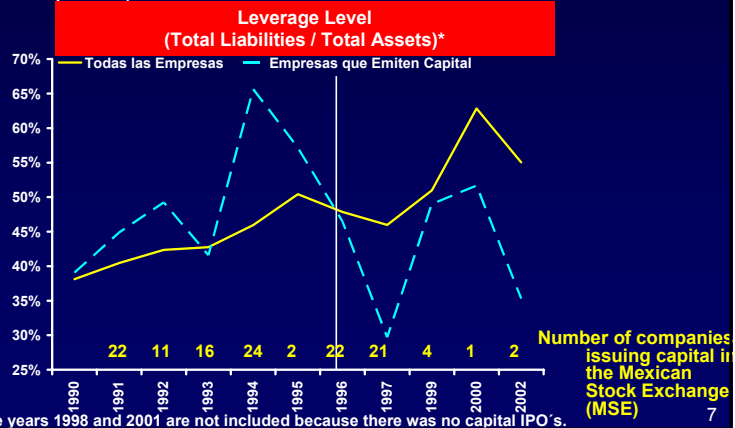
- *The pecking order by which companies first choose domestic resources, then debt, and only in third place capital issues.*
- *During the 1995 crisis, companies had an excess capacity that allowed them to grow their sales without needing to invest.*
- *Due to the above, and to the lack of available of bank credit, companies decreased their leverage during the years following the crisis and some even turned to capital issuing in spite of low indebtedness levels.*
- *In recent years, companies have turned to financing via debt, due among other reasons, to their low leverage levels. However, we may expect that when the former option is no longer viable and to the extent that economic growth increases an increase in the demand for financing via capital issues will occur.*

6

## However...

### → The former implies:

- From 1990 to 1995, companies would issue capital once their degree of leverage did not allow them to assume further debt.
- From 1996 to 1998 the decrease in credit supply led companies with low leverage levels to issue capital.
- From 1999 to 2002 reactivation in the credit market and opportunities in the debt market led companies to generally prefer, this type of financing. (Graphs have been translated wherever possible)



## Why a National Market?

### → It is important to have a domestic market.-

The local stock market must work as a financing option especially for medium size companies, who cannot issue directly in international markets (the smallest Mexican company that quotes ADR's has assets worth 65 million dollars).

### → However, the MSE has not fulfilled this role.-

The Mexican market has characterized itself for having only very big companies. The smallest active non-financial Mexican company quoted in the MSE has assets approximately worth 13 million dollars while in NASDAQ there are companies starting at 4 million dollars.

## Why a National Market?

Scarce development in Mexican markets is not due to company "migration" to international markets. (Graphs have been translated wherever possible)

### Net Financing to the Non-Financial Corporate Sector/Private Investment

	BMV			Mercados Internacionales		
	Acciones	Deuda Corporativa	Total	ADRs	Deuda Corporativa *	Total
1991	1.22%	2.03%	3.25%	6.04%	7.02%	13.06%
1992	1.49%	2.21%	3.69%	4.42%	6.50%	10.92%
1993	3.51%	2.62%	6.13%	3.92%	13.33%	17.25%
1994	3.47%	1.38%	4.86%	2.37%	11.22%	13.59%
1995	0.05%	0.86%	0.91%	0.22%	1.86%	2.08%
1996	1.66%	1.38%	3.05%	1.06%	8.65%	9.72%
1997	1.36%	4.49%	5.85%	1.24%	9.67%	10.90%
1998	0.00%	2.05%	2.05%	0.00%	2.98%	2.98%
1999	0.56%	0.06%	0.62%	0.21%	3.32%	3.53%
2000	1.49%	3.22%	4.71%	0.46%	5.04%	5.51%
2001	0.00%	4.05%	4.05%	-0.20%	1.83%	2.03%

\* Financiamiento bruto, las amortizaciones no están consideradas

Source: MSE

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## CONTENTS

- **MOTIVATION**
- ✓ **DEBT MARKET**
- **SHARES / CAPITAL MARKET**
- **GENERAL ASPECTS**
- **CLOSING REMARKS**

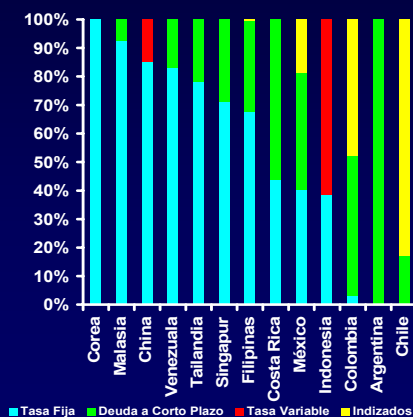
10



## Progress

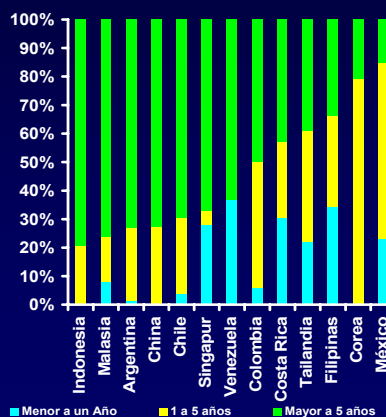
- ➔ **Main actions undertaken:**
  - *Development of long-term fixed rate public bonds market, which is essential for the development of a corporate bonds market. (Graphs have been translated wherever possible)*

**Composition of Government Debt by Instruments, 2001\***



■ Tasa Fija ■ Deuda a Corto Plazo ■ Tasa Variable ■ Indizados  
 \* Latin America as of June 2002  
 Source: Del Valle, 2003

**Composition of Government Debt by Maturity, 2001\***



■ Menor a un Año ■ 1 a 5 años ■ Mayor a 5 años  
 \* Latin America as of June 2002  
 Source: Del Valle, 2003

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## Progress and Challenges

- ➔ **Main actions undertaken (cont.)**
  - *Tax exemption on government bonds has been eliminated, which has encouraged competition.*
  - *The development of institutional investors, AFORES in particular, has allowed the development of a long-term debt market. Because an assessment of the portfolio in terms of the market value (market-to-market) is required, there is a relatively liquid market of long-term government bonds.*
- ➔ **Challenges**
  - *Lack of sophistication in evaluating corporate credit risk, which limits development in this market and makes it more vulnerable. To the extent that this type of analysis is developed, there will be counterweights from credit rating agencies.*
  - *Corporate debt issues do not have a secondary market, which increases credit risk assumed by AFORES. Making the reporting of these instruments compulsory could contribute to increase their liquidity.*
  - *It is important to look into possible bank collusion problems in funding and AFORES markets regarding primary issues of long-term bonds.*

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## **CONTENTS**

---

- **MOTIVATION**
- **DEBT MARKET**
- ✓ **SHARES / CAPITAL MARKET**
- **GENERAL ASPECTS**
- **CLOSING REMARKS**

13

## **Progress in Regulatory Matters**

---

- ➔ *Reforms have been undertaken to foster and promote:*
  - *Transparency.*
  - *Protection for the investor.*
  - *Access to the general investing public.*
- ➔ *These reforms, approved in April 2001, concentrated mainly on two types of law:*
  - *Law for the Exchange Market.*
  - *Law for Institutional Investment Companies.*

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## ***Law for the Exchange Market: Rights of Minority Shareholders***

---

- ➔ *With 10% of shares entitled to restricted voting, the following rights are granted:*
  - *Appointing a counselor.*
  - *Convening a general assembly of shareholders.*
  - *Legally opposing assembly resolutions and promoting suspension of agreements (with 20%).*
  - *Postponing assembly voting for three days.*
- ➔ *The right to appoint a commissioner with 10% of equity capital.*
- ➔ *The right to demand counselor and commissioner responsibility by civil means with 15% of equity capital.*
- ➔ *Making documents related to items to be discussed at the corresponding assembly available to shareholders at least 15 days in advance.*
- ➔ *Votes may be cast by mail, fax, or electronic means, through stock brokerage houses that represent the shareholder.*

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## ***Law on the Stock Exchange Market: Rights of Minority Shareholders***

---

- ➔ *Other additional reforms to:*
  - *Improve corporate governance of issuing bodies.*
  - *Limit issues of shares different from ordinary shares and ban mechanisms that make the access to voting shares more expensive.*
  - *Broaden cases where the use of privileged information is presumed and defined as a crime, and facilitate CNBV intervention as well.*
  - *Define and sanction practices that move away from sound market uses, such as its manipulation and the diffusion of false information.*
  - *Demand higher standards regarding information disclosure.*

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## **Law on Institutional Investment Companies**

---

- ➔ *Avoid conflicts of interests through corporate governance structures in the industry.*
- ➔ *Improve distribution channels of institutional investment companies creating the role of share distributor of institutional investment companies.*
- ➔ *Make the investment regime more flexible, by allowing institutional investors to:*
  - *Invest in stock denominated in foreign currency.*
  - *Operate share loans.*
  - *Operate with derivatives.*
  - *Invest in real estate.*
  - *Offer “funds of funds”.*
  - *Leverage their capital.*

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## **Privileged Information**

---

- ➔ *Substantial progress has been made in regulatory matters, especially in categorizing crimes and attributing sanctions attribution by the CNBV.*
- ➔ *Penalizing these types of actions and making the sanctions public knowledge is essential.*
- ➔ *An academic paper (Bhattacharya and Daouk, 2000) finds that:*
  - *“..it is the enforcement of the law and not the existence of regulation that penalizes the use of privileged information, what matters”*
  - *The cost of issuing capital decreases 5% on average if the use of privileged information is punished –through case prosecution.*

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## Privileged Information: Evidence for Mexico

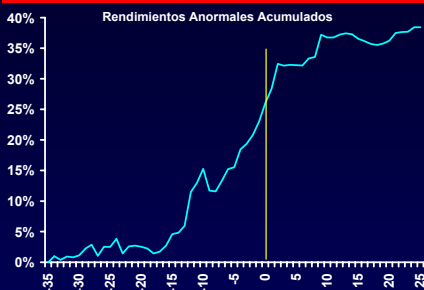
- ➔ An analysis was performed to look for evidence of the existence of privileged information in Mexico.
- ➔ The research looks for abnormal yields during the days previous to the announcement of an event, such as an acquisition or a disinvestment, and caused by these information leaks.
- ➔ Normal yields were estimated over a period of 30 days, corresponding to the period from 55 to 26 days before the announcement of the event, as a function of the market yield ( $r_{it} = \alpha + \beta r_{mt}$ ).
- ➔ This shows the estimate of the normal yield that a share should have. Abnormal returns are obtained by subtracting the estimated normal yield from the share's observed yield.

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## Privileged Information: Evidence for Mexico

(Graphs have been translated wherever possible)

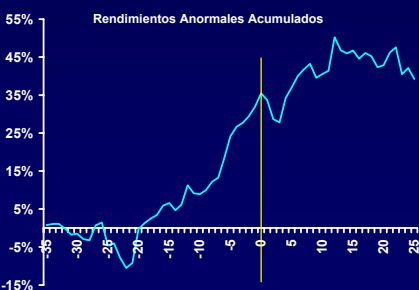
Savia. Acquisition 29th June 1998



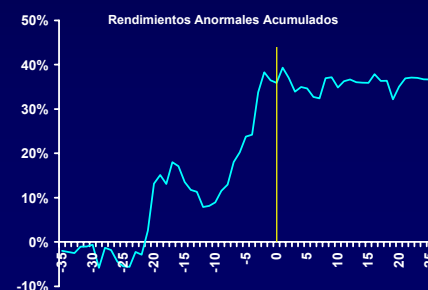
TV Azteca. Acquisition 15th December 1999



Grupo Continental. Acquisition 3rd April 2000



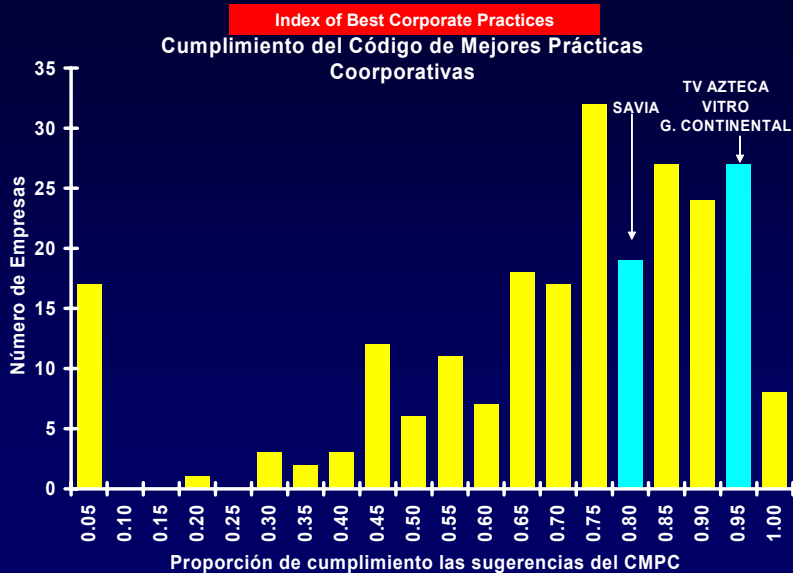
Vitro. Disinvestment 25th February 2002



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## Best Corporate Practices Code

- ➔ An index was created based on the Best Corporate Practices Code. (Graphs have been translated wherever possible)



Source: CMPC questionnaires and own estimates.

21

## Transparency

- ➔ MSE must improve its role as the main information supplier, and guarantee easy access to that information as well.
- ➔ The concern in obtaining income for providing information must not limit access to basic information.
- ➔ It is important to consider that registering new shares and operations must be the main source of income. (Graphs have been translated wherever possible)

### Income in Some of the World's Stock Exchanges\*

	NYSE 2001	NASDAQ 2001	TSE 2001
<b>Fuente de los Ingresos</b>			
Cuotas de listado y por transacciones	34.6%	53.7%	68.0%
Total información	37.8%	28.1%	24.1%
Información de Mercado	15.8%	-	-
Procesamiento de información	22.0%	-	-
Otros	27.6%	18.2%	7.8%

\* This information was not found for MSE.

Source: NYSE, Nasdaq, and TSE.

22

## Transparency

- ➔ *Information where there is immediate and free access in MSE's webpage is very limited, and its access is complicated compared to the information that can be accessed on the pages of other stock exchanges. (Graphs have been translated wherever possible)*

### Information Available on Stock Exchange Webpages

	Tabla con las Ofertas Públicas Iniciales	Tabla con los Participantes en el Mercado de Bonos	Pago de Dividendos de la acción (Histórico)	Opciones de acciones	Descripción de Tenedores de la acción	Información Financiera (Accesos directos a los estados financieros con rezagos de al menos un año)	Acceso directo a información de analistas
Tokkyo Stock Exchange	✓	✓		✓			
New York Stock Exchange	✓	✓	✓		✓	✓	✓
NASDAQ	✓		✓	✓	✓	✓	✓
Bolsa de Madrid	✓	✓	✓			✓	

Bolsa Mexicana de Valores

Source: TSE, NYSE, Nasdaq, Madrid Stock Exchange, and MSE.

- ➔ *It is essential to adopt an internationally recognised accounting system such as USGAAP or IAS.*
- ➔ *Publicizing successful cases of companies that have managed to grow due to public capital issues, reflecting in attractive yields for investors.*

23

## Liquidity

- ➔ *It is imperative to undertake actions that guarantee liquidity during difficult times, especially for new issuer shares.*
  - *Create schemes with adequate prudential regulation to carry out short sales and operator leverage share sales.*
- ➔ *The above will encourage the development of specialists or market makers.*

24

## Short- Selling

- ➔ Operations in which a stock exchange acts on account of and according to the orders of a customer to borrow stock and selling it, committing to returning the stock in a defined term.
- ➔ Because the loss in these types of operations is not limited, it is important to demand precautionary prudential measures, such as demanding a customer a net position of at least 50% of the short-term stock and updating it –make a margin call- every time the increase in the price of the share exceeds certain limit.
- ➔ In the event that the customer does not comply with the margin call in a certain period (24 hours), the stock exchange must buy the stock to settle the short-term position, keeping the remaining balance in the customer's account. Otherwise the stock exchange will be sanctioned.
- ➔ In addition, it is important to issue rules of capitalization for this type of operation, as well as other measures to limit the risk to which the stock exchange is exposed.

Investor's Balance	
②	\$ 15,000 Cash
③	(1,000)(\$10) Short-term sale
	\$5,000 Position ②

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## CONTENTS

- **MOTIVATION**
- **DEBT MARKET**
- **SHARES / CAPITAL MARKET**
- ✓ **GENERAL ASPECTS**
- **CLOSING REMARKS**

26



## Cost of Issuing

- ➔ *In Mexico, the cost of issuing is 10 times greater than the cost of issuing in the United States.*
- ➔ *Apparently, these higher prices are not reflected in greater resources destined for the supervision of the stock market. (Graphs have been translated wherever possible)*

### Cost of Issuing Credits, IOU's, and Stock Certificates\*

Plazo	3 años			5 años			10 años		
	CNBV	BMV	EU	CNBV	BMV	EU	CNBV	BMV	EU
<b>Monto (millones)</b>									
100	18.5	12.4	7.6	15.9	10.5	4.5	14.0	9.1	2.3
200	17.3	10.7	4.2	14.8	9.2	2.5	12.9	8.0	1.3
500	10.5	9.7	2.2	8.1	8.4	1.3	6.3	7.3	0.7
1,000	7.3	8.0	1.5	5.2	7.3	0.9	3.7	6.7	0.5

\* Costo Anualizado en Puntos Base

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## CONTENTS

- **MOTIVATION**
- **DEBT MARKET**
- **SHARES / CAPITAL MARKET**
- **GENERAL ASPECTS**
- ✓ **CLOSING REMARKS**

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## **Closing Remarks**

- *After three years where the value of capitalization in terms of GDP decreased, the stock exchange has started to recover. In 2003 capitalization value has grown 1.5 percent points of GDP.*
- *Initial public offerings by companies with high degree of leverage are starting to appear. In October, Sare Holdings, S.A, issued shares for the first time, with a leverage of 53.75%, substantially above the level of companies that had issued in the last years and above the average of companies listed.*
- *It is important to take advantage of this moment to consolidate legal reforms passed in 2001:*
  - *Penalize the use of privileged information.*
  - *Apply measures to encourage liquidity regarding corporate debt and shares.*
  - *Perform a greater effort to facilitate access to information.*
  - *Continue with legal reforms that improve corporate governance.*
  - *Allow, with adequate precautions, AFORES to invest in certain shares of Mexican companies.*
  - *Reduce cost of issues by MSE and CNBV.*

29

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# **The Stock Market: Progress and Challenges**

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**Seminar on Competition and Regulation  
in the Financial Services Sector**

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**Lorenza Martínez Trigueros  
Bank of Mexico**

**18th November, 2003**

30

# Changing market institutions and the role of competition authorities

Keith Waehrer

U.S. Department of Justice

Antitrust Division

1

The views expressed in this talk are  
my own and are not purported to  
reflect those of the United States  
Department of Justice.

2

### Cost to Consumers of Exchanges

- Spread—The difference between the price for buying and selling using market orders.
- Commission or fee to the exchange.

3

### Two dimensions of competition in exchange markets

- Competition between Exchanges or other trading methods.
- Competition between market makers.

4

Recent transition to electronic markets in the U.S. involved changes in institutional structures creating more competitive and efficient markets.

- Dissemination of market information to a broader set of market participants.
- Increased market access.
- Increased competition between market makers.
- Entry of new exchanges.

5

Reaction of incumbent interests

- Competitors formed joint ventures: Fxall, Atriaux, Tradeweb, BrokerTec, Bondbook, etc.
- Question for competition authorities: Are these joint ventures an anticompetitive attempt to limit the increased competition from electronic markets

6

Examples of U.S. Department of Justice investigations of incumbent reactions to the advent of electronic trading

- Investigation of Fxall and Atriox in the over-the-counter foreign exchange market.
- Investigation of BrokerTec and the Merger of BrokerTec and ICAP in the inter-dealer broking of government bonds.

7

Concerns in FXall/Atriox investigation

- Banks through the rules of the request for quote system would tilt the rules in their favor or facilitate collusion.
- Foreclosure of other electronic trading platforms.

8

### Issues in FXall/Atriax investigation

- Market definition: Do electronic platforms compete with the voice over-the-counter market?
- Is the coordinated entry provided by the joint ventures valuable to the market?

9

### Concerns in the BrokerTec Civil Investigation

- Forclose other interdealer brokers or “exchanges”.
- Limit market access.

10

### Concerns in the BrokerTec/ICAP Merger Investigation

- Elimination of Competition between BrokerTec and ICAP.
- Ancillary agreements between BrokerTec partners and ICAP.

11

### Issues in the BrokerTec Investigations

- Is the coordinated entry provided by the joint ventures valuable to the market?
- Are some market participants excluded from the interdealer market and would access promote efficiency?
- Market definition: electronic versus voice and type of security.

12





# MEXICO'S EXPERIENCE WITH BANKING REGULATION AND COMPETITION

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Pascual García Alba Iduñate



## 1. Why regulate?

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Undesirable regulation, but some sectors require it, when:

- Natural Monopoly
- Externalities
- Non-exclusivity (impossibility to exclude)
- Renewability



## 2. Banking Sector

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Some characteristics of the banking sector:

- Converts savings into investments
- Provides liquidity
- Contributes to the payment system



## 3. Why regulate banks?

---

- Small creditors to monitor
- Duplication in monitoring
- Incentive for excessive risk (betting for resurrection)
- Contagion of bank failure
- Externalities of the payment system ("too big to fail")



## 4. Precedents

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- During the Great Depression, bank runs were considerable
- Several countries adopted various statutes to avoid repetition (Q regulation, restriction to branches, Glass-Steagall)
- Until 1989, in Mexico credit controls regarding quantity and purposes



## 5. Current Regulation

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With Basilea agreements and adjustments we head towards:

- Based on capitalization requirements
- Better risk measurement
- Deposit insurance (public or private)
- Supervision and quick intervention
- Private qualification



## 6. Mexican Experience

Changes over the last decades involve several aspects:

- Elimination of selective stalls, legal reserves, without issuing any other mechanism to replace these ones
- Privatization with the purpose of maximizing government revenues (3.5% of GDP versus 20% of bank rescue)



## 7. Mexican Experience 2

- The Rescue originally allowed to conserve banks
- Afores to Banks
- Bureau of credit belonging to banks
- Deregulation of foreign investment
- Limits to deposit insurance
- Guarantees
- Bankruptcy law (Commercial Insolvency)



## 8. Official Evaluation

---

“Bank credit to private sector began to increase in 1989, two years before privatization. It continued growing until the crisis of 1994, when it reached 43.6% of GDP. After this crisis, it fell to 8.8% in 2001, one of the lowest levels in the last twenty years.”



## 9. Official Evaluation (continues)

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“Privatized banks operated with profits during the initial years. In 1994 they registered a marginal loss. In 1995 and 1996 losses increased. Starting 1997 losses began to fall. Banks registered profits again starting 2001.”



## 10. Official Evaluation (cont.)

“Several arguments about the causes of bank crisis have been exposed. However, *there is a consensus in the opinion* that banks’ balance sheets deteriorated mainly because of the effects that the December 1994 devaluation had on interest rates, inflation and production.”



## 11. OECD Evaluation

“Liberalization was followed by a sequence of peak-depression as in other countries, in which inappropriate policies led to a banking crisis.”

- Did not foresee an explosive increase in credit
- Nor excessive risk-taking



## 12. "Alternative Vision"

FGD: Financial factors explain economic vulnerability in 1994:

- Elimination of controls and legal reserves
- Inefficient banking regulation
- Irregularities in privatization
- Development Banks without control



## 13. "Alternative Vision" 2

"This combination of factors is a unique experience of how, in spite of important economic achievements, financial liberalization can be decomposed, in the absence of measures against predatory practices that banks can undertake under full guarantee of deposits"



## 14. Banking Competition


- Big banks take advantage of scale economies
- They have greater solvency
- Experience does not support this (Strategic Finance, NSL Securities)
- “Too big to fail”
- CFC has authorized concentrations, except for that between the two biggest banks, afterwards merged to foreign banks.



## 15. Banking competition 2

- Highly concentrated sector
- Suitable for monopolistic practices
- Precedents in Cetes and credit cards
- Credit Bureau
- Coincidentally, commissions have increased
- Authorities must stay alert





## 16. Was the bank crisis overcome?

---

- Yes, for banks, but not for the country
- Banks operate with profits
- Even though they don't lend money
- Profits are due to service commissions, which are among the highest in the world
- In return, the country will have to continue paying the rescue

# Sector Regulation and Protection of the Bank Saver

**FEDERAL COMPETITION COMMISSION**

**Seminar on Competition and Regulation in the  
Financial Service Sector.**

**18<sup>th</sup> of November 2003**

**Mexico City**

Institute for the Protection of the Bank  
Savings (IPAB)

Carlos Isoard  
Speaker of the Government Board

1

## Index

- Banking Risk I
- Financial Security Network II
- Deposit Insurance and Financial Stability III
- Moral Hazard IV
- IPAB and the System Efficiency V
- Limited Coverage Transition VI
- Conclusion VII

2

## I. Banking Risk

Banking business is a vulnerable one.

Banks assume and manage risks, which is why they are vulnerable to liquidity and solvency problems:

- They transform short term deposits into less liquid loans and investments.
- The risk profile of those accredited is not always evident.
- Financial environment is a dynamic and complex one.
- The bankruptcy of banks affects confidence on the financial system.

In addition, information to participants is asymmetric.

3

## II. Financial Security Network

A Network of Financial Security promotes stability.

Countries have decided to establish this kind of arrangements due to the following:

- The importance of banks in the economy.
- The potential risk for depositors of suffering losses in the presence of bank problems.
- The need for reducing spreading risks.
- By protecting depositors, confidence in the system is promoted and the risk of a bank run as well as its spreading to healthy banks are reduced, in benefit to the system stability .

The Network complements the discipline the market exercises.

4

## II. Financial Security Network

In spite of the institutional arrangement, the Network must include the following functions:

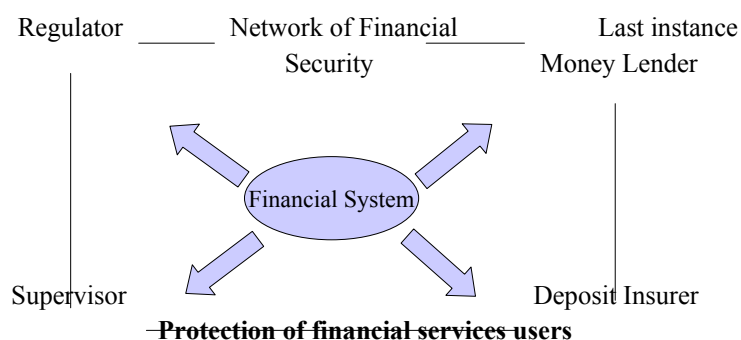
- Regulation
- Supervision
- Last instance money lender
- Deposit Insurance
- Exit of bankrupt banks.

The Network carries a Moral Hazard potential.

5

## II. Financial Security Network

- The following agreement has been chosen in Mexico:



6

## II. Financial Security Network

Sector efficiency is achieved through the optimum execution of the key powers of each member of the Network.

- Mandates must be in line with adequate powers and well defined objectives.
- Distribution of assignments and responsibilities clarifies the role of Network members.
- The coordination and exchange of information between members of the Network are essential.

7

## III. Deposit Insurance and Financial Stability

The system of Deposit Insurance:

- As part of the Network, it contributes the stability of the financial system since it avoids bank runs and their spreading to healthy banks.
- An ill-designed system leads to moral hazard.

8

## IV. Moral Hazard

Moral hazard is mitigated by the following:

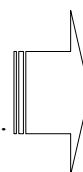
- Adequate Incentives.
  - Good corporate government and careful risk management.
  - Efficient market discipline.
  - Effective prudential Regulation and Supervision.
- Good design of Insurance.
  - Limits: amount and type of operations and people covered.
  - Co-insurance.
  - Premiums adjusted by risk.
  - Early alert and effective legal action.
  - Anticipated closure of banks.

9

## V. IPAB and System Efficiency

Deposit Insurance in Mexico has the following characteristics:

- It is regulated in a specific law.
- Adequate funding system.
- Compulsory participation of all banks.
- Possibility of restoring adjusted shares by risk.
- Explicit and Limited coverage.



*Vs.  
Adverse  
Selection*

10

## V. IPAB and System Efficiency

Regulation within the law provides certainty to depositors about the functioning of the insurance.

- It reveals coverage amounts.
- It indicates the type of obligations covered.
- It clearly defines those subject to coverage.

11

## V. IPAB and System Efficiency

The funding system of the IPAB favors financial stability.

It generates trust in depositors and diminishes the risks of a bank run because of the following:

- Fund created by shares charged to the banks.
- Capability to hire credits in emergency situations.
- Power to use resources from Branch 34 to cover guaranteed obligations.

12

## V. IPAB and System Efficiency

To avoid adverse selection and contribute to minimizing moral hazard:

- Participation of all multiple bank institutions is demanded; and,
- The power to establish differentiated fees according to risk is granted to the Institute.

13

## V. IPAB and System Efficiency

Limited and explicit coverage encourages the evaluation of banking risk by the following participants:

- Financial Entities, as well as
- Depositors with some financial culture.



With sufficient and timely information, participants are in a position to exercise market discipline.

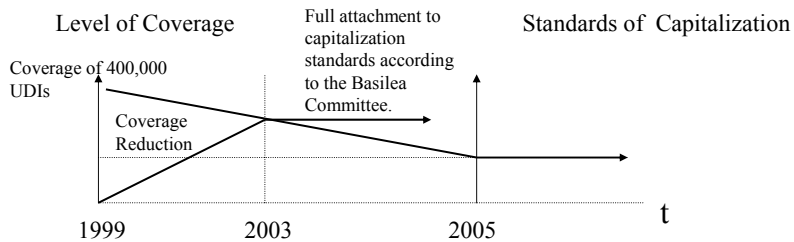
14



## VI. Transition Coverage Limited

The deposit insurance ranges from a total coverage to a limited one.

- A gradual transition was established to allow the strengthening of the framework of regulation and supervision.



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## VI. Limited Coverag Transition

A transition program of seven phases that concludes the 31st of December of 2004 was adopted.

Coverage	1/June/1999	1/Jan/2000	1/Jan/2001	1/Jan/2002	10 million of UDIs* in obligations that had not been uncovered.	5 million UDIs in deposits and credits.	400 thousand UDIs in deposits and credits.
Accumulative Un-coverage	<ul style="list-style-type: none"> <li>•Subordinate obligations</li> <li>•Related obligations</li> <li>•Obligations not subject to healthy practices and uses</li> </ul>	<ul style="list-style-type: none"> <li>•Certain obligations from derivate operations</li> </ul>	<ul style="list-style-type: none"> <li>•Obligations of additional derivative operations</li> <li>•Instruments of capitalization</li> </ul>	<ul style="list-style-type: none"> <li>•Deposits in guarantee and from tax collection.</li> <li>•Contributions in favor of the Federal Treasury.</li> <li>•Liquidation of Assets accounts</li> </ul>	1/Jan/2003	1/Jan/2004	1/Jan/2005

\*UDIs stands for Investment Unit, it is an exchange rate indexed to the variations in prices. 400,000 UDIs. Coverage by person or institution.

If the permanent criteria of coverage was in force today, it would fully protect 99% of the contracts and 2/3 of the balance of deposits in the system. 16

## VII. Conclusion

By protecting depositors from losses, the IPAB procures trust in banks because it minimizes the risk of bank runs and its spreading to healthy institutions, and there by contributes to the stability of the financial system.

The protection to the saver the IPAB provides is more efficient when each of the Networks functions is fulfilled and is complemented with market discipline.

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[www.ipab.org.mx](http://www.ipab.org.mx)

Contact:

investor-relations@ipab.org.mx

18

# Competition in Banking Sector:

## Chinese Experience

2004-7-29

November 2003

1

## Reform of State-Owned Banks

In 1998, they held  
share of  
approximately 88.8%  
in terms of deposit  
and 91.1% in loans.

2004-7-29

November 2003

2

## Non-performing assets

As reported, compared with data in the late 2002, by the end of September, 2003, the nonperforming-loans decreased RMB 88.876 billion, the rate of nonperforming-loans was 24.13%, a decline of 4.83%.

2004-7-29

November 2003

3

## Objective

The objective is to decrease 3% to 5% in nonperforming-loans every year, it could be anticipated under 15% before the year 2005.

2004-7-29

November 2003

4

## The Opening to Joint-Stock Banks

Item	State-owned Banks	Joint-stock Banks
Amount in decrease (compared with the beginning of 2003)	81.1	57
The rate of nonperforming-assets	22.9%	9.34%
The rate of decrease in nonperforming –assets (compared with the beginning of 2003)	4.02%	3.51%

Time: July, 2003 Unit: RMB Billion

2004-7-29

November 2003

5

## The Opening to Foreign Banks

- Regulation has been amended gradually. For instance, the ‘Regulation for Foreign Financial Organs’ practiced from February the 1<sup>st.</sup>, 2002, raised the rate of foreign deposit obtained in Chinese market from 40% to 70%.

2004-7-29

November 2003

6

## Foreign Banks approved

By the end of 2002, 53 foreign banks had been approved to do RMB business in China. While in 1999 the number is 25, in 2001 it is 31.

2004-7-29

November 2003

7

## Improvement in National Treatment Progress

Year (up till)	Year of 1999	Year of 2002
Number of Branches	154	146
Number of Subbranches	--	9
Number of Legal Organs	13	19
Number of Accessory	--	6
Asset (U\$ Billion)	32.516	39.154
Loan (U\$ Billion)	--	18.603

2004-7-29

November 2003

8

# Competition in Banking Sector: Chinese Experience

Zhang Chenying (P.R.C.)

As an APEC member, China has endeavored greatly in opening which is extending to various economic fields. Financial reform is no doubt one of the most essential part of such endeavors. The goal of the reform is 'to streamline the financial organization system, marketing system, supervision system, and regulation system', in a word, it is to make a well- preparation for complete financial competition. It involves banking, securities, insurance industries and so on. Banking industry plays an important role in the financial system in China.

## · Reform of State-Owned Banks

Under China's previous planned economy, the financial system was a part of administration-controlled sector. The four state-operated banks, the Industrial and Commercial Bank of China, the Agricultural Bank of China, the Bank of China and the Construction Bank of China, have mutually exclusive division of their business scope. From the late 1970's, they became state-owned banks, and State is the only share-holder.

The four state-owned banks dominate the domestic financial market. In 1998, they held share of approximately 88.8% in terms of deposit and 91.1% in loans. Although we have more than one hundred joint-stock commercial banks and more number of cooperatives, the assets of the four state-owned banks were about 68.1% in that of the entire domestic banking system. We can call that a typical monopoly. Their dominance is mostly due to historical factors. Firstly, they have strong support from the state, the name of 'state-owned' implies credibility. Second, they are large in number of branches, offices and staff. Third, there has been a long-term and continual business relationship between banks and corporations, especially the group enterprises and state-owned or state-shared corporations, most of which are chief customers of the state-owned banks.

Nevertheless, the state-owned banks suffer their own troubles, such as the large amount of nonperforming-assets, the neglect of supervision. As reported, compared with data in the late 2002, by the end of September, 2003, the nonperforming-loans decreased RMB 88.876 billion, the rate of nonperforming-loans was 24.13%, a decline of 4.83%. <sup>1</sup>Either of these is possible to arose financial disaster. Hereby the reform focuses on two aims, one is the prevention of financial risk, the other is to increase competition. The

---

<sup>1</sup> International Finance, 2003.11.03

objective is to decrease 3% to 5% in nonperforming-loans every year, it could be anticipated under 15% before the year 2005.

The reform will be in three stages. First, improve the inner management in the banking system, which will strengthen the power in competition. Second, make some state shares available for private investment, which will change the state-owned banks into state-shared banks. Third, to list the banks on the public stock market. The Construction Bank of China is anticipated to be the first. It will participate in domestic stock at the beginning, while, making great efforts to reduce the rate of nonperforming-assets and then go to Hong Kong, Singapore or the US securities markets. Actually it would be a period of time in preparation, the time- table for these step is likely to be 2005.

### **The Opening to Joint-Stock Banks**

Before China entered the WTO, she had more than one hundred and twenty joint-stock commercial banks, whose total assets exceeded RMB 2,560 billion, that is about 13.6% of that the total for the entire financial industry in China. In the following three years, more joint-stock banks have set up. As reported, the situation of joint-stock commercial banks is much better than that of state-owned banks.

Item	State-owned Banks	Joint-stock Banks
Amount in decrease ( compared with the beginning of 2003)	81.1	57
The rate of nonperforming-assets	22.9%	9.34%
The rate of decrease in nonperforming-assets ( compared with the beginning of 2003)	4.02%	3.51%

Time: July, 2003

Unit: RMB Billion

Some leading shareholders are state-owned corporations or groups, in this way, this kind of banks may be called an indirect state-owned banks. On July 22<sup>nd</sup>2003, five privately-owned banks were examined by experts; they are Bank of Guangdong Huanan, Bank of Shenzhe Minhuan, Commercial Bank of Jiangyin, Bank of Shenyang Ruifeng and the Greatwall Bank of Xi'an. The participation for the examination of civilian capital in banking was a focus.

Liu Mingkang, the chairman of China Banking Regulatory Commission indicates that more than 35,500 cooperatives in the rural area will be amalgamated into 2,000. Private investors are welcome to acquire the



share.<sup>2</sup>It could be imagined that the private banks will get stronger and become a competitor in the financial service sector.

## The Opening to Foreign Banks

Prior to China's entrance into WTO, foreign banks were approved to do some transaction limited to foreign currency, but only for corporation. From December 11<sup>th</sup>. 2001, when China became a member of WTO, China is more open to foreign financial organs to do business in China. According to the promises in WTO, the financial market opens gradually.

### (1) Abolishing the limitation in foreign currency transactions

Foreign banks may now do business in the field of foreign currency not only with corporations but also with the Chinese citizen. Regulation has been amended gradually. For instance, the 'Regulation for Foreign Financial Organs' practiced from February the 1<sup>st</sup>., 2002, raised the rate of foreign deposit obtained in Chinese market from 40% to 70%.

Compared with the situation in 1999, the foreign business in finance is in a higher rank, meanwhile, more in asset.

Year ( up till )	Year of 1999	Year of 2002
Number of Branches	154	146
Number of Subbranches	--	9
Number of Legal Organs	13	19
Number of Accessory	--	6
Asset ( US\$ Billion)	32.516	39.154
Loan ( US\$ Billion)	--	18.603

### (2) Abolishing the limitation in RMB

China Banking Regulatory Commission will abolish the limitation neither in area nor in customer step by step, five years after the entrance of WTO, that is in 2007, when there is not any limitation to foreign banks.

By the end of 2002, 53 foreign banks had been approved to do RMB business in China. While in 1999 the number is 25, in 2001 it is 31.<sup>3</sup> Besides of Shanghai, Shenzhen, Dalian, Tianjin, Guangzhou, Zhuhai, Qingdao, Nanjing and Wuhan are the new areas where the foreign banks began to come in. The total amount of RMB in assets for foreign banks is 54.28 billion. Furthermore, foreign financial organs may do RMB business with Chinese corporations (but business to Chinese citizen is still not approved). Before 2004, it will be 13 cities where foreign banks may operate in RMB, besides the nine mentioned

<sup>2</sup> 《国际金融报》，2003年11月3日。<the International Finance>,2003.11.03.

<sup>3</sup> Gong Jianling. The issue of regulation for the foreign banks, Economics, 2003.1(龚剑玲,《论过渡期的外资银行监管问题》,载《经济问题》,2003年第1期。)

above, they are Jinan, Fuzhou, Chengdu and Chongqing. In 2005, Kunming, Beijing and Xiamen will be the new comer; Shantou, Ningbo, Shenyang and Xi'an will be subsequent in the next year.

### (3) Encouraging Share-hold in native banks

Foreign banks are welcome to share in Chinese banks. On December 29<sup>th</sup>, 2001, the Bank of Shanghai was approved to be the first foreign- share bank in China. The share of the foreign investors is 18%.

Nowadays, the share for the foreign banks in Chinese financial market is approximately 2%, with the development of opening, foreign banks will get great progress, in the coming 10 to 15 years it could reach to 30%.

### **Improvement in National Treatment Progress**

In the long term, the China Banking Regulatory Commission will provide the same regulation in China, to both domestic banks and foreign banks. Nevertheless, differences between the two types do exist in some respects at present. It bases on following reasons:

Firstly, during the course of opening, China is not a complete open market yet, certain limitation to foreign banks is permitted;

Secondly, foreign banks take the tax advantage. For the qualified foreign banks, they are exempt from income tax in the first year; in the following two years, the tax rate is 7.5%; from then on, the rate keeps at 15%. Comparatively, the income tax rate for domestic banks is 33%. Further more, domestic banks should pay additional education tax and city construction tax.

Thirdly, the two types of banks face to different policy in operation style. Although foreign banks in China are limited in separate operation, differ from that of Chinese banks, their headquarters abroad run a universal operation in their home states.

As a member of APEC, according as the agreement in Financial Sector, China will advance the course of opening. In the next two to five years, foreign banks will gain national treatment, they will be identical with Chinese banks.

As mentioned above, Chinese financial system runs in separate operation. In 1984, China has two types of banks, they are central bank and specialized banks. The central bank was in charge of supervising the banking, insurance, securities industry. In the early 1990's, there used to be a short period of time when the finance businesses were operated in universal style. The commercial

bank was the initial participant in securities industry.

To prevent the risk, regulations prohibit such universal style. The Commercial Bank Law(1995), Insurance Law(1995) and Securities Law(1999) build up the regulation framework in financial system. Moreover, there are three commissions in charge of them individually. They are China Securities Regulatory Commission(1992), China Insurance Regulatory Commission(1998), China Banking Regulatory Commission(2003). In this way, the shape of separate business completed. The restrict separation system will be insisted in a long period of time, while the universal operation style is the trend in the future.

Following is a brief introduction to securities and insurance competition in China.

### **Competition in Securities**

The Chinese securities market was founded in the early of 1990's. At that time no foreign organs take part in it. The Morgan International and the Construction Bank of China set up the first joint international financial limited liability company, that is in the year of 1994. With the opening, some of the joint corporations come in to the market, such as Hainan Airline.

In May of 2003, the United Bank of Switzerland and Yecun Securities of Japan became the first two qualified foreign institutional investors, that approved by China Securities Regulatory Commission are able to participate Chinese capital market. Within the subsequent three months, the investment amount to US\$300 million.

To review the procedure of securities competition, the progress is obvious. Been avoided, a joint member, the foreign financial organs became an individual participant in Chinese securities market. On the other hand, the qualification is restrict. For example, the investment amount (US\$ 50-800 million), time to remit (three years later). More experienced during practice, the Commission would ease the regulation.

### **Competition in Insurance Industry**

In 1992, AIA (American International Assurance) set up a company in Shanghai, it is considered as the first foreign insurance company in China. By the end of 2001, there are 19 joint insurance companies, 13 branches and 2 agencies. At present the number is one third beyond the historical number of 2001. Prior to 2005, the geographic restriction will be abolished, therefore, Chinese people could enjoy more service from foreign insurance companies.

Competition is the energy to market, the same in financial service. As a developing economy, there is a long way ahead for China. China did, always and will keep its promises to APEC. There is no doubt that we will see more openness in China's financial services market day by day, and in the meanwhile, it will be openness in order.

I would like to learn more about your experience, which must be very useful to China.

# ***Banking Sector Competition and Regulation***

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November 2003

## ***Agenda***

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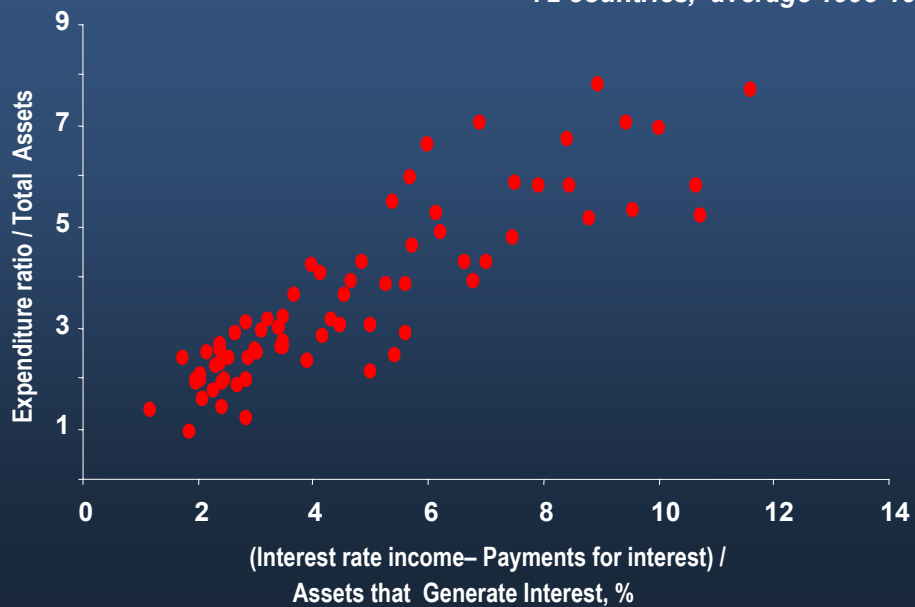
- **Theoretical aspects and International evidence**
- **Mexico's Case**
  - Some considerations
  - Competition Environment
- **Conclusions**

## Competition Theory: Recent developments

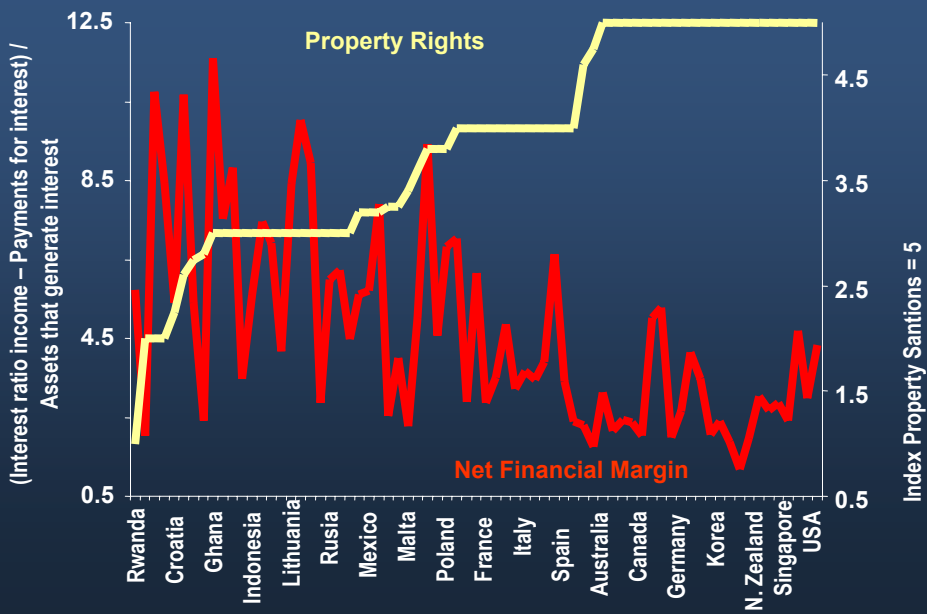
- **Mergers not necessary imply market power.**
- **Conditions that create entry barriers are increasingly relevant.**
- **Performance also reflects institutional and regulatory aspects.**

## Expenditure efficiency and financial margin

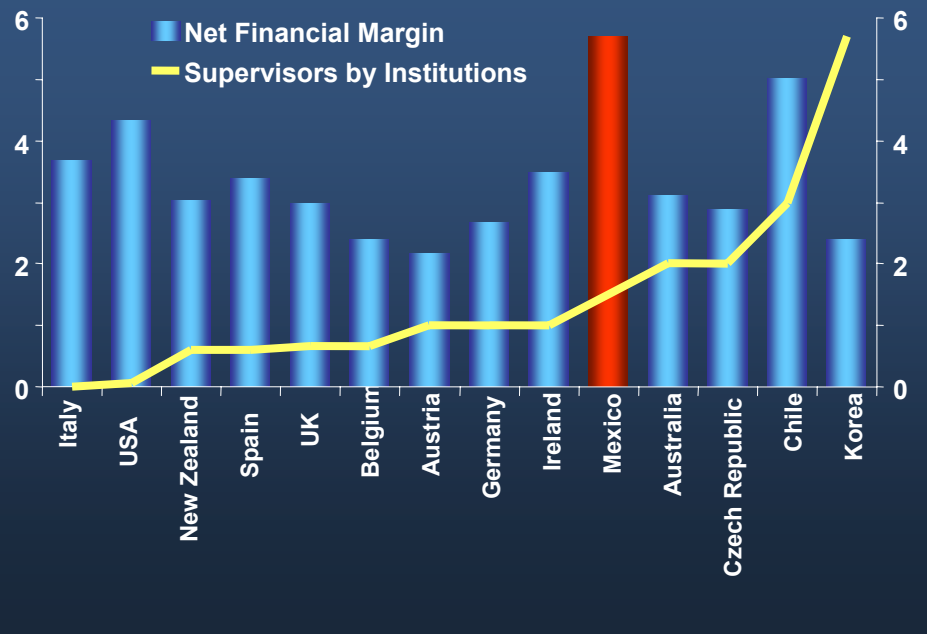
72 countries, average 1995-1998



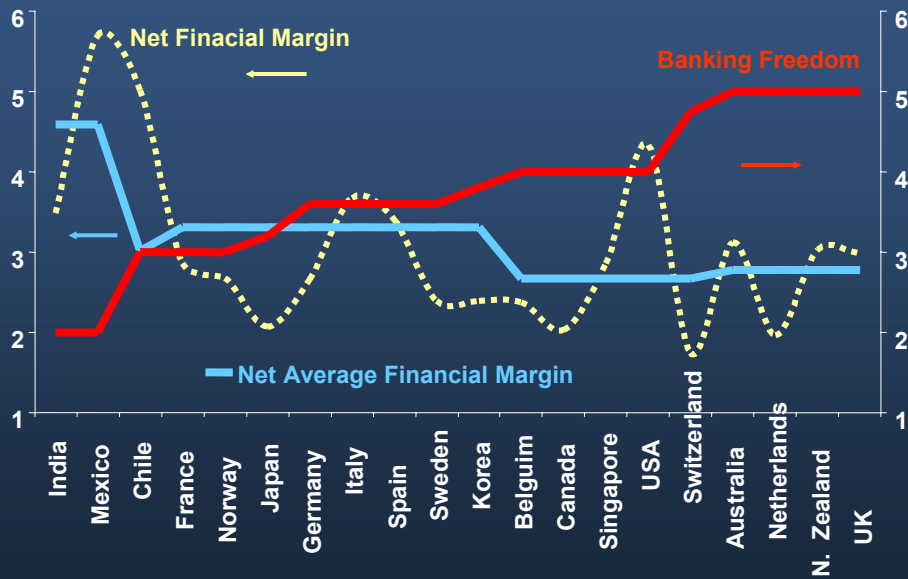
## Financial Margin and Property rights



## Financial Margin vs. Institutions Supervisors



## Financial Margin vs. Banking Freedom

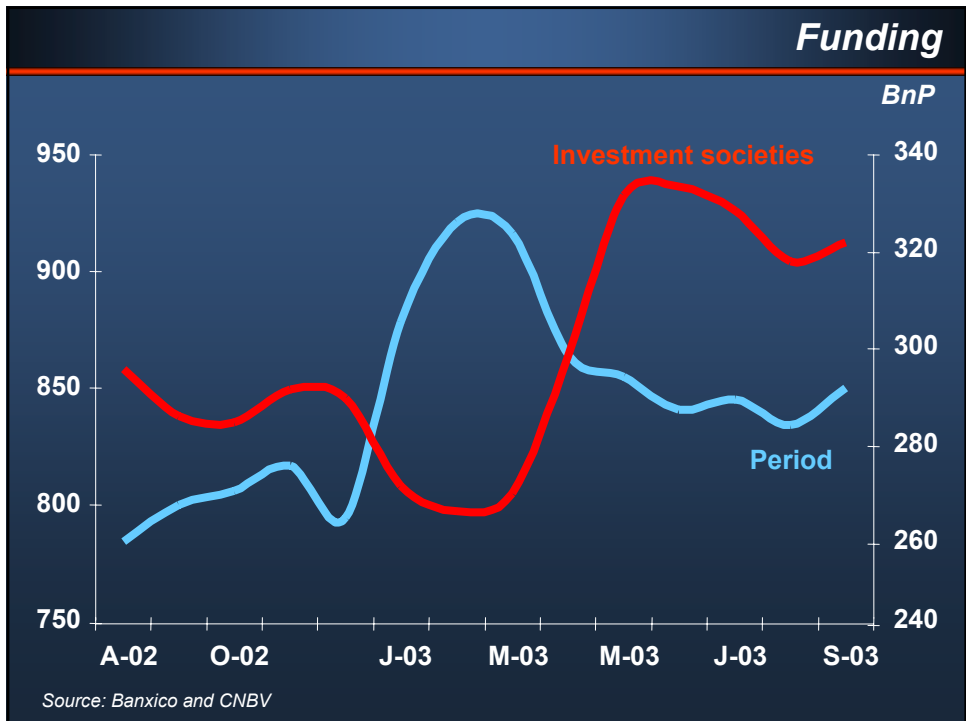
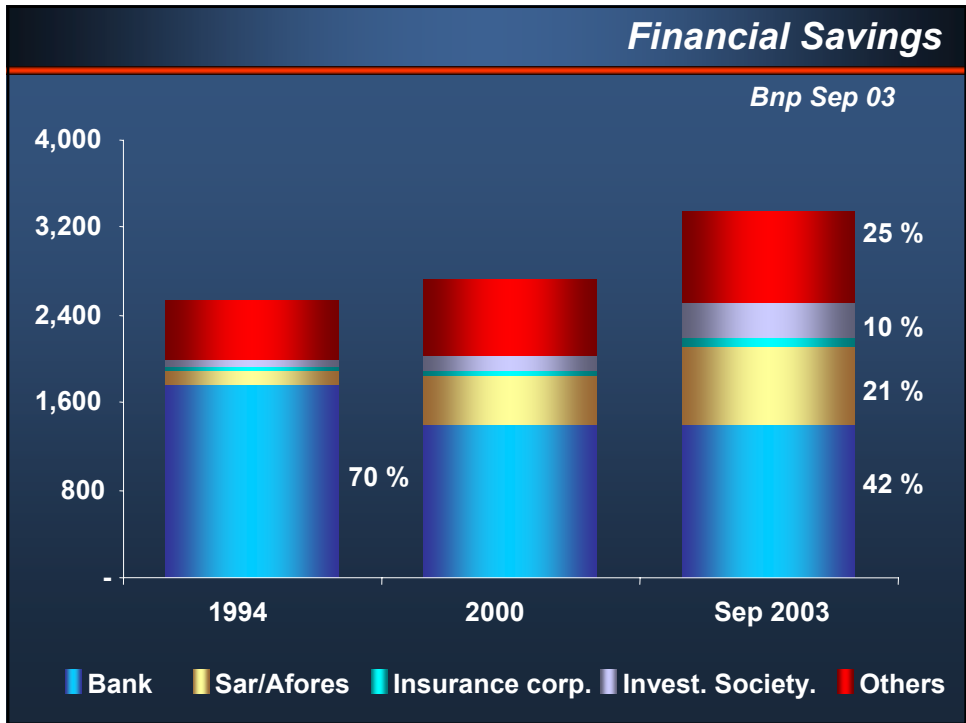


Source: own calculations based on data by Barth, Caprio & Levine (2001)

## Mexico Case

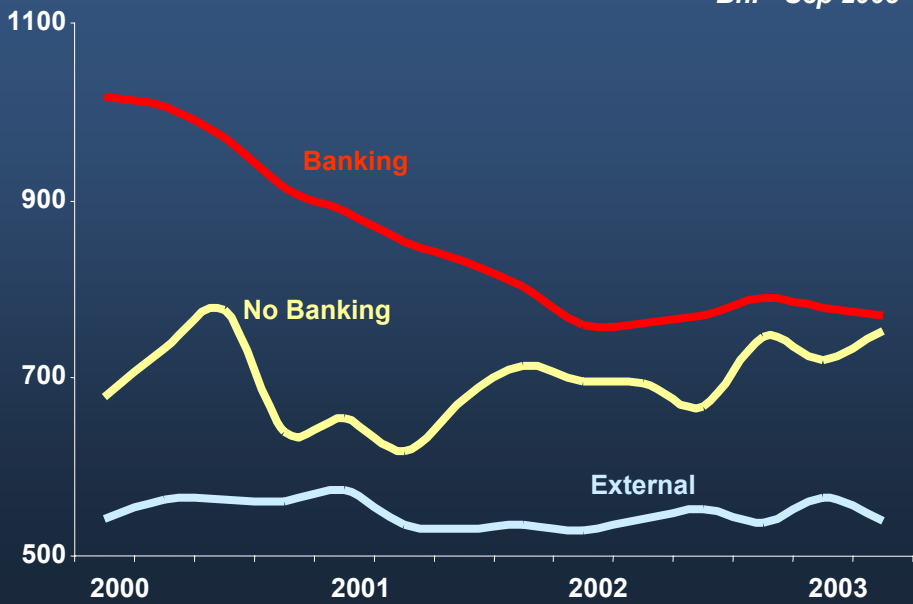
- Some considerations
- Competition environment





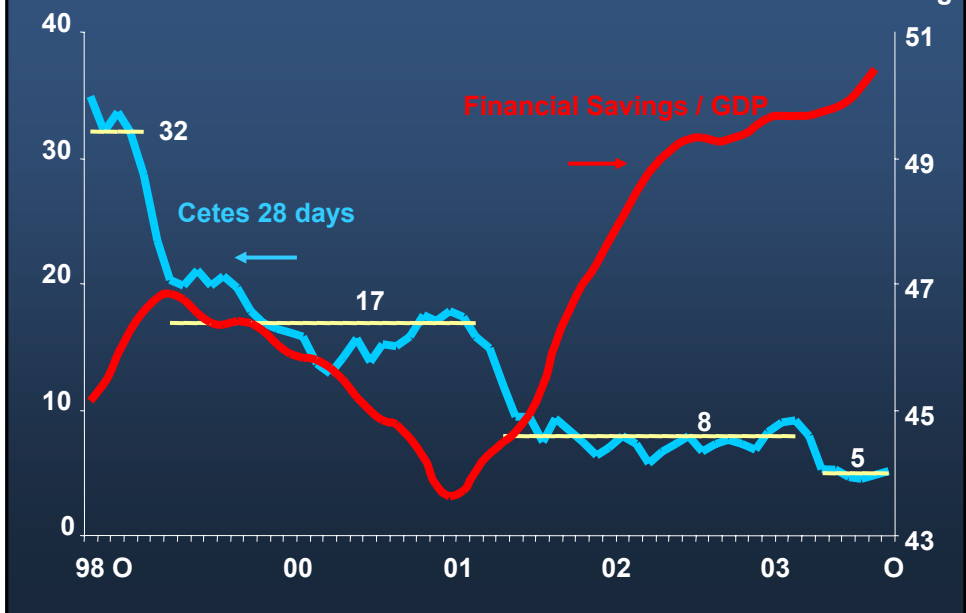
## Private Sector Financing

BnP Sep 2003



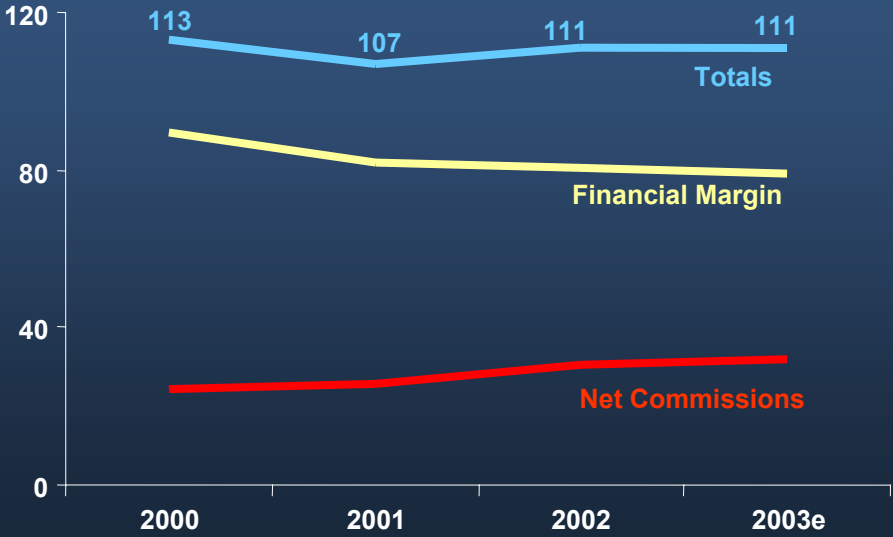
## Rates and Savings

Percentage



# Bank Income

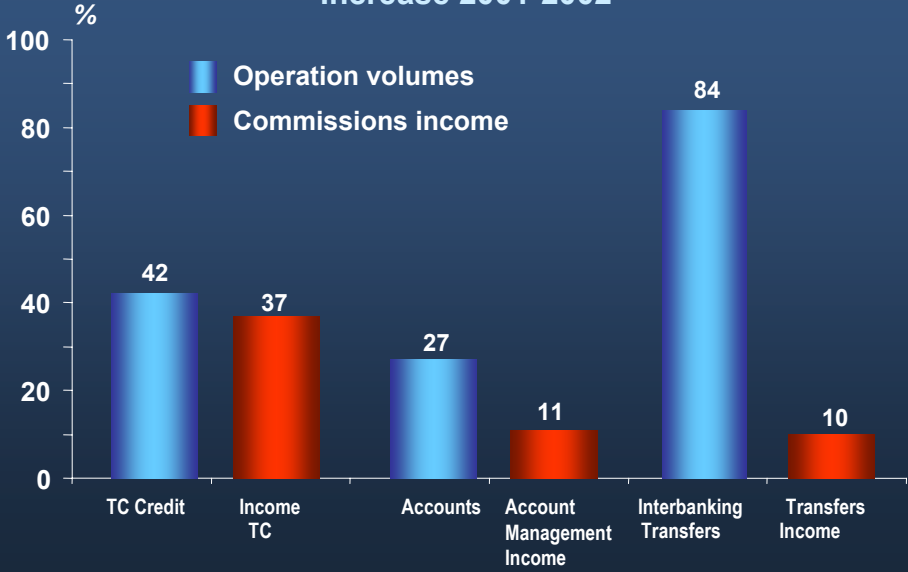
BnP (Sep. 03)



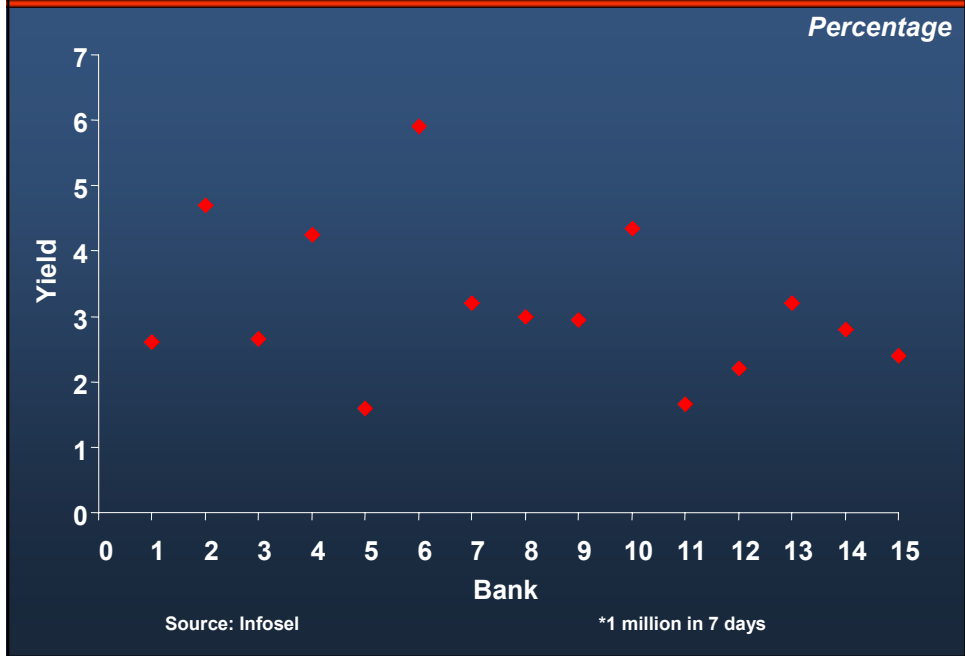
Source: CNBV

# Volumes, not Prices

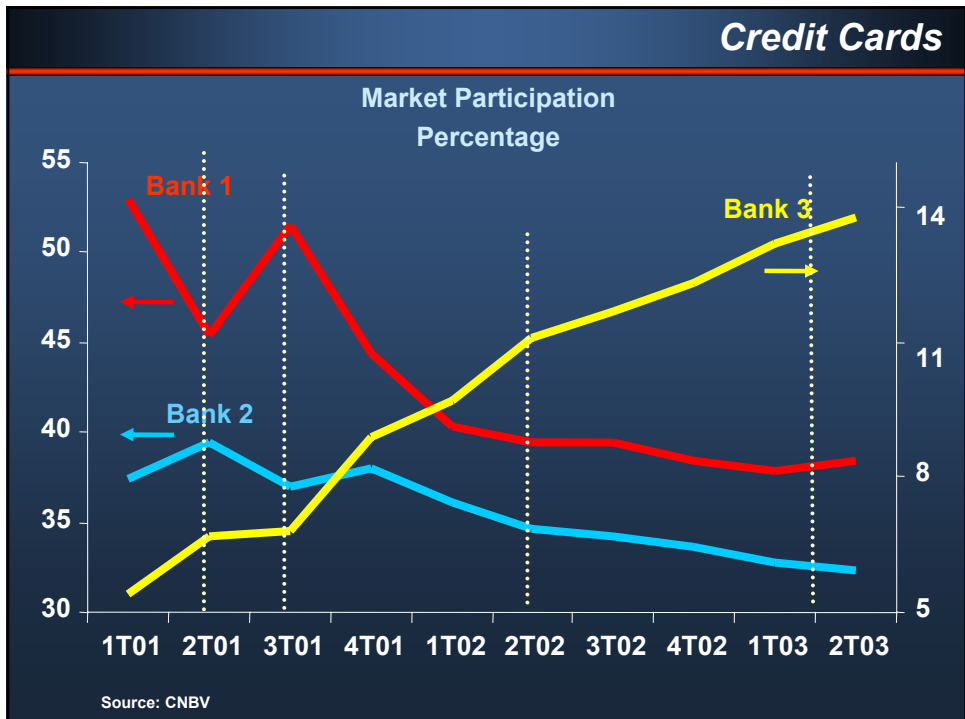
Increase 2001-2002



## Promisory Bank Note



## Credit Cards



## Credit Cost

TV value (today) = \$6,000

Term = 12 months

Pesos ctes Sep '03

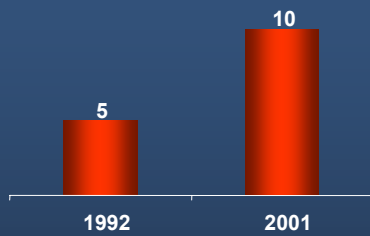


Rates used are averages for different banks during the year.  
Source: Condusef

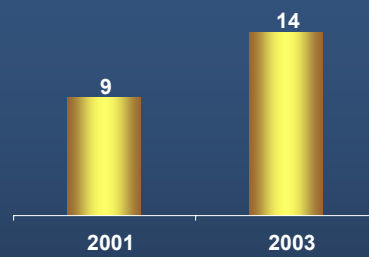
## Market Participation

%

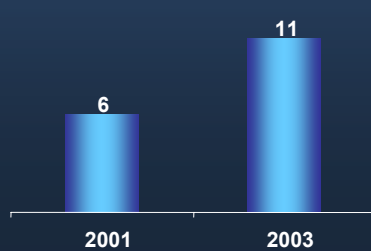
Deposits



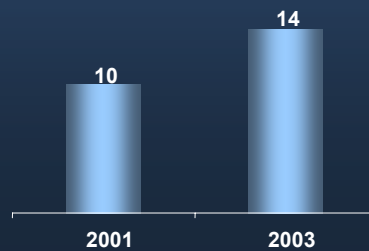
Credit Cards



Commercial Credit



Consumer Credit



Source: CNBV

## *Conclusions*

- **Competition has intensified**
- **Desirable to continue in:**
  - **Information**
  - **Market Discipline**
  - **Corporate Governance**

***Banking Competition and  
Regulation:  
BBVA Bancomer Experience***

*CFC and APEC*

Manuel Sánchez  
Economic Studies  
November 18th, 2003

***Contents***

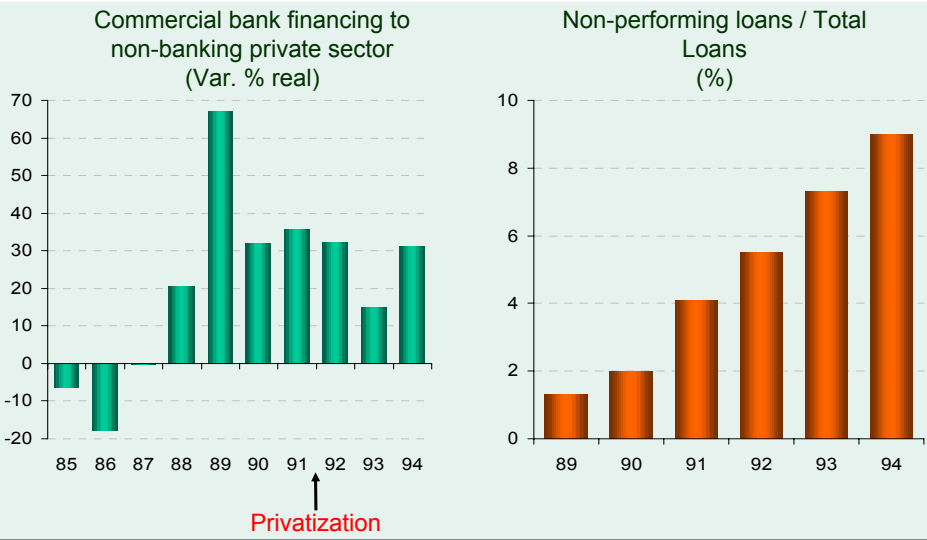
Liberalization and Competition

Benefits for banking users

BBVA Bancomer Experience

Challenges and Perspectives

*Ten years ago, the banking system was in full expansion, facing incipient problems*



*This expansion occurred within an inadequate regulatory framework*

- Lax accounting standards
- Deficient reserve and capital requirements
- Unlimited deposit insurance



## ***1995 Macroeconomic crisis led the banking system to insolvency***

- There was a significant impact on the banking system.
  - \* Debtors' inability to liquidate debts.
  - \* Non-payment culture.
  - \* Lack of liquidity, provisions requirements and negative bank capital.
- The emergency program preserved users' savings and the operation of the payment system.

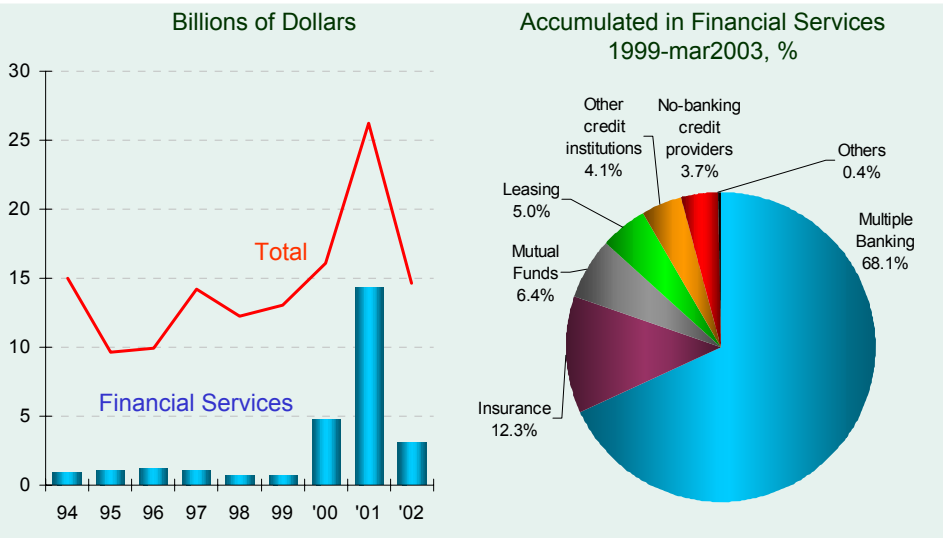
## ***Mexico learned lessons from the crisis and reduced legal and regulatory weaknesses***

- Regulation for responsible bank management
  - \* More rigorous portfolio loan and capital ratings
  - \* Credit Information Societies (CIS)
  - \* Elimination of foreign investment restrictions
  - \* Gradual reduction of deposit insurance
- Legal framework to protect property rights
  - \* Guarantees miscellany
  - \* Bankruptcy Law

## Liberalization and Competition

**As a result, DFI\* has been channeled to the financial system**

(Total DFI and in financial services) \*Direct Foreign Investment



## Liberalization and Competition

**Therefore, banking system has globalized and has strengthen its financial situation**

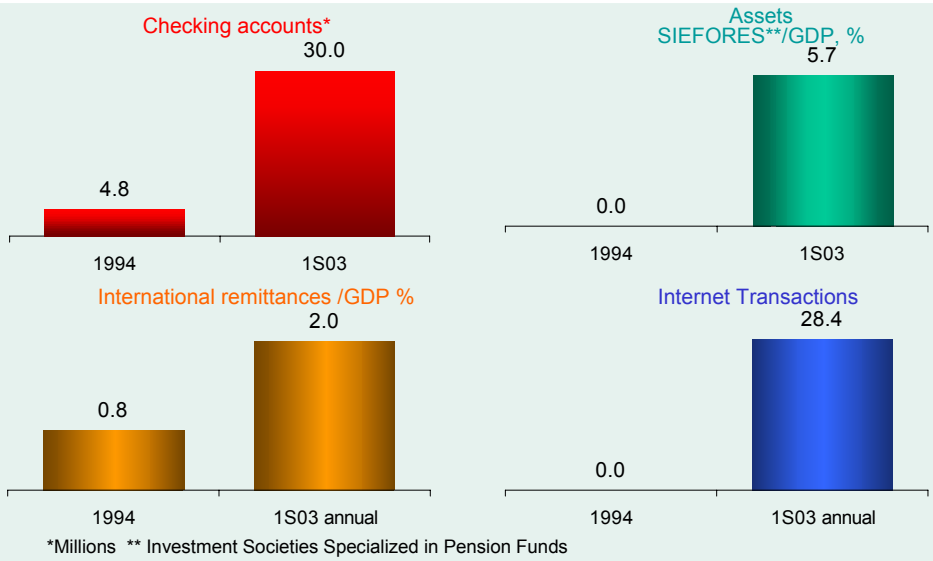
	Dec 1994	Jun 2003
Number of Banks	34	32
Mexican	32	12
Foreign	2	20
Capitalization*, (%)	9.6	22.1
Index of non-performing loans portfolio *, (%)	7.3	4.2
Reserves/Non-performing loans portfolio*, (%)	47.9	142.5

\*Previous Rules for 1994 and new for 2003

## Benefits for banking users

BBVA Bancomer

*In spite of credit contraction, banks continued to increase their supply of products and services*

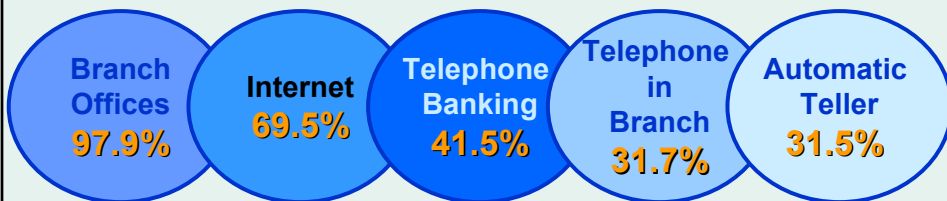


## Benefits for banking users

BBVA Bancomer

*Users have taken advantage of a variety of banking distribution channels*

(Use of banking distribution channels by PYMES\*, %)

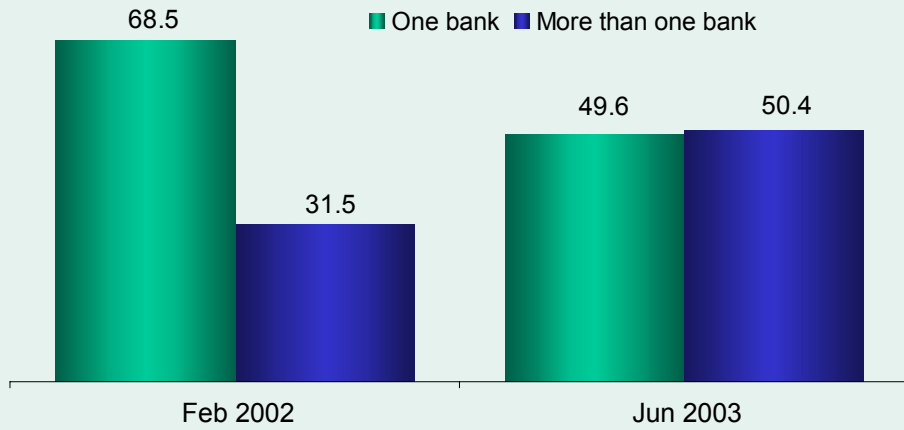


Source: Market Study sponsored by BBVA Bancomer  
\*Small and Medium Size Enterprises

**Benefits for banking users**

*The aforementioned has allowed the private sector a greater diversification of its banking relationships*

(% de PYMEs that use one or more banks)

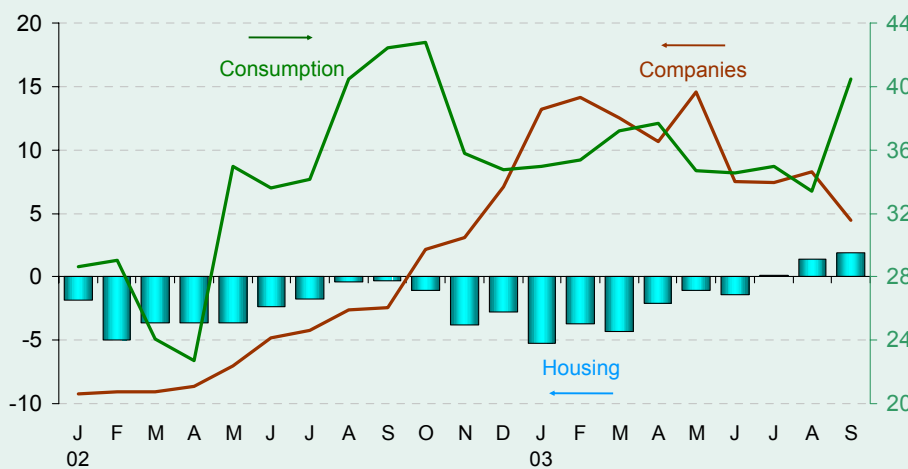


Source: Market survey sponsored by BBVA Bancomer

**Benefits for banking users**

*Capitalization, legal improvement and lower inflation have allowed recovery of bank loans*

(Current loan portfolio to the private sectors, var. % real annual)

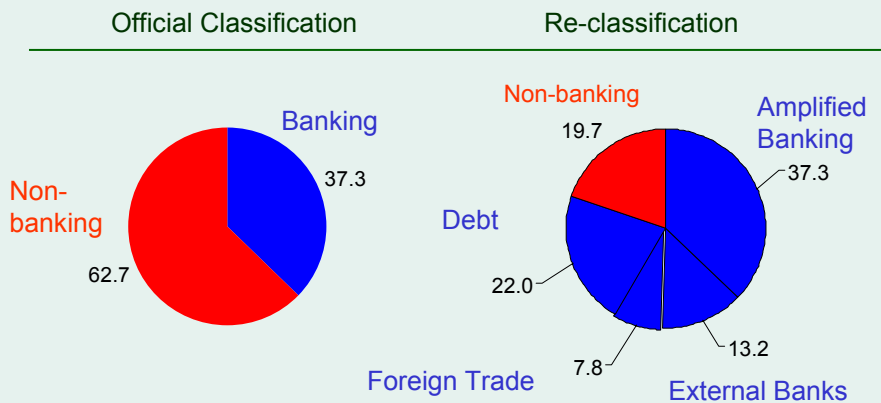


## Benefits for banking users

BBVA Bancomer

***At the same time, an increase in non-banking financing has been facilitated by banks***

(Components of total financing to the private sector, % of total, 2T03)



## BBVA Bancomer Experience

BBVA Bancomer

***BBVA is bank number 32 in the world***

- Its total assets amount to 293 bd, around 46% of Mexico's GDP
  - \* Annual profits of 3.3 bd
- It operates a network of 7,500 branch offices in 37 countries.
- It provides services to over 35 millions clients, and employs 90 thousands workers.
- Among the 40 biggest banks of the world, BBVA is the sixth most efficient

**BBVA Bancomer Experience**



***BBVA provided Bancomer knowledge, experience and 3.6 bd capital***

(%)

	1998*	2000	2002
Total Capitalization	13.3	13.1	15.7
Efficiency**	71.6	69.9	56.5
ROE***	3.9	5.7	16.4
ROA	0.3	0.5	1.5

\* Previous capitalization rules

\*\* Non-financial expense/Net Financial income + net income for commissions and intermediation

\*\*\* Profitability over average majority capital holdings

**BBVA Bancomer Experience**



***...extending Bancomer's leadership in the financial sector***

	Market position
Total banking assets	1
Traditional funding and domiciliary payments	1
Assets in Management*	1
Pensions (reserves)	1
Amount of international remittances	1
Insurance Banking (contracts signed)	1
Branch offices network	1
AFOREs** (Assets in Management)	2

\* Debt investment societies

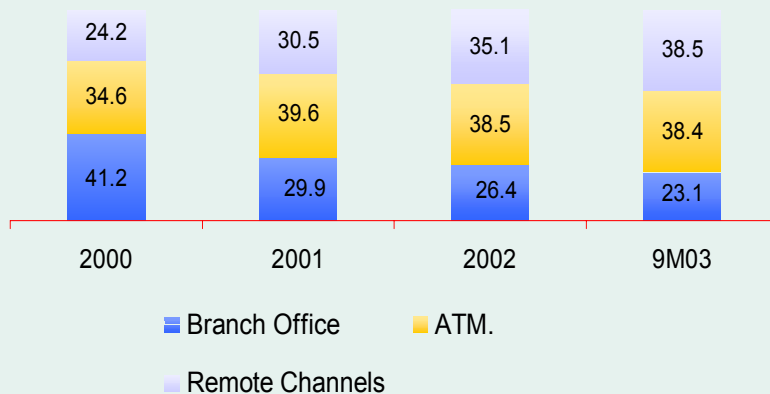
\*\* Pension Funds Administrators

## *...allowing it to participate in new markets*

- Leader as a broker of corporate bonds
- Only institution with a money desk in the secondary bonds' market
- Investment degree in foreign currency granted by the three main credit rating agencies
- On Dec.'02 Merrill Lynch recommended Bancomer as one of the ten most attractive banks in the world, and in Jan.'03 as one of the seven best banks in emerging economies.

## *...and benefit from its technological advantages*

Composition of transactions BBVA Bancomer %



## Challenges and Perspectives

### *Maintaining credit dynamism in banks requires essential conditions*

- Banking prudence
- Price stability consolidation
- Enforcement of laws protecting property rights



To take the credit/GDP relationship to the OECD's average implies almost a pp that annually grows faster than GDP per capita in Mexico.

Source: R. Levine (2002), *More on Finance and Growth: More Finance, More Growth?*

## Challenges and Perspectives

### *The banking system's future health implies adjusting regulation and avoiding past mistakes*

#### Regulation

- Simplify banking regulation and adequate it to risk
- Modernize non-banking intermediation rules

#### Mistakes

- Non-economic pressures for loan granting
- Regulating banking prices



## Challenges and perspectives

BBVA Bancomer

### *The banking system has important areas of opportunity* (2002)

	Mexico	Spain
Funding / GDP (%)	17.7	72.3
Financing* / GDP (%)	15.5	101.4
Investment Funds / GDP (%)	5.3	24.7
Number of investment societies	364	2,466
Office Branches per 1,000 inhabitants	0.1	0.9
Accounts per inhabitants	0.3	1.9

•Commercial bank financing to non-banking private sector (Direct, Fobaproa\*\* and Udis\*\*\*)  
 •\*\* Bank savings protection governmental trust  
 •\*\*\* Investment units

## Challenges and perspectives

BBVA Bancomer

### *We foresee the continuation of a gradual expansion in banking business* (Variation % real annual, end of period)

	2003	2004
<b>Total funding</b>	<b>7.1</b>	<b>5.4</b>
Traditional funding	5.2	3.5
Mutual Funds*	18.2	15.2
<b>Current loans portfolio to the private sector</b>	<b>7.9</b>	<b>10.9</b>
Consumption	31.9	25.4
Corporate	3.0	7.5
Mortgages	4.2	7.9

\* Managed by banks and financial groups.

## Conclusions

- Mexico learned the lessons from the 1995 crisis and reduced regulatory and legal weaknesses
- As a result, the banking system is globalized and has strengthened its financial situation
- Capitalization, legal improvement and lower inflation has allowed bank loans to recover
- At the same time, an increase in non-banking financing has been facilitated by the banking system
- BBVA provided Bancomer with technology and a lower risk, allowing it to strengthen its global presence and enter in new markets
- Maintaining credit dynamism requires a stable macroeconomic environment, respect for property rights and banking prudence
- The banking system's future health implies adequate regulation and avoiding past mistakes
- We foresee the gradual expansion of banking business

## ***Banking Competition and Regulation: BBVA Bancomer Experience***

*CFC and APEC*

Manuel Sánchez  
Economic Studies  
Noviembre 18th, 2003



*Superintendencia de Banca y Seguros*

## **FINANCIAL SERVICES AND COMPETITION IN PERU**

### **FROM THE POINT OF VIEW OF THE SUPERINTENDENCE OF BANKING AND INSURANCE**

#### **REGULATION AND COMPETITION IN THE FINANCIAL SERVICES MEXICO, NOVEMBER 17 – 18, 2003**

In order to achieve a better understanding of the roll performed by Superintendence of Banking and Insurance in the improvement of financial services and the competition in the Peruvian Republic, it is necessary to give an small explanation about this SupervisorY Entity, its strategies and the output obtained.

Superintendence of Banking and Insurance sets forth the regulatory and supervisory framework to which companies operating in the financial, insurance and private pension fund systems will be subject, including those carrying out activities which are similar or complementary to the corporate purpose of such entities. Superintendent of Banking and Insurance is Mr. Juan Jose Marthans, who started over his period in July 2002. There are three (3) Deputy Superintendents at Superintendence of Banking and Insurance, each one heads one Deputy Superintendence, which are its direct operative areas. Their names are listed below:

- Deputy Insurance Superintendence, Head is Mr. Armando Cáceres
- Deputy Banking Superintendence, Head is Mr. Luis Arizmendi
- Deputy Private Pension Funds Superintendence, Head is Mrs. Lorena Masias

Actual Superintendence administration has as one of its goals to burst and to strengthen the roll played by Superintendence of Banking and Insurance; in order to perform this, it is necessary first to understand and spread its Mission and its Foresight.

#### **MISSION**

To create all the conditions that allow maximization of the value of financial, insurance and private pension fund systems, promoting an increase reliability and protection of main interests of the public using these systems. This will be achieved through transparency, truth and quality of the information; this way soundness and solvency of the institutions that build these systems will be kept.

#### **FORESIGHT**

Superintendence of Banking and Insurance aims to be known by the public, institutions overwatched and the national and international institutions as the leader institution for supervisory and regulatory purposes in the matters related to the financial, insurance and private pension fund systems.

In order to promote and strength roll performed by Superintendence of Banking and Insurance, five (5) strategies have been drawn, they are:

#### **Strategy 1**

Redesign internal procedures in order to be able to perform actions of preventive supervision, it means to look for signals that could show up a weak, a failure in the



## *Superintendencia de Banca y Seguros*

institutions and to give soon an immediate correction, before they become a problem, a mistake. This will be done through:

- Rationalization of the legal framework, it means lesser but clearer, full and timely standards.
- Improve in-situ supervision (at the office of the supervised entities) and extra-situ (at the Superintendence offices)
- To boost competition through access to the market, to put in the hands of the public, supervised entities, intermediaries, clients, etc, more resources to make them know the conditions and all products offered in the country (Peru)
- To guaranteed stability of the systems, because this is an important support tool for social and economic development
- To promote the strengthen of the weaken institutions of the system or their way out from the market, trying to avoid financial disorders.

### **Strategy 2**

Looking for an increased integration of the different units that belong to Superintendence of Banking and Insurance. This integration is trying to:

- Blend experience with knowledge at the working teams.
- Unify all supervision efforts in matters referred to investments in the Banking, Insurance and Private Pension Fund Systems .
- Aproppriate Legal Support, with full, adequate, clear, precise and timely standards.
- Complement functions of the Economic Studies Office in matters referred to Insurance and Private Pension Fund Systems.

### **Strategy 3**

To execute and develop an information system about the overwatched entities, through:

- Improvement of the technological side.
- To achieve a better efficiency in the communications through all the possible information electronic ways and resources with supervised entities (more quantity, less time, better security).
- Setting up an internal management system that be timely and reliable.

### **Strategy 4**

To build up a strong, reliable, technical and transparent institutional image of Superintendence of Banking and Insurance, through:

- Education and information about the Banking, Insurance and Private Pension Fund Systems.
- Trying to meet all needs of people that may use the previously mentioned systems.
- Reduction of the little negative perception of some economic agents, that could not be appropriate informed about the overwatching process performed by Superintendence of Banking and Insurance.
- Setting up a positive link with all entrepreneurial communities.

### **Strategy 5**

Looking for a more financial strengthen of the Institution, increasing soundness and reliability of Superintendence of Banking and Insurance. This could be achieved trough:

- Looking for more and new financial resources.
- Rationalization of all expenses.
- Developing an evaluation system with performance degrees, signals or indicators.



## *Superintendencia de Banca y Seguros*

- Looking for a real integration of all people working at Superintendencia of Banking and Insurance.

It is also important to state that it exists an area named Intendence of Competition in the Insurance Market. The tasks of this area are:

- a) Overwatch and assess behaviour of all participants of the Peruvian Insurance market. This task could be achieved following all complaints from policy holders, submitted to the Bureau of Attention to the Public that is part of Superintendencia and also those ones submitted from other Consumer Protection Institutions.
- b) To enhance, promote free competition in the insurance market through processing and spreading all information that may help to increase transparency at the insurance market.
- c) To propose, suggest to Deputy Insurance Superintendent, all mechanisms and ways that allow to ensure free competition in the insurance market. Trying to avoid this way non-competitive mis-behaviours as: price concertation, non-loyal competition, or abuse of domination positionings.
- d) To manage and keep updated the Register of all Products, offered by insurance companies in the Peruvian market.
- e) To overwatch appropriate fulfillment by insurance companies of Art. 326° of Financial and Insurance Law and the Organic Law of the Superintendencia of Banking and Insurance, that is referred to conditions and contents of all insurance policies.
- f) To issue, on behalf of Insurance Deputy Superintendencia, the technical opinion need by the Bureau of Attention to the Public according to numeral c), Art. 8° of Resolution SBS N° 200-2003.
- g) To fulfill all opinion requirements and documents, handled by different private and public institutions about the insurance market and actual related standards.

### **OUTPUTS ACHIEVED**

As a direct effect of measures implemented by this administration, some results have been achieved, as:

- Commissions and costs charged by the financial institutions started to be published, trying to make them of public domain. This also pushed in the reduction of the two costs listed below.
- Reduction in the banking costs, loans for consumption, travel, entrepreneurial, mortgages, etc.
- Reduction in the fixed costs charged by the Private Pension Fund Administrator for managing the individual accounts of the members or affiliates.
- Reduction in the cost of premiums for insurance purposes (death, handicapped and survival), for instance, from 1.35% to 0.88%.
- Better prices and new products for insurance purposes.



## *Superintendencia de Banca y Seguros*

- Set up of a Register, as a part of the Superintendence website, with all products commercialized in the Peruvian Insurance Market, trying to make of public domain the whole wording and clauses in order to make the people interested in purchasing insurance be able to get, analyze and compare benefits and costs offered by insurers operating in Peru.
- Set up of insurance product named SOAT (it means Transit Accidents Compulsory Insurance). This insurance product covers death, permanent and temporal disability, medical and burial charges as a direct consequence of an accident for all passengers and non-passengers (it means all people involved in an accident)

All effects above listed have made and aims to: Enhance Transparency and Competition in all Financial Institutions in Peru, supporting social and economical develop of the country.

1. **TRANSPARENCY:** Making of public domain, using all available communication sources, as much information as possible, trying to make clients, and people interested be able to make their free and own choice for any financial product offered by the Peruvian financial system.
2. **COMPETITION:** Promote that all Financial Institutions offer to possible consumers, general public, clients, etc more and better products at competitive prices. This can be achieved through new products, improving their areas of Client Support, promoting training, new facilities, new technologies, costs rationalization, identifying investment priorities and fulfilling of all legal standards.

Lima, November 12<sup>th</sup>, 2003.