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Risk Based Supervision

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RBS

In the wake of the most recent financial crisis, the most common question relies on the ability of financial entities and supervisors to understand and mitigate inherent risks in financial entities.

What is RBS?

It is the supervision scheme in which the supervisor assesses the different business areas of financial entities, the quality of the systems and the internal controls, in order to identify the major areas of concern and risk.

RBS looks for a robust supervisory framework for monitoring the risk levels in the operations of financial entities.

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RBS

Advantages

- Sets forth a common terminology and framework for risk management.

- It is flexible enough to apply to all services and products, as well as to all types of financial entities.

- It aims to define a supervision strategy tending to identifying and preventing risks.

- Allows the efficient allocation of supervision resources by identifying the more vulnerable entities in terms of risk.

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RBS

Regulatory Authority experience (CNBV)

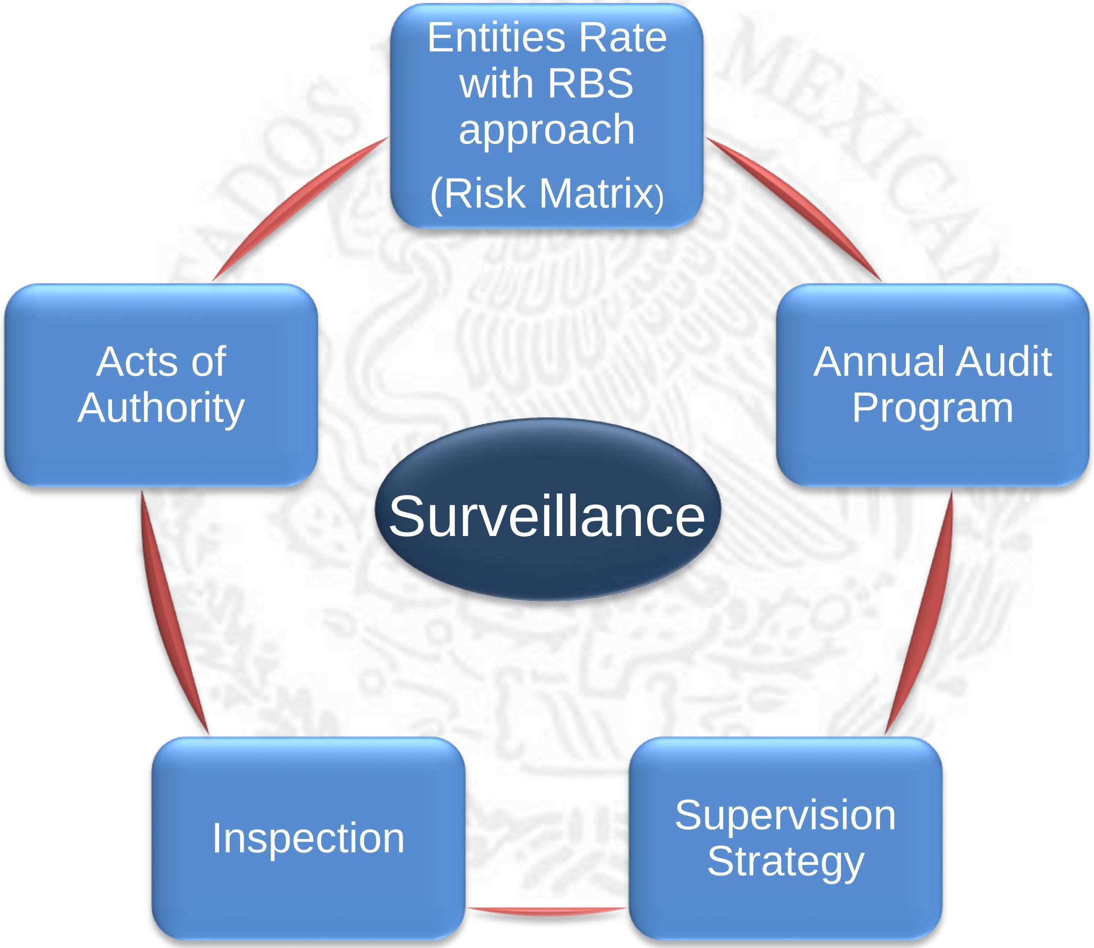
The CNBV has pursued strategies to reduce a risk profile of supervised institutions. This agency understands that regulatory compliance is not sufficient to maintain financial stability.

The CNBV has been working on:

- Standardization of criteria and procedures among its internal units, including risk metrics, to identify main risks and conduct inspections.
- A unique supervision guidance manual.

For such purposes, the CNBV uses risk benchmarks to evaluate business models and the effectiveness of management and controls, as the best forward-looking indicators of risk (Risk Matrix).

RBS Approach



Risk Matrix

The Risk Matrix is the financial entity's risk profile summary based on the supervision process.

The supervisor uses his experience and all available information derived from the surveillance and inspection process, such as:

- Previous audits outcomes.
- Quarterly financial reports and general surveillance aspects.
- Follow up of observations and corrective measures.

Risk Matrix

The Risk Matrix gives a risk-based rating of each supervised entity.

Core Activities

Core Activities (Stock Exchange)
Negotiation
Technological Infrastructure
Participants Surveillance
Self-regulatory activities

For each supervised entity, the core activities are identified.

They are not only based on business lines, but on critical activities that are mandatory for each financial entity.

Risk Matrix

Core Activities **Weighting**

Core Activities (Stock Exchange)	Weight %
Negotiation	**50%**
Technological Infrastructure	100%
Participants Surveillance	**30%**
Self-regulatory activities	**20%**

Each activity is weighted depending on how critical it is to assure business continuity.

They appear in order of importance, from most to less significant.

Risk Matrix

Core Activities | **Weighting** | **Inherent Risks**

Core Activities (Stock Exchange)	Weight %	Risks					
		Market	Liquidity	Credit	Legal	Operational	Technological
Negotiation	**50%**						
Technological Infrastructure	100%						
Participants Surveillance	**30%**						
Self-regulatory activities	**20%**						

The CNBV's risk management unit has developed a methodology to measure market, liquidity and credit risks for banks and brokerage houses.

Legal, Operational and Technological risks are considered based on the supervision experience.

The CNBV's supervision units use this methodology to populate the matrix.

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Risk Matrix

Core Activities | Weighting | Inherent Risks | Mitigating factors

Core Activities (Stock Exchange)	Weight %	Risks						Mitigating factors		
		Market	Liquidity	Credit	Legal	Operational	Technological	Corporate Governance	Internal Control	Risk Management
Negotiation	**50%**									
Technological Infrastructure	100%									
Participants Surveillance	**30%**									
Self-regulatory activities	**20%**									

The mitigating factors can include policies, procedures and rules for managing and mitigating an entity´s risks.

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Risk Matrix

Core Activities | Weighting | Risks | Mitigating factors | Rating

Core Activities Stock Exchange	Factor %	Risks: Market	Risks: Liquidity	Risks: Credit	Risks: Legal	Risks: Operational	Risks: Technological	Mitigating factors: Corporate Governance	Mitigating factors: Internal Control	Mitigating factors: Risk Management	Rating
Negotiation	**50%**	**N/A**	**N/A**	**N/A**	**3**	**4**	**4**	**3**	**3**	**3**	**3**
Systems	100%	**N/A**	**N/A**	**N/A**	3	4	4	3	3	3	**3**
Participants Surveillance	**30%**	**N/A**	**N/A**	**N/A**	**3**	**4**	**4**	**3**	**3**	**3**	**3**
Self-regulatory activities	**20%**	**N/A**	**N/A**	**N/A**	**3**	**3**	**3**	**3**	**3**	**3**	**3**
											3

According to each category, the entity receives a total risk-based rating.

Audit Frequency

This rating pretends to establish a criteria to determine the audits frequency, considering entities' risks and their importance level within the financial system.

(Frequency in months)

Risk rating	Trends		
	Increasing	Flat	Decreasing
4	12	12	18
3	18	24	24
2	30	36	42
1	42	42	42

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Conclusions

The CNBV considers RBS approach as a robust supervisory framework for monitoring the risk levels in financial entities operations, but we are continuously enhancing our Risk Matrix and RBS criteria.

The CNBV has been working on a risk-based supervision project that:

- Allows to focus resources on entities with higher risk.
- Improves the quantitative valuation of credit risk, liquidity risk, and market risk.
- Works on a standardized supervision methodology.

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RBS of Issuers

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Enforcement of Financial Information

The Mexican National Banking and Securities Commission (CNBV) is the authority responsible for determining the accounting standards applicable to listed companies.

In November 2008, the CNBV along with the Mexican Standard Setter Board (CINIF) announced the decision that Mexican public companies would be required to apply International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

In January 2009, secondary regulation was amended in order to compel all public companies to adopt IFRS and International Standards on Auditing (ISA) starting in 2012 (excluding financial issuers).

The CNBV worked together with public companies and other market participant aimed at having a smooth and successful transition process.

Enforcement of Financial Information

The CNBV is also the authority responsible for supervising and enforcing the accounting standards used by listed entities.

The enforcement system involves the annual analysis and review of the financial information of a number of issuers selected through a model that takes into account the following elements:

- Risk Based Approach
- Random Selection
- Rotation

The Selection Model at a glance

The model considers qualitative and quantitative data for every issuer, collected by the CNBV, either provided directly by the issuers or gathered from other sources.

The data is categorized and every attribute is assigned a score.

In this assessment the following features are evaluated in order to obtain the final score:

- Financial information
- Auditor characteristics /auditor opinion
- Corporate governance
- Historical compliance with regulation
- Public information (material events, press, etc.)

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The Selection Model at a glance

The model also includes the estimation of:

- The potential impact of a misstatement on the markets
- The probability of misstatements

The final selection of issuers subject to review is complemented with *rotation* and *random selection*.

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Analysis of Financial Information

The analysis of the financial information of the selected issuers involves, among other aspects:

- Evaluation of compliance with accounting standards (recognition, measurement and disclosure requirements).

- Examination of historical financial information.

- Evaluation of corporate governance issues.

- Analysis of the public information disclosed by issuers to identify possible false or misleading disclosures.

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What happens next…

Should any suspicions of possible infringements to the accounting or disclosure requirements arise during the analysis of the financial information, the CNBV can either:

- Ask issuers and independent auditors for explanations about the possible infringements.
- Request the issuer or the independent auditor to provide the necessary information through an official communication.
- Perform inspections to the issuer and/or the independent auditor.

What happens next…

If it is determined that the issuer did not comply with the applicable accounting standards, the CNBV can:

- Impose a fine from $154,000 USD to $514,000 USD.
- Request the restatement and publication of modified financial statements.

Additionally, the CNBV can refer executive officers for criminal investigation to prosecutors.