



## Santiago Principles Self-Assessment

### Budgetary Income Stabilization Fund

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#### — Pillar 1 —

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## **Legal framework, objectives, and coordination with macroeconomic policies**

### **Principle 1 Description:**

1. The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).

1.1. The legal framework for the SWF should ensure legal soundness of the SWF and its transactions.

1.2. The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed.

### **Principle 1 Implementation:**

The legal framework and main objectives for Mexico's SWF are clearly defined in i) the Budget and Fiscal Responsibility Law (hereinafter BFRL), and ii) the Agreement that establishes the Rules of Operation for the Budgetary Income Stabilization Fund. The framework is designed specifically to establish a sound and effective operation for the BISF, ensuring the achievement of its objectives.

The BFRL defines obligations and procedures to ensure fiscal sustainability and to promote the implementation of countercyclical policies. In line with this, the BFRL establishes the creation of a SWF (the BISF) with a clear mandate aligned with its goals. Mexico's SWF is constituted by assets managed in a Public Trust with direct legal relationship with the Federal Government.

The Ministry of Finance serves as the Settlor of the Trust, and one of the Federal Development banks, "Nacional Financiera" (hereinafter NAFIN), serves as the Trustee.

The legal framework and supporting documentation delineating Mexico's SWF, as well as its rules of operation, key features are publicly disclosed and can be found in the official websites of the Congress and the Official Gazette of the Federation.

- Rules of the Budget and Fiscal Responsibility Law <sup>[4]</sup>

- Agreement that establishes the Rules of Operation for the Budgetary Income Stabilization Fund <sup>[5]</sup>

### **Principle 2 Description:**

The policy purpose of the SWF should be clearly defined and publicly disclosed.

### **Principle 2 Implementation:**

The BISF's main objective is to reduce the effects on the economy and public finances of a decrease in the Federal Government's revenues with respect to those authorized by the Congress in the annual Revenue Act. The purpose is clearly defined and decreed in article

**Principle 3 Description:**

3. Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

**Principle 3 Implementation:**

The BISF is one of the tools that is used by the Federal Government to fulfil the goals stated in the BFRL (see GAPP 2), particularly in the implementation of countercyclical policies:

- BISF accumulates more resources when economic conditions are improving. The resources allocated to the BISF are calculated as a fixed percentage of the estimated government oil revenues and the revenue surpluses. As such, these resources increase whenever the government oil revenues increase.

- BISF's assets are used to protect public finances, especially when economic conditions are worsening. BISF assets are intended to help reduce the effect of economic Contractions on fiscal revenues as a consequence of downturns in the GDP, a decline in oil revenues and oil production, among others. According to the latter, the purpose of the fund is aligned with fiscal policy, acting as a countercyclical measure to preserve macroeconomic stability.

**Principle 4 Description:**

4. There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations.

4.1. The source of SWF funding should be publicly disclosed.

4.2. The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

**Principle 4 Implementation:**

The BFRL and the Rules of Operation of the Budgetary Income Stabilization Fund explicitly define the sources and uses of the SWF assets, and this information is publicly available.

- The sources of the BISF's assets are defined in articles 19, 19 Bis and 87 of the BFRL. According to these articles, the BISF accumulates resources through i) a fixed percentage of the revenues approved by the Congress and of the Federal Government surpluses ii) up to 30% of the Central Bank's operational profit (by law, central bank's operational profits have to be given to the Federal Government).
- The uses of the BISF's assets are defined in articles 21, 21 Bis of the BFRL and in the

Rules of Operation of BISF. According to these articles, assets are to be used only to:

- i) compensate decreases in government revenues under the amount approved by congress, and
- ii) cover the cost of hedging instruments acquired by the government to contribute to stabilizing the Federal Government's revenues.

**Principle 5 Description:**

5. The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

**Principle 5 Implementation:**

NAFIN reports relevant SWF's financial information to the Ministry of Finance on a monthly basis. Additionally, the BFRL and the Rules of Operation of the BISF require the Ministry of Finance to report quarterly to the Congress about the BISF's revenues, expenditures, reserves and other relevant financial information, as well as its effects on aggregate macroeconomic data.

This information is publicly available in the Ministry of Finance institutional webpage in the Quarterly Reports Section, in the Public Finances Appendix.

Reports to the Congress [6]

## **Pillar 2**

### **Institutional Framework and Governance Structure**

**Principle 6 Description:**

6. The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.

**Principle 6 Implementation:**

The BISF is established as a Public Trust, and consequently, its governance framework is defined in the Trust Contract ("The Contract"). According to this:

- The Economic Planning Unit (EPU), which belongs to the Ministry of Finance, is responsible for overseeing that the Trust's resources are applied for the stated purposes.
- A Technical Committee, integrated by the Undersecretary of Finance and Public Credit, the Undersecretary of Revenues and the Undersecretary of Expenditure, is responsible for i) authorizing the amount of resources to be used to fulfil the Fund's objectives, ii) approving monthly financial statements and iii) determining the portfolio's currency

composition, among others.

- NAFIN manages the Trust and, in order to distinguish the federal resources from operations related to the BISF, may create subaccounts.
- NAFIN must make use of the Mexican Federal Treasury (hereinafter “TESOFE”) to manage the Fund’s resources.
- For the implementation of hedging programs aimed to contribute with the stabilization of the Federal Government’s revenues, the Federal Government can request the Central Bank’s intermediation (as the Financial Agent of the Federal Government) to comply with such purpose.

#### **Principle 7 Description:**

7. The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF’s operations.

#### **Principle 7 Implementation:**

The Ministry of Finance and Nafin clearly defined the BISF’s objectives and governing body structure in the Trust Contract: •The BISF’s objectives are clearly established in article 21 Bis of the BFRL and the Rules of Operation.

- A Technical Committee is defined as the main governing body of the BISF. The Committee members are the Undersecretary of Finance and Public Credit, the Undersecretary of Revenues and the Undersecretary of Expenditure.
- The Economic Planning Unit is responsible for overseeing that the Trust’s resources are applied for the stated purposes.

#### **Principle 8 Description:**

8. The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

#### **Principle 8 Implementation:**

The faculties of the Technical Committee are clearly enlisted in the Trust Contract and they are established specifically to reach SWF’s objectives:

- Authorize the amount of resources that must be used to fulfil the fund’s objectives.
- Brief the Federal Government of the resources that result from contributions to the BISF.
- Approve the Trust’s financial statements.

- Determine the portfolio's currency composition.
- Authorize the hiring of external auditors.
- Approve the fees for the legal guardians designated by the Trustee.

#### **Principle 9 Description:**

9. The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.

#### **Principle 9 Implementation:**

NAFIN, as the SWF Trustee, is in charge of implementing the strategies defined by the Technical Committee, according to the set of faculties it has, in an independent manner in order to reach the BISF objectives. To comply with the SWF objectives, NAFIN's investment strategy must ensure low risk and high liquidity investments.

The latter is in accordance to TESOFE's investment policies (provided by the TESOFE Law). For the implementation of hedging programs aimed to contribute to the stabilization of the Federal Government's revenues, the Federal Government can request the Central Bank's intermediation (as the Financial Agent of the Federal Government) to comply with such purpose.

TESOFE Law <sup>[7]</sup>

#### **Principle 10 Description:**

10. The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

#### **Principle 10 Implementation:**

The accountability framework is defined in the public Trust Contract:

- NAFIN, as the SWF Trustee, is responsible for the BISF assets' protection and operation. It has to be transparent and accountable for the management of the resources and obliged to deliver relevant information and documentation to the EPU.
- If NAFIN were to be found guilty or negligent in its acts and responsible for BISF assets losses (according to Mexican Legislation), it would be responsible and obligated to respond according to Law.
- NAFIN has the faculty to request TESOFE the terms and conditions the deposits are subject to, as well as the delivery of financial statements.

- The EPU is responsible for overseeing that the Trust's resources are applied for the stated purposes and is in charge of solving any BISF administrative issues.
- The Technical Committee is responsible for determining the general activities of the Trustee as long as its instructions are within its faculties.

**Principle 11 Description:**

11. An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

**Principle 11 Implementation:**

The Congress requires quarterly reports of the revenues, expenditures and reserves to the Ministry of Finance. This includes statistical information of the BISF.

Reports to the Congress [8]

**Principle 12 Description:**

12. The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

**Principle 12 Implementation:**

The public Trust Contract establishes that the Trustee, in line with the Law of Acquisitions, Leases and Services of the Public Sector, is responsible for hiring an external auditor, with previous authorization from the Technical Committee and appointed by the Ministry of Public Services. According to the Guidelines for the Appointment and Control of External Auditors, issued by the Ministry of Public Services, it is the Auditor's responsibility, among other obligations, to review the financial statements issued by the Trust.

Guidelines for the Appointment and Control of External Auditors [9]

**Principle 13 Description:**

13. Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff.

**Principle 13 Implementation:**

The government authorities and staff involved in the BISF are public officers; thus, they are subject to the Federal Law of Liabilities of Public Officers (LLPO). In accordance with the fourth title of the LLPO, the Ministry of Finance and NAFIN define professional and ethical standards that are made known to its employees and are publicly disclosed in their websites.

**Principle 14 Description:**

14. Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.

**Principle 14 Implementation:**

All transactions with third parties are based on economic and financial grounds. Banco de Mexico's Fundamental Law establishes that Banco de Mexico (the Central Bank) will provide treasury services to the Federal Government and act as its financial agent in domestic and external credit operations. Therefore, the Federal Government requests the Central Bank to implement BISF hedging operations.

Banco de Mexico's Fundamental Law [10]

Furthermore, if necessary, NAFIN has procedures that define the steps to be followed in acquiring services from third parties in accordance with the Credit Institutions Law (CIL) and the Trust Contract.

Credit Institutions Law [11]

**Principle 15 Description:**

15. SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

**Principle 15 Implementation:**

According to Mexican legislation, Credit Institutions' international operations must comply with the host countries' financial regulation. In addition, BISF's main operations with international counterparties, as the annual oil hedging strategy implemented by the Federal Government through its financial agent, Banco de México, are also subject to all regulatory requirements of the counterparties' countries and, therefore, are conducted in compliance with all applicable regulatory and disclosure requirement of the counties in which they operate

**Principle 16 Description:**

16. The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.



### **Principle 16 Implementation:**

The governance framework, objectives and operational management of the BISF are defined in the rules of operation of the BISF and the BFRL (publicly disclosed). This documents clearly establish that the operational management has to be carried out exclusively by NAFIN and the TESOFE in compliance with the Regulation of the Law of Treasury Service of the Federation (RLTSF), and according to the policies defined by the Technical Committee. Additionally, for the BISF hedging operations, the Federal Government can request the Central Bank's intermediation (as the financial agent of the Government) to comply with such purpose.

Regulation of the Law of Treasury Service of the Federation <sup>[12]</sup>

### **Principle 17 Description:**

17. Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

### **Principle 17 Implementation:**

The EPU is authorized to request NAFIN relevant information regarding the Fund's activities and financial statements. The Ministry of Finance publicly discloses quarterly public finances reports through its website, which contains the most relevant financial information about the BISF.

## **Pillar 3**

### **Investment and Risk Management Framework**

#### **Principle 18 Description:**

18. The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.

18.1. The investment policy should guide the SWF's financial risk exposures and the possible use of leverage.

18.2. The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.

18.3. A description of the investment policy of the SWF should be publicly disclosed.

#### **Principle 18 Implementation:**

The management of the Fund's deposits, as stated in the Trust Contract, will rely upon on the TESOFE. Therefore, the legal framework that defines the investment strategy is provided by three main sources: the TESOFE Law, the TESOFE's Regulation Document,

and the Investment Guidelines designed by the TESOFE's Technical Committee. The first two layout broad outlines and principles of its management policies, meanwhile the third specifies details on the portfolio investment strategy. Due to the Fund's nature, the investment strategy is passive management, focusing on maintaining low risk and high liquidity. This framework fulfils the principles of a sound and strong portfolio. The BISF's investment policy is guided by sound principles that guarantee efficient management through clearly defined control mechanisms. The maximum weights of investment vary among instruments. The less risky assets –such as government bonds and bank deposits– have, by far, a greater maximum weight in portfolio assets than those with high financial volatility. The same criteria apply for the time horizons: longer horizons are compatible with safer assets. For the implementation of hedging programs aimed to contribute with the stabilization of Federal Government's revenues, the Federal Government requests Banco de Mexico's intermediation to invest BISF resources in the acquisition of financial derivatives to reduce the exposure of Federal Government revenues according to the approvals of the Technical Committee. The BISF operates under a public framework that offers the necessary information for a broad understanding of the investment policy.

#### **Principle 19 Description:**

19. The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

19.1. If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.

19.2. The management of an SWF's assets should be consistent with what is generally accepted as sound asset management principles.

#### **Principle 19 Implementation:**

In order to achieve low risk and high liquidity, the TESOFE's Technical Committee ensures an investment strategy that does take into account the financial and economic circumstances, as well as the passive strategy previously designed. The guidelines establish investment criteria and limits expressed in UDIS, an inflation-indexed unit of account. This allows the Fund to operate according to the economic and financial conditions. The Investment Guidelines provide the basic principles of a solid portfolio, as well as economic and financial grounds.

The framework for the BISF's investment policy clearly covers extensively, through its explicit legal structure – as well as its investment guidelines–, the basic principles of a solid portfolio by minimizing risk and maximizing long-run stable growth. As part of the strategy to minimize risk, the use of financial derivatives is authorized for hedging purposes with the intermediation of Banco de Mexico, which serves as the financial agent of the Federal Government

#### **Principle 20 Description:**

20. The SWF should not seek or take advantage of privileged information or inappropriate

influence by the broader government in competing with private entities.

**Principle 20 Implementation:**

Due to its constitution as a stabilization fund, it is against its purpose to seek advantages such as those arising from privileged access to market information that could cause negative effects on other agents or on financial markets. According to its legal framework, the BISF's operations are not subject to special financial or legal conditions, but they should comply with all financial regulation.

**Principle 21 Description:**

21. SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

**Principle 21 Implementation:**

Due to its constitution as a pool of assets with high liquidity, there are no shareholder ownerships others than the ones defined by the Trust Contract, where NAFIN is the Trustee and the Ministry of Finance serves as the settlor.

**Principle 22 Description:**

22. The SWF should have a framework that identifies, assesses, and manages the risks of its operations.

22.1. The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning, and an independent audit function.

22.2. The general approach to the SWF's risk management framework should be publicly disclosed.

**Principle 22 Implementation:**

The identification, assessment and management of the BISF's risks are clearly defined in the TESOFE's Law and the Investment Guidelines. In addition, establishing the use of systems and programs enables the adequate monitoring and management of relevant risks.

**Principle 23 Description:**

23. The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

**Principle 23 Implementation:**

The Contract states that the Ministry of Finance is authorized to request the BISF's financial statements, assets and investment performance on a monthly basis through the EPU, and the EPU is obligated to report this information to the Technical Committee for further observations and approval.

**Principle 24 Description:**

24. A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.

**Principle 24 Implementation:**

The Ministry of Finance shares the vision and objectives of the IFSWF and the Santiago Principles. It has defined a strong legal, institutional and management framework that contributes to ensuring that the BISF operations are aligned to the GAPP. This framework includes surveillance activities made by the Superior Audit Office of Mexico.

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