BBVA | RESEARCH

Banking Outlook

Mexico

July 2013
Economic Analysis

- Savings and credit in the banking system continue to rise, albeit at lower rates. This phenomenon is associated with a slowdown in economic activity in 2013 with respect to 2012
- The Federal Government has presented a Financial Reform Initiative. This Initiative proposes changes in laws and regulations with the aim of meeting commitments of the Pact for Mexico in order for private banking to lend more and to strengthen development banking
- The Initiative contains reforms which improve the legal framework and will have a positive impact on credit supply, once it is fully adopted. If all the companies needing credit were to obtain it, bank credit would increase by 7.4 pp with respect to GDP
- However, in order to achieve a level of penetration similar to that of other countries with a similar degree of development as Mexico, complementary measures are needed: the low penetration of bank credit reflects factors related to the demand for financing

BBVA Bancomer

Content

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1. Summary

Savings and credit

Saving and in credit in the banking system both continue to grow, in spite of the slowdown which has been observed in the Mexican economy over the year so far, albeit at a slower pace than In the previous year. On April 2013, the real credit portfolio granted by commercial banks to the private sector reported real year-on-year growth of 6.7%. Over the first four months of 2013, the average rate of growth in traditional saving was still lower than the rate in 2012, standing at 3.5%.

Financial Reform: a better legal framework for lending

On May 8, the Federal Government announced the Financial Reform Initiative, within the framework of the Pact for Mexico. The initiative consists of 13 decrees which propose different changes in laws and regulations, which will now be debated in Mexico's House of Representatives and the Senate, and which are focused on the following four main thematic areas:

1. A new mandate for development banking, to encourage growth in the financial sector;
2. To promote competition in the banking and financial system, to bring down charges and expenses;
3. To create additional incentives for banks to lend more; and
4. To strengthen the financial and banking system, to encourage the sector to report sustained growth (improving prudential regulation).

This initiative is intended to comply with the following commitments of the Pact:

- For banks to lend more and more cheaply
- To strengthen development banking to increase credit

Generally speaking, it is an important set of reforms which should improve the legal and regulatory framework, introducing certain necessary adjustments in the country's laws for a better instrumentation of the Basel III capital regulation. The Initiative also proposes an adequate framework for liquidation of banks, better legal rules for recovering guarantees, improvements in the powers of regulatory authorities, expansion of new platforms for providing financial services through allowing popular saving and credit institutions to be able to operate through the correspondent model. It is also proposed to improve and increase data available to credit information companies, to adopt measures to increase competition in the financial system, stricter laws for the securities market, by incorporating the investment advisor regulatory framework, while it is also proposed to introduce certain new instruments which will increase securities market's deepness.

Low demand might limit the positive impact of higher supply of credit

Although the reform can have a positive impact on credit demand in Mexico, it is important to note that this is not a complete solution to the problem of low financial penetration. Why? Because the low penetration is partly due to demand factors. A number of surveys show that a high percentage of companies do not contract banking credit because they say they do not need it or are not interested (the cost is not important).

This document includes an analysis of the National Micro Enterprise Survey (ENAMIN) which confirms the hypothesis stated above. One of the reasons why demand for credit is low amongst micro enterprises is the Mexican economy's high level of informality. This is shown in many micro enterprises with low incomes, whose owners are in fact self-employed workers, who have low education levels, and do not keep accounting records, inter alia. In our opinion, if structural forms are implemented to improve the productivity of the Mexican economy, and if the fiscal reform which will be submitted to Congress in fall 2013 achieves its goal of increasing formality, then this will be an important step forward to achieve higher growth in bank credit and in economic activity in general.

This document also includes an exercise to estimate the potential impact of a reform which eliminates restrictions on supply of lending to firms. If all the companies which say they need a credit and have not taken it out with banks due to the costs, or which have taken it out with other intermediaries obtained it from a bank instead, then there would be a 7.4% increase in bank corporate lending as a proportion of 2012's GDP. This would mean significant growth in credit penetration, but the levels of penetration would still be low if we compare Mexico with other countries with a similar level of development. This point reinforces the argument that demand factors largely explain the low level of credit penetration in Mexico.

Lending to SMEs by Federal States

An analysis of the information published by the National Banking and Securities Commission (CNBV) of credits to micro, small and medium sized enterprises (SMEs) by federal state is presented. The information shows that the aforesaid credits are highly concentrated (five federal states account for 71% of the total), although this concentration has fallen over the last decade. Various credit indicators are also compared with efficiency metrics in each state's corporate law proceedings, to determine if greater speed or institutional efficiency is associated with larger credit balances and flows. Results show certain positive associations but the evidence is not conclusive. Nevertheless, these first results shed light on the challenges which lie ahead if the Financial Reform is to enable credit to flow to all the regions in the country.

Default by credit amount

An analysis based on the information published by the CNBV confirms that there is a negative correlation between the size of a company receiving credit, and default. In other words, smaller companies tend to show higher levels of default. It could be that the higher risk posed by smaller companies to banks is not only reflected in the interests they are charged by the banks, but also in these companies' need to have their own guarantees or governmental guarantee schemes to mitigate contingencies and allow credit to flow towards these kinds of smaller-sized companies.

In short, this edition of ***Mexico Banking Outlook*** addresses the Financial Reform Initiative which has been presented by the Federal Government. The report identifies a number of aspects which will have a positive impact on the financial sector and certain factors which should be taken into account, not only to assess their positive impact but also to determine what other public policies could be implemented to increase the benefits of the financial reform.

2. Current Situation

2.a Total Lending of Commercial Banking to the Private Sector

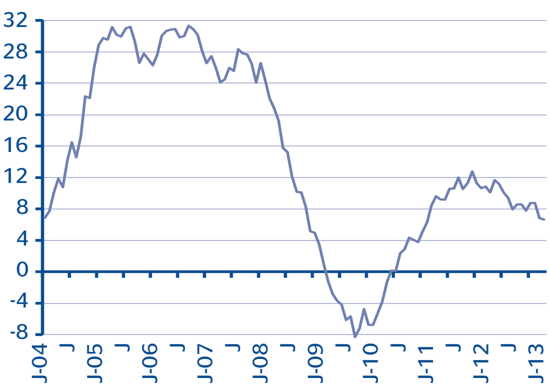
2.a.1 Recent evolution of bank credit

From June 2010 until April 2013, the portfolio of total current credit granted by commercial banks to the private sector continued to report positive real year-on-year growth rates. This means that lending has reported positive growth rates for 35 consecutive months (Chart 1).[1] Since December 2011, however, the rate of growth has slowed, so that on April 2013 this credit portfolio posted real annual growth of 6.7%.

Consumer credit was most affected by the 2009 recession, and out of the three most important credit categories, it was the one which took most months to return to positive real growth rates. From the second half of 2011 onwards, it also became the most dynamic, a situation which has continued until now (Chart 2).

Chart 1

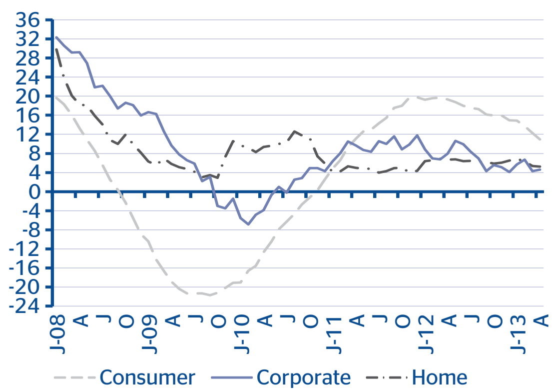
Total credit from commercial banking to the private sector (Real annual growth rate, %)



Source: BBVA Research with Bank of Mexico data.

Chart 2

Bank credit to consumer, home and corporate (Real year-on-year growth rates, %)



Source: BBVA Research with Bank of Mexico data.

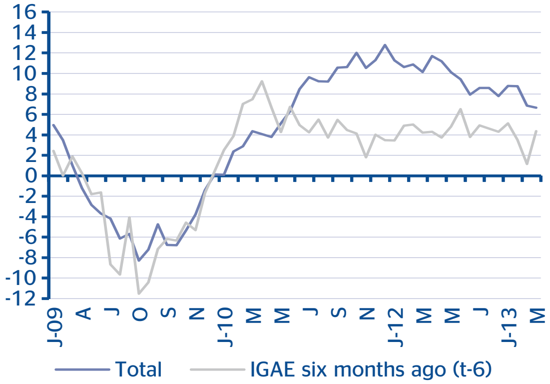
Credit to the private sector has a positive correlation with changes in economic activity.[2] One example can be seen when comparing the Global Economic Activity Index (IGAE) published every month by the INEGI, with a lag of 6 periods, with the real annual rate of growth in total lending to the private sector. Chart 3 shows that the average real rate of growth of the IGAE for the first half of 2012 was 4.8%, and in this period the average real growth of total lending to the private sector was 11%. In the second half of that year, the average growth rate of the IGAE fell to 3.2% and that of credit fell to 8.7%. For the first quarter of 2013, growth of the IGAE was less (0.8%), and it was the same story with total credit to the private sector (8.1%). Therefore, the lower real annual growth in total lending to the private sector observed on April 2013 may be due to a lower rate of growth in economic activity.

[1] It is important to note that the total current credit portfolio granted by commercial banks to the private sector was affected by the recession in 2009, and it was from June 2010 onwards when it once again reported positive real growth rates.

[2] In addition to analyzing a correlation or association between lending patterns and the most important macroeconomic variables - as we do in this report - reference can also be made to a relationship of cause and effect which economic activity has on the different types of lending. Statistic tests such as the Granger causality (one variable precedes the other) with quarterly figures of these variables indicate such a (Granger) causality of economic activity to credit.

Chart 3

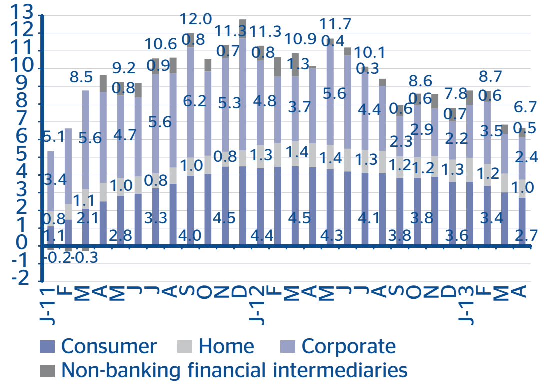
Total credit to the private sector and IGAE of six months ago (Real annual growth rate, %)



Source: BBVA Research with Banco de México and INEGI data

Chart 4

Total credit to private sector: contribution to real growth of total credit per component (%)



Source: BBVA Research with Bank of Mexico data.

2.a.2 Contribution to growth of private sector credit by components

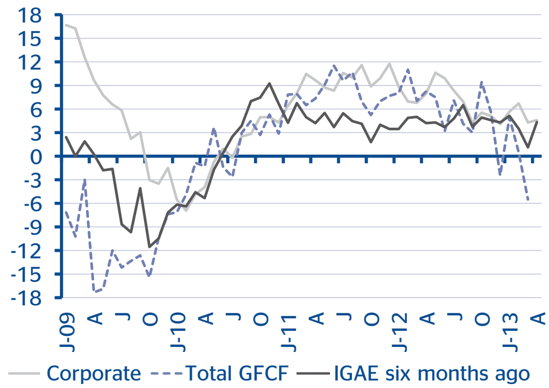
The expansion of total credit to the private sector can also be analyzed from the standpoint of the contribution which its components have had. From January 2011 to April 2013, the average real annual rate of growth of total lending to the private sector was 9.7%. Each one of its four components made the following contribution: lending to companies contributed 4.3 percentage points (pp), consumer credit 3.6 pp, home credit 1.1 pp and credit granted to non-banking financial intermediaries (IFNB), made a contribution of 0.6 pp. It is important to note that credit to IFNB plays a less important role, as over the period in question this credit only accounted for an average of 3.7% of the total credit portfolio of commercial banking to the private sector. Judging by the above figures, it is evident that the drivers of lending to the private sector over this period were business and consumer credit.

2.a.3 Corporate lending: recent evolution connected with economic activity

Credit granted by commercial banks to companies in the private sector has a significant correlation with the evolution of the macroeconomic environment (Chart 5). On the one hand, growth in economic activity (measured by the IGAE) could be related with this credit on the demand side, given that the higher the growth in the economy, the more business opportunities could be created, opportunities which are in turn financed with bank credit. On the other hand, inasmuch as the process of economic growth is underpinned by the increase in investment – measured by fixed gross capital formation (FBCF)– bank credit for companies could be channeled through investment projects and held to drive economic growth through investment.

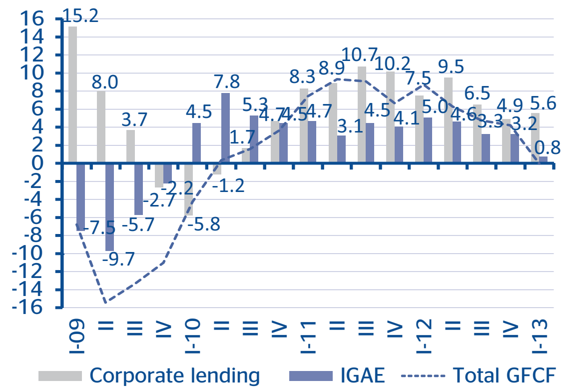
The relationship between growth in the IGAE and the FBCF with the growth in corporate lending is confirmed if we calculate the quarterly averages of the real annual growth rates, which are shown in Chart 6. As we can see, in the first quarter of 2013, the average growth in corporate lending was 5.6%, lower than the growth of 7.5% recorded in the same period of 2012. Furthermore, the real annual growth in this credit at April 2013 (4.7%) was also lower than that of the same month of 2012 (8%). This pattern of credit to companies has arisen in a context of lower growth in IGAE and FBCF in the first quarter of 2013: 0.8% and 0.0%, respectively.

Chart 5
Corporate lending, IGAE and gross fixed capital formation (Real annual growth rate, %)



Source: BBVA Research with Banco de México and INEGI data

Chart 6
Corporate lending, IGAE and gross fixed capital formation (Real annual growth rate, quarterly average, %)



Source: BBVA Research with Banco de México and INEGI data

The foregoing implies that worsening macroeconomic variables prompt lower growth in corporate lending. One possible reason for this pattern is that a slowing or falling in activity reduces the number of new business opportunities which require funding through credit. Another explanation is that companies may be delaying their investment projects (or their decision to demand credit) until the macroeconomic environment improves.

2.a.4 Consumer lending: recent evolution connected with formal employment

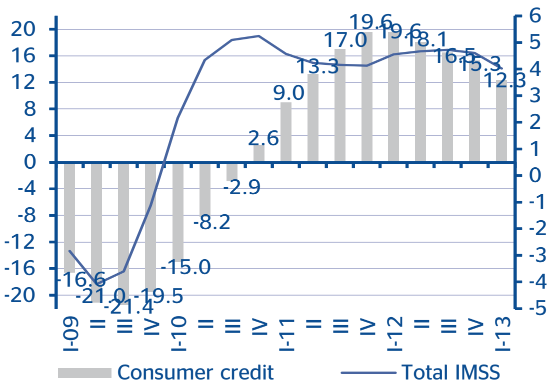
On April 2013, real annual growth in total consumer credit was 11%, with the highest rate of growth in Other Consumer Credits (OCC) (15.4%), followed by credit cards (9.9%) and a slight fall in credit for acquiring durable consumer goods category (BCD) (-0.9%).

The recession of 2009 had a negative effect on consumer credit in the three categories: Credit Cards, OCC and BCD. Once the 2009 recession ended, consumer credit also grew, and did so strongly. However, since the second half of 2012 growth in consumer credit has slowed, something which might be due to the maturity of some of its components, as with OCC and Credit Cards.

Another possible reason for the slowing in consumer credit granted by commercial banks concerns the evolution of economic activity. In this case, the transmission channel appears to be employment. This relationship is observed in Chart 7, in which growth in consumer credit is compared with growth in the total number of workers registered with the Mexican Social Security Institute (IMSS) As might be expected, on November 2010 the annual rate of growth in total workers registered with the IMSS was 5.4%, dropping to 3.7% on March 2013.

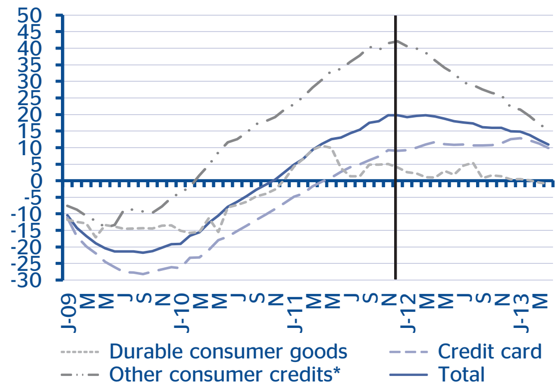
One of the reasons for this relationship might be that credit through credit cards is largely granted to people with stable income, implying someone who works in the formal sector. Another possible explanation for the relationship between consumer credit and formal employment may be through the Other Consumer Credits item, which includes paycheck credit. Because financial intermediaries seek to grant this credit to people with stable employment in a formal institution, and the salary is paid by deposit to a bank account, then lower growth in the number of formal workers could reduce the possibility of banks granting these kinds of credits.

Chart 7
Consumer credit and total number of workers registered with IMSS (Real annual growth rate; %)



Source: BBVA Research with Bank of Mexico and IMSS data

Chart 8
Consumer bank credit: growth by component (Real annual growth rate, %)



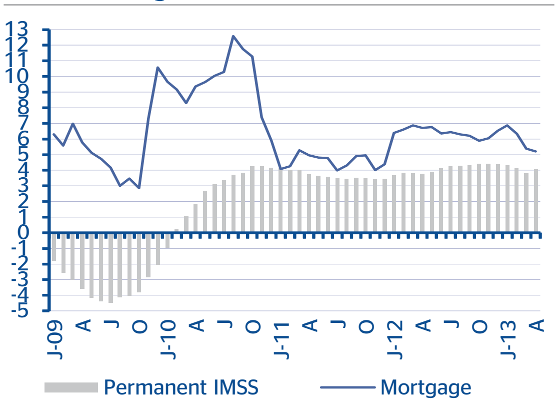
Source: BBVA Research with Bank of Mexico data

The data shown seem to imply that unless formal employment grows at rates higher than those recently observed, there should continue to be moderate growth in consumer credit.

2.a.5 Mortgage lending: influenced by formal employment and payment capacity

The economic recession of 2009 did not have a significant impact on mortgage credit granted by commercial banks because this is a long term type of lending, which is gradually repaid and which therefore takes a long time to be reduced. It is a different story, for example, with short term corporate loans, because if the credit is not renewed the balance diminishes. An adverse macroeconomic environment usually increases credit risk and plays a part in many credit agreements not being renewed. What is more, the balance of mortgage lending also continued to grow, partly due to Mexico's housing deficit.

Chart 9
Mortgage lending and total number of workers registered with IMSS (Real annual growth rate, %)



Source: BBVA Research with Bank of Mexico and IMSS data

Chart 10
Mortgage lending and real salary index, (Real annual growth rate, % and 12-month moving average of base index January 2009)

Source: BBVA Research with Banco de México and INEGI data.

Furthermore, on November 2009 part of the current credit portfolio which had already been granted in investment units (Udis) was transferred to the current peso lending book. This loan book transfer temporarily increased the real annual growth rate, and once 12 months had elapsed after the transfer, the growth rate fell. In other words, on October 2009 the growth rate stood at 2.9%, and the following month - when the portfolio was transferred - it rose to 7.3%, and the average rate registered from November 2009 to October 2010 was 9.9%. From November 2010 on, the rate began to fall, bringing the average growth rate from November 2010 to April 2013 to 5.6%. In the fourth month of 2013, the rate stood at 5.2%.

The slowing rate of growth in credit seems to be connected with the slowdown in the number of permanent workers registered with the IMSS, and with a fall in income in real terms. The latter trend is evident if we compare real annual growth in mortgage lending with the 12-month moving average of workers registered with the IMSS (Chart 10).[3] This relationship seems to imply that without growth in real salaries, possible new clients have a lower payment capacity. This relationship does not, however, imply causality because there may be other factors which inhibit demand for housing, such as an increase in the prices of homes which customers might wish to buy on credit.

Evaluation

Lending to the private sector - with its different types - is related to the main macroeconomic variables, particularly GDP or IGAE, with gross fixed capital formation, employment (measured using the number of total permanent workers in the IMSS) and with their real income. Consequently, the slowdown in economic activity may be responsible for the slower rate of growth in total credit and in its most important categories. In other words, the slowdown observed in the first quarter of 2013 in GDP and in gross investment of 0.8% and 0%, respectively, could have an impact on the future patterns of corporate lending.

The lower growth in GDP may affect the rate of growth in formal employment, either the number of total or permanent workers registered with the IMSS. This in turn could reduce the rate of growth in consumer and mortgage credit. If the lower rate of growth in economic activity is a temporary phenomenon and the economy returns to higher rates of growth over the next few months, then there might be a more positive performance in credit over the following months.

[3] A real salary index was calculated with a base of January 2009, and a 12-month moving average was taken from these real values. This was done to eliminate seasonal factors in salary adjustments and thus to smoothen the series.

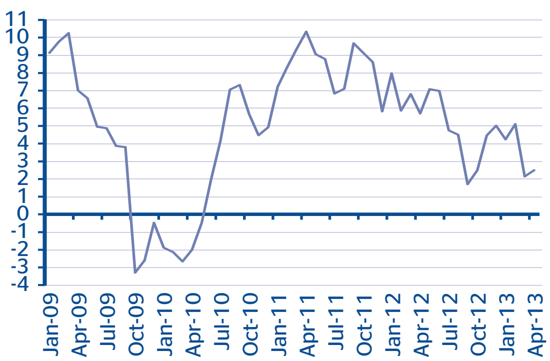
2.b Savings in Commercial Banks: Recent Evolution

2.b.1 Traditional bank savings

Commercial banks' traditional savings, which are made up of demand and time bank deposits, were also affected by the recession in 2009, which caused negative real growth rates between October 2009 and May 2010. Since June 2010, with the brighter macroeconomic outlook, traditional bank savings grew again, and, up to April 2013, traditional savings have reported growth for 35 successive months.

Chart 11

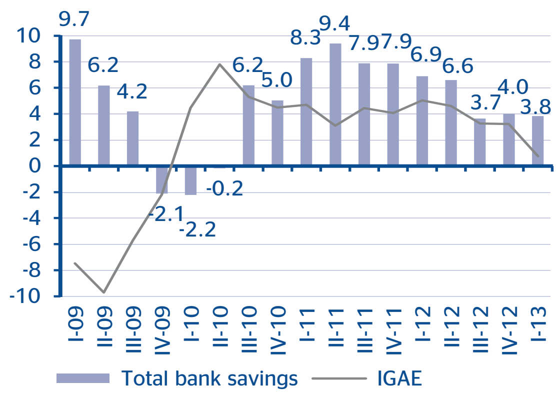
Commercial bank traditional savings (Real annual growth rate, %)



Source: BBVA Research with Bank of Mexico data.

Chart 12

Traditional bank savings and IGAE (Real annual growth rate, quarterly average, %)



Source: BBVA Research with Banco de México and INEGI data

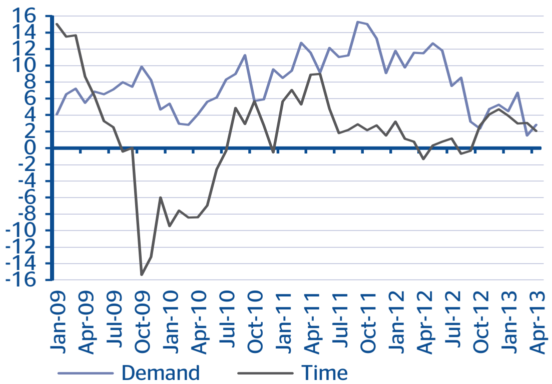
However, the highest rates of growth in traditional savings were reported from June 2010 to April 2011 (Chart 11). In 2011, its average real annual growth rate was high (8.4%), while in 2012 its average fell to 5.4%. Over the first four months of 2013, the average rate of growth in traditional savings was still lower than the rate in 2012, and stood at 3.5%.

The lower rate of GDP growth has had an influence on the pattern of traditional savings (Chart 12). In the first half of 2012, real annual growth in GDP was 4.7%; but fell to 3.2% in the second half of that year; and in the first quarter of 2013 the rate was 0.8%. This means that lower growth in income precedes a lower amount of new resources channeled towards bank saving instruments which are part of traditional banking savings.

2.b.2 Commercial banking traditional savings: pattern by components

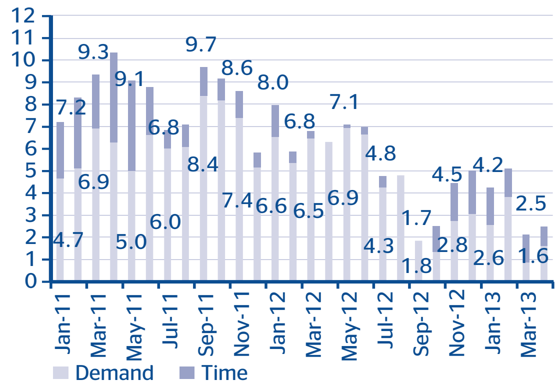
Demand and time deposits have shown different trends due to the variables affecting them. Time deposits and savings in debt mutual funds (SID) are saving instruments which are mutually replaceable. The relationship between the two is such that when one grows the other shrinks, or, in the best case scenario, it grows marginally. This pattern was seen on October 2008 when there were considerable losses in SID, leading many savers to channel their funds towards short term bank savings. Once the losses in SID were recovered, the rate of growth in time deposits first slowed and then fell. In addition to being affected by the recovery in SID, time deposits were also hit by the economic recession of that year, leading to negative real growth rates from August 2009 to July 2010 (Chart 13).

Chart 13
Demand and time deposits (Real annual growth rates, %)



Source: BBVA Research with Bank of Mexico data.

Chart 14
Traditional savings: contribution of demand and time deposits to growth (Percentage points)



Source: BBVA Research with Bank of Mexico data.

During that period, demand deposits had positive real growth rates and were the component of traditional savings which grew the most. For example, from January 2010 to April 2013 the real annual growth of traditional savings was 5.1 percentage points (pp). Demand deposits accounted for 4.5 pp of its growth and time deposits contributed 0.6 pp. On April 2013, traditional savings grew 2.5 pp, 1.6 of which stemmed from demand deposits and the other 0.9 pp from time deposits (Chart 14).

This tells us that demand deposits are the savings component that most contributed to traditional savings growth. The rationale behind that growth is that demand deposits are used both as a savings instrument and as a transactional tool. Both factors have had an influence on its performance.

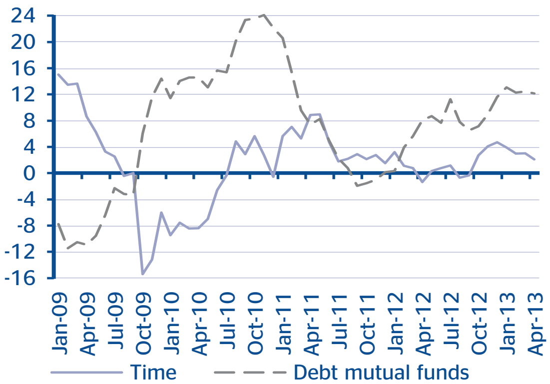
2.b.3 Time deposits and debt mutual funds (SID)

As stated above, time deposits and debt mutual funds (SID) are savings instruments which are mutually replaceable. In certain periods we may observe that, as income increases, one of those two components grows while the other one falls. This pattern is due to the considerable degree of replaceability between both types of savings (Chart 15). Periods of growth in SID are associated with periods of growth in GDP, but also with economic periods in which interest rates are stable or show a downturn. On the other hand, rises in interest rates prompt losses in SID, leading savers to channel their resources towards secure saving instruments which do not show this trend, such as time deposits.

At 2005 year end, the balance of resources deposited in SID amounted to 64.1% of the time deposits amount. Savers' strong preference for SID has driven their growth, and on June 2012 their balance reached the same level as time deposits. In the following months, SID surpassed time deposits, so that on April 2013, resources channeled into SID were 8.7% higher than the balance of time deposits.

The stronger performance of SID since early 2012 has been in line with the modest growth rate of time deposits. From January 2012 to April 2013, the average real annual growth rate in time deposits was 1.8%, while the equivalent rate for SIDs was higher, at 8.6%. The contrast is higher for April 2013, since in that month real annual growth rate of time deposits was 2.1%, while for SIDs the rate was higher, 12.1%.

Chart 15
Time deposits and debt mutual funds
(Real annual growth rates, %)



Source: BBVA Research with Bank of Mexico data.

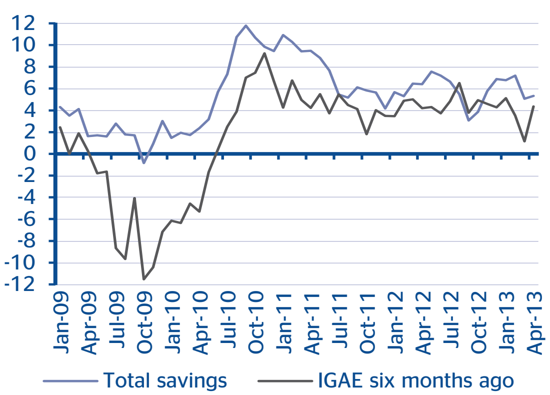
Chart 16
Total savings: demand + term + debt mutual funds (Real annual growth rate, %)

Source: BBVA Research with Bank of Mexico data.

2.b.4 Total Savings: sum of traditional savings (demand + term) with SID

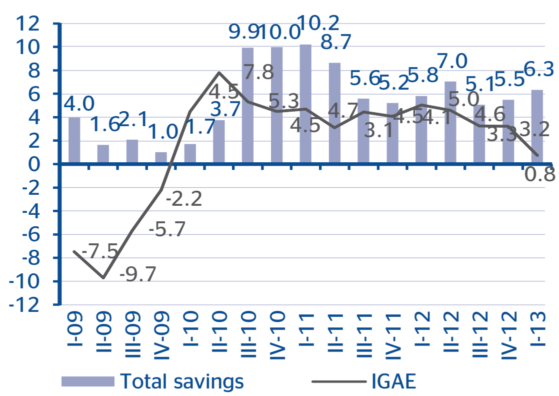
Total savings are defined as the sum of traditional bank savings (demand plus time deposits) together with SID. These savings may be considered as an aggregate measure of financial savings, without the replacement between bank time deposits and SIDs.[1]

Chart 17
Total savings and IGAE
(Real annual growth rate, %)



Source: BBVA Research with Banco de México and INEGI data

Chart 18
Total savings and IGAE (Real annual growth rate quarterly average, %)



Source: BBVA Research with Banco de México and INEGI data

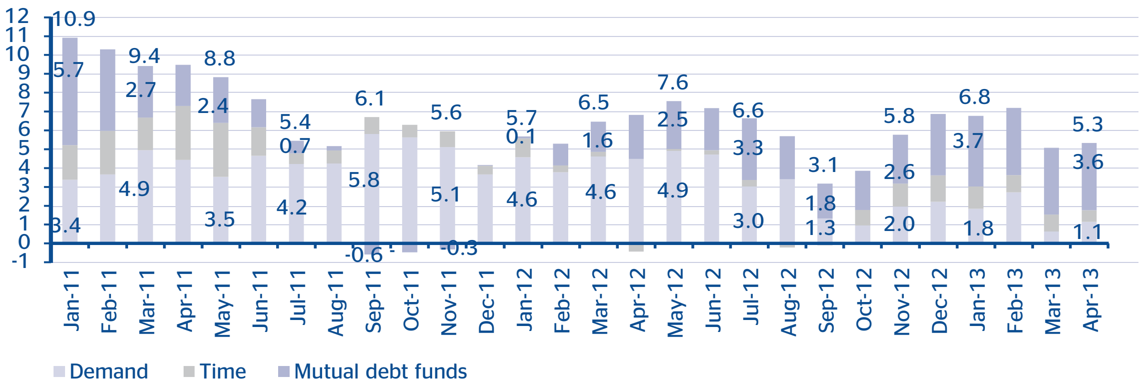
Total savings were affected by the 2009 recession (Charts 16 and 17), but once the recession effect faded, total savings reported a fresh growth. However, as both GDP and personal income growth slowed, total savings were also down. Average real annual growth rate in total savings between January 2010 and April 2013 was 6.5%; in the first four months of 2013, this growth was 6.1% and on April 2013 it stood at 5.3%.

[1] The correlation between growth rates of total savings and IGAE with a lag of six months for the period from January 2009 to April 2013 was 0.798. That correlation was higher than the existing for the same period between IGAE and demand deposits (0.296), between the IGAE and time deposits (0.591) and between IGAE and SID (0.231). This could indicate that savings in its aggregated form might be a better indicator of the trend in financial savings than its separate components, given that the aggregated definition includes the replacement effect between those components.

2.b.5 Total savings: contribution to its growth by component

One way of gauging the importance of each savings component is to determine the contribution that each component makes to the total savings growth. For example, from January 2010 to April 2013, real annual growth in total savings was 6.5%: 3.2 pp came from demand deposits; 2.9 pp from SID and only 0.4 pp from time deposits. Specifically, on April 2013 total savings rose 5.3%: of which 3.6 pp stemmed from SIDs; 1.1 pp from demand deposits; and the remaining 0.6 pp from time deposits. Those figures show that the two main components of total savings are demand instruments and SIDs, given that the contribution of time deposits to total savings has remained low.

Chart 19
Total savings: contribution of components to growth (Percentage points)



Source: BBVA Research with Bank of Mexico data.

Evaluation

Demand deposits are the most dynamic component and that which makes the highest contribution to growth in traditional bank savings. The trend in time deposits has been of a lower rate of growth and lower contribution towards growth in traditional savings. The latter has occurred mainly because of the competition time deposits face from the SIDs. The importance of the SID, meanwhile, has increased in absolute and relative terms as a savings instrument, given that at 2005 year end the balance of resources which had been channeled towards this instrument accounted for 64.1% of time deposits. This situation has been modified, and on April 2013 the balance of resources channeled to the SID was 8.7% higher than time deposits balance.

Total savings, or the sum of traditional savings with the resources channeled towards SID, shows that the long term rate of growth in total savings stood in the neighborhood of 6.9%, if we consider the average real annual rate of growth for the last ten years (from May 2003 to April 2013), and 6.1% taking into account the average for the last five years (May 2008 to April 2013). The average real annual growth rate for traditional savings for the last ten years was 5.7%, and 5.9% for the last five years..

It is important to note that at present banks have been able to satisfy credit demand with the resources stemming from deposits. However, if bank credit continues to grow at an average annual rate of 8%, as it has done since the second half of 2010, banks will face the challenge of increasing their rate of growth in savings to a similar level. By this means, bank savings will be able to continue supplying the demand for credit in the future and banks will also have resources to continue to fuel Mexico's economic growth.

Box 1: Corporate Lending: Relationship between Amount, Company Size and Non-Performing Loan Ratio

In July 2009, the National Banking and Securities Commission (CNBV) began to publish two relevant monthly information series. The first refers to the balance of corporate lending granted by commercial banks, broken down into 20 ranges or segments of loans granted. For each loan segment, CNBV provides data on total loans and past due loans, so as to determine the Non-Performing Loans (NPL) ratio of companies with a bank credit in Mexico. This information can be used to link companies' NPL ratio by loan segment with their size. The second series consists of monthly information which can be used to calculate the average amount of the new loans granted to each borrower (companies) according to its size, as it was described in the November 2012 edition of *Mexico Banking Outlook*.

On the basis of those two series, a relationship can be established between the NPL ratio by loan segment and the size of the companies which received it. This provides an approximation which can help to infer the NPL ratio of Micro, Small, Medium and Large companies. In this article we describe and comment the details of the procedure followed to relate NPL ratios with the size of companies. Results obtained show that smaller amounts of loans (granted to smaller size of companies) are related to higher delinquencies and therefore higher credit risk.

Segmentation of the amount of credit to companies

The information on the loans granted to companies according to the 20 segmentation groups allows us to verify certain relevant details about credit performance. One of those details is the distribution of the loan portfolio to companies according to their loan size (Table 1). For example, at the end of 2009, 20.4% or 30.1% of the total loan portfolio was granted for amounts of up to 10 and 25 million pesos, respectively. These proportions rose to 22.6% and 32.9% on March 2013. As we shall see below, these amounts and percentages of credit can be related to the size of the companies which receive them.

Table 1

Credit granted by commercial banks to companies by interval in balance of credit amount
Figures: ranges in thousands of pesos; loan portfolio, in millions of pesos

	December 2009			March 2013			Average Credit by Company Size		
Amount of Credit (Figures in thousands of pesos, mp)	Total Portfolio	Structure %, Accumulated	NPL Ratio	Total Portfolio	Structure %, Accumulated	NPL Ratio	Amount of Credit Granted in 2012 by Company Size	Avge. amount of Credit in 2012: Millions of pesos	Maximum Amount in a Month of 2012: Millions of pesos
0-10	335	0.0	9.0	502	0.0	3.6			
10-25	1,093	0.2	7.8	1,173	0.1	4.1			
25-50	2,566	0.5	4.9	2,220	0.3	3.1			
50-100	5,291	1.0	4.5	4,860	0.7	3.3	MICRO	0.672	0.844
100-250	11,715	2.4	5.2	15,414	2.0	3.3			
250-500	13,841	3.9	5.8	19,875	3.7	3.7			
500-1,000	20,031	6.2	5.3	29,549	6.2	4.1			
1,000-2,500	39,699	10.7	4.4	63,040	11.5	3.5	SMALL	1.527	1.755
2,500-5,000	35,851	14.7	3.9	58,770	16.4	3.6			
5,000-10,000	50,525	20.4	3.8	73,531	22.6	3.2	MEDIUM	5.805	7.631
10,000-25,000	86,489	30.1	2.1	121,995	32.9	3.1			
25,000-50,000	78,442	39.0	1.6	109,886	42.1	2.6			
50,000-100,000	75,311	47.5	1.3	113,209	51.6	2.6			
100,000-250,000	114,463	60.4	1.6	154,263	64.6	1.5			
250,000-500,000	93,818	70.9	1.7	137,518	76.2	1.1	LARGE	39.023	43.034
500,000-1,000,000	92,610	81.4	0.0	133,837	87.4	0.9			
1,000,000-2,500,000	110,272	93.8	1.5	115,634	97.1	1.1			
2,500,000-5,000,000	47,104	99.1	0.0	22,155	99.0	0.0			
+ 5,000,000	7,798	100.0	0.0	11,750	100.0	0.0			
Without classification	-			-					
Total	**887,253**		**1.9**	**1,189,181**		**2.1**			

Source: National Banking and Securities Commission, Table 040-11-C-R1

Average amount of new credit granted to companies in 2012 according to their size[1]

The information on segments of loans granted to companies can be related to their size if the amount of the average new bank credit (or credit marginally drawn) which companies had in 2012 is taken as indicator of the size of such companies. According to CNBV information, in that year, microenterprises received, on average, loans of less than one million pesos; small companies were granted loans in amounts of about 1.5 million; medium-sized companies received amounts of up to six million pesos on average; and large companies were granted loans of the order of 39 million pesos on average (Table 2).

Relationship between the credit balance and the company's size

Table 1 relates the balance of the corporate lending book of December 2012 broken down into loan segments with the size of companies based on the information on the average amount of loans granted in 2012 by company size. As stated above, loans of up to one million pesos are considered to refer to microenterprises, and loans in a range between 1 and 2.5 million pesos as granted to small companies. It is also assumed that loans of over 2.5 million to 10 million pesos were issued to medium-sized companies and the rest were granted to large companies.[2]

Table 2

Credit granted by commercial banks to companies: average monthly amount of the new credit granted per borrower according to company size in 2012

	Amounts in millions of current pesos			Large = 100 %	
Company Size	Annual Average	Monthly Maximum	Monthly Minimum	Annual average	
Micro	0.672	0.844	0.530	Micro / Large	1.72
Small	1.527	1.755	1.362	Small / Large	3.91
Medium	5.805	7.631	4.810	Medium / Large	14.88
Large	39.023	43.034	35.165	Large / Large	100.00
Total Corporate	**4.321**	**4.849**	**3.677**	**Total / Large**	**11.07**

Source: National Banking and Securities Commission, Table 040-11-C-R1

Since average loan ranges granted by commercial banks to companies in accordance with their size and with their NPL ratio by amount of credit obtained are available, we can establish a relationship between loan amounts and company size. Table 2 shows that lower amounts of credit are usually granted to smaller-sized companies, while larger credits correspond to large companies. This relationship is very much what one might expect, under the assumption that banks analyze companies' payment capacity to grant them credit, and such capacity is proportional to either the companies' size or their capacity to generate cash flows. Company size can be measured by sales, fixed assets, number of employees, or other variables. Thus, it is unlikely that a microenterprise or small company will be granted a loan for an amount several times larger than its size.

Evolution of NPL ratio according to estimate made for company size

Table 1 also shows that the smaller the size of the company, the higher its NPL ratio; while the larger the size of the company, the lower its NPL ratio. If we chart the NPL ratio by company size, we see that since July 2009 there has been a consistent relationship: the smaller the size of the company, the higher its NPL ratio (Chart 20). Furthermore, if NPL ratios are standardized based on the NPL ratio of large companies, which is the lowest of all the groups of companies considered, we see, for example, that micro enterprises on July 2009 registered a NPL ratio which is 4.9 times higher than that of large companies. On March 2010, the NPL ratio of microenterprises increased to 5.9 times, possibly as a result of the 2009 recession, and once the adverse effects of the recession began to fade, the ratio began to narrow (Chart 21). This indicators show that

[1] In Box 3, Bank lending to companies: how much might it increase as a result of the Financial Reform?, CNBV information on the average of the new credit granted to companies according to their size is also used. In the Mexico Banking Outlook of November 2012 this information was also used in the report entitled "Statistical series on new business credit by company size".
[2] It is important to note that there may be some doubt about loans issued between the range of over 10 and until 25 million pesos, as one part of these loans may have been issued to medium-sized companies of a larger size within their category while another part may have been issued to large companies which were of a relatively smaller size within their category. If additional ranges of loan amounts were available, for example, from 10 to 15; from 15 to 20; and from 20 to 25 million, this doubt could be clarified. On December 2012, the outstanding amount of loans within this range accounted for 9.9% of the total corporate loan portfolio.

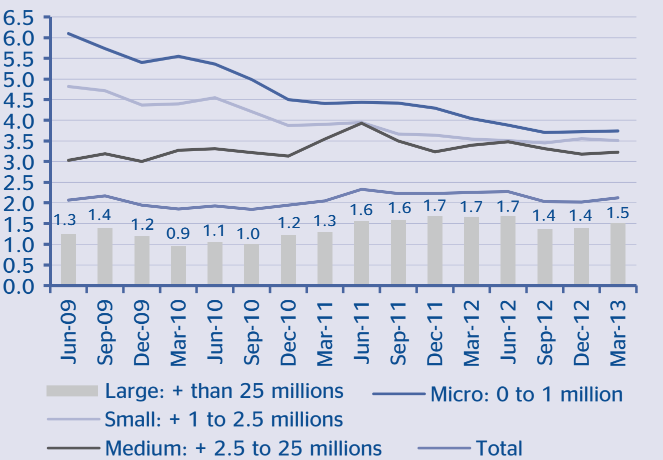
in the event of a serious deterioration in the macroeconomic setting, as it occurred in 2009 due to that year's recession, the sensitivity to default for smaller-sized companies is much higher than the sensitivity for larger companies. Once there is a favorable macroeconomic environment, suitable for economic growth, credit delinquencies in smaller companies fall, while there are no significant changes in the NPL ratio of large companies, although the data show that smaller sized companies represent higher credit risk compared to larger ones.

Comparison between the NPL ratio of corporate lending of banks with that of Sofoles

CNBV also publishes statistical series with similar loan segments of loans granted to companies by limited purpose financial companies (Sofoles). Ranges in the amount of loans to companies of Sofoles are similar to those of commercial banks, and the comparison of the NPL ratio of Sofoles with those of banks shows that NPL ratios of the former are higher than those of banks. It is interesting to note that NPL ratio for loans from 500 thousand to one million pesos is much higher for Sofoles than for banks (Chart 22).

Chart 20

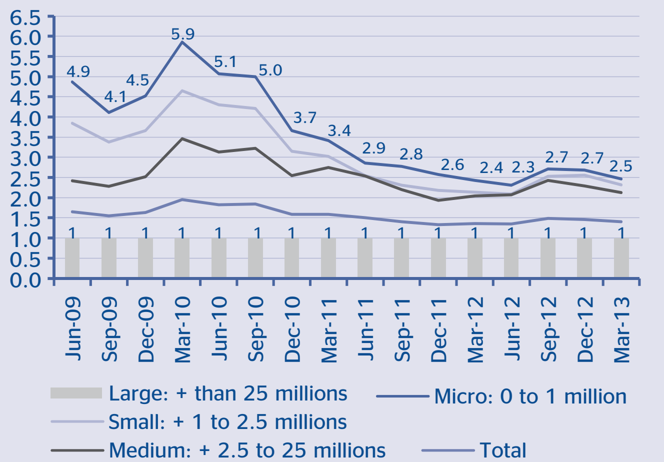
Corporate lending: NPL ratio according to the amount of the loan (% and figures in thousands of current pesos)



Source: BBVA Research with National Banking and Securities Commission (CNBV) data

Chart 21

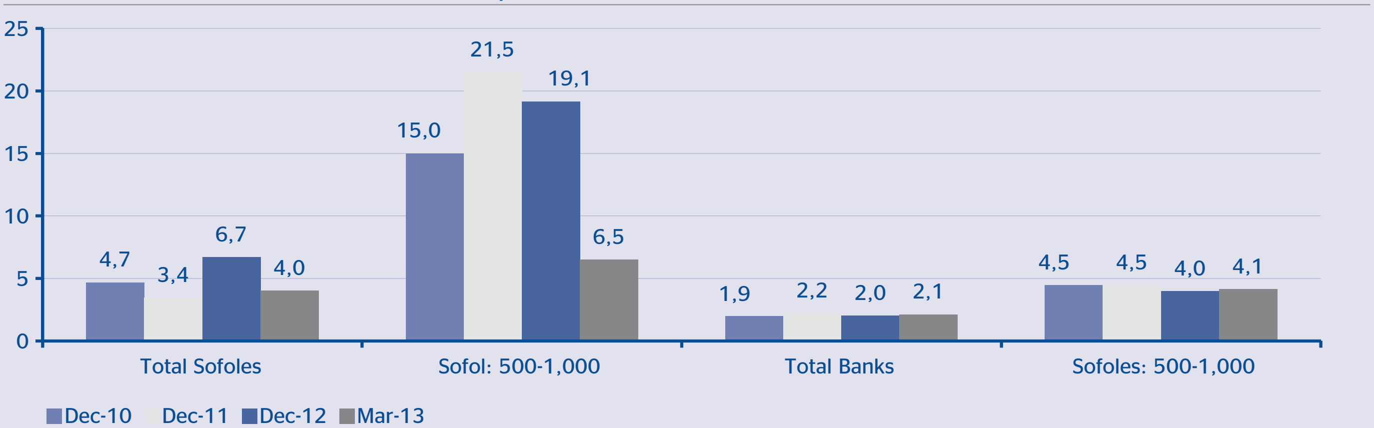
Corporate lending: NPL ratio of large companies vs NPL ratio of other company sizes



Source: BBVA Research with National Banking and Securities Commission (CNBV) data

Chart 22

NPL ratio of credit to companies granted by banks and by Sofoles: total credit balance and credit balance arising from loans between 500 thousand and 1 million pesos, %



Source: BBVA Research with National Banking and Securities Commission (CNBV) data

Evaluation

CNBV information shows that there is an important correlation between the NPL ratio and companies' size. It is possible the higher risk posed by smaller companies to any banking institution is not only reflected in the interests these companies pay, but also in the requirement of having their own guarantees or government guarantee schemes to mitigate contingencies and allow credit to flow towards these kinds of companies. It is also important not to overlook the fact that in many cases, smaller-sized companies do not have proper financial statements, which are necessary to evaluate their payment capacity, and this creates a problem of asymmetric information for banks. This could also mean that smaller-sized companies might show higher levels of delinquencies because banks lack of reliable information which allow them to adequately quantify the credit risk of those companies.

With these factors considered, it seems that the new guarantees program, announced at the end of the first quarter of 2013 by NAFIN and applicable to micro enterprises and Small and Medium Enterprises (SMEs)[3] which have not had access to credit and for those which could have better credit conditions, is adequately focused, as it focuses on the kinds of companies which represent the greatest credit risk. This program, however, might be insufficient due to the large number of microenterprises and SMEs which do not yet have banking credit, as explained in Box 5 of this report, and which may possibly apply for such credit. Therefore, it is also advisable to implement reforms which enable conditions to enforce mercantile contracts and to improve the execution of credit guarantees, in order to increase and enhance the offer of private financial intermediaries. These subjects are included in the Financial Reform Initiative recently sent to Congress by the Federal Government.

At the most critical points of the dip in the economic cycle, there is also evidence that smaller-sized companies are more sensitive to the adverse macroeconomic environment than larger companies. In order to quantify the greater sensitivity of smaller-sized companies to the economic cycle, it will be necessary to have more information than that which is currently available.

Finally, the rapid growth in lending to smaller-sized companies may be reflected in an increase of the NPL ratio in corporate lending, and such an increase can be on an important scale, as may be deduced, to some degree, by the NPL ratio of corporate credit granted by Sofoles.

[3] On March 27, 2013 the Minister of Finance, gave a speech in Mérida, Yucatán, providing details of the characteristics of the new rules for guarantees geared towards micro-companies and SMEs, and which is called "Nafinsa Solutions - more credit for more companies".

Box 2: Statistics of the National Banking and Securities Commission (CNBV) on Lending to SMEs by Federal State and Indicators in Judicial Proceedings Efficiency

In previous editions of ***Mexico Banking Outlook***, and in this edition (See ***Box 1: Corporate Lending: Relationship between Amount, Company Size and Non-Performing Loan Ratio***) we have analyzed part of the information published by the CNBV with the details of the credit granted to companies by commercial banks. This gives us a better idea of how the credit market works. Following that line of analysis, in this section we examine the CNBV's published data about bank lending to companies by federal states and its relationship with certain available efficiency indicators about corporate law proceedings.

CNBV statistics on credit to micro enterprises and SMEs by federal state

The information is available in two versions. The first is historical information about bank corporate lending balances for the period from September 2001 to July 2012, broken down by federal state and by other variables such as company size. The second version is published monthly since July 2009, and also includes credit balances by state and information on of new bank credits granted.

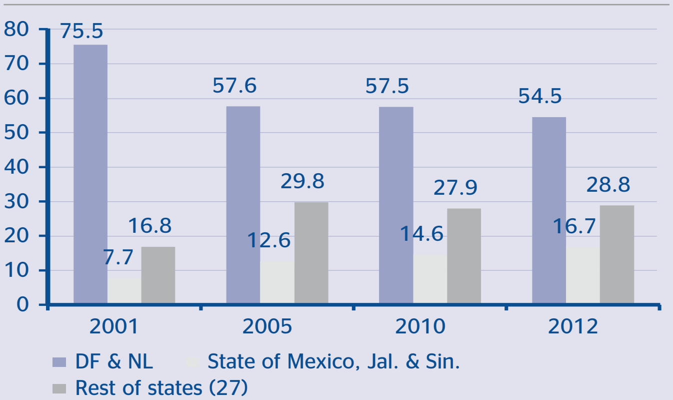
A similar trend is apparent in lending to micro and small enterprises: in 2001 over 80% of lending was concentrated in DF and NL, but in recent years their proportion has been reduced, so that by 2012 six states accounted for approximately 70% of this credit (Chart 24).

The monthly information on the amount of new corporate lending, available since 2009, confirms that the states which have gained share - Edo. de México, Jalisco, Sinaloa and Guanajuato - have been those which have received the largest flows of credit (Chart 25), and that this credit has been channeled towards a greater number of borrowers (Chart 26).

The CNBV's data also allow us to measure the relative importance of the balance of corporate lending compared with the balances of other credit types. Chart 27 shows that in 2010, for every 100 pesos of credit granted by multiple banks to the private sector, an average of 47 pesos was channeled into companies. Although 15 states reported figures above that level, certain differences can be noted between them. In Sinaloa and NL, for example, approximately 74 and 72 pesos out of every 100 pesos of credit to the private sector went to companies, while in Chiapas and Oaxaca, the amount of credit channeled towards companies is between 25 and 27 pesos for each 100 of credit to the private sector, respectively.

Chart 23

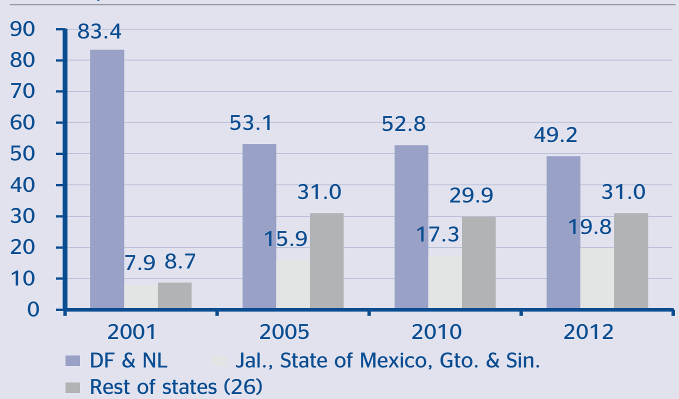
Patterns of penetration of corporate lending by federal state, information on balances.



Source: BBVA Research with CNBV data

Chart 24

Patterns of penetration of credit to micro enterprises and SMEs by federal state, information on balances



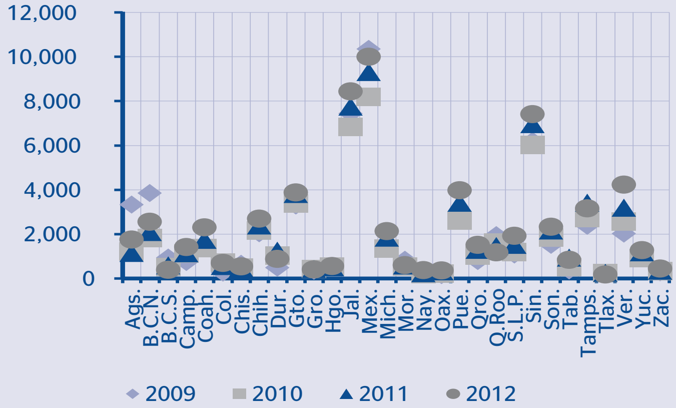
Source: BBVA Research with CNBV data

Historical information on balances shows that in 2001 slightly over 75% of corporate lending was focused on two states: Mexico City (Distrito Federal, DF) and Nuevo León (NL). In later years, the proportion of these states drops, although a high concentration of credit remains, since in 2012 five federal states (DF, NL, Edo. de México, Jalisco and Sinaloa) accounted for 71% of the total (Chart 23).

For micro and small enterprises, it turns out that an average of 21 out of every 100 pesos of credit to the private sector, are used by these companies, implying that credit to micro and small companies represented 42% of the balance of corporate lending in 2010. The highest amount of credit is channeled to this segment in Colima, with 36 pesos per every 100 of total credit to the private sector. Campeche has the lowest amount, with 5 pesos per every 100 of total credit (Chart 28).

Chart 25

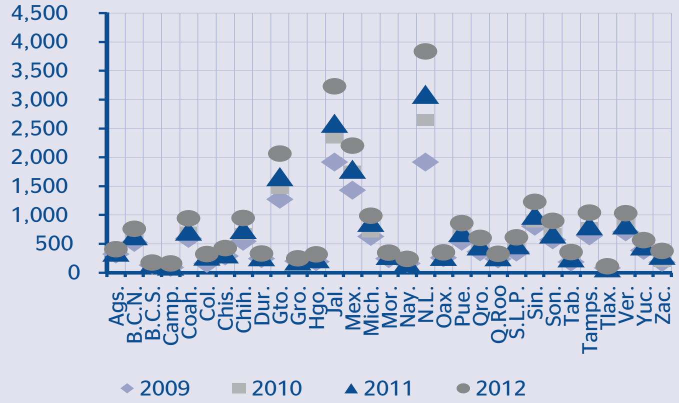
Average monthly credit granted to companies by federal states (Figures in millions of pesos of Dec-12)



Note: Mexico City (D.F.) has been excluded from the chart in order to present a clearer picture of the rest of the states. Source: BBVA Research with CNBV data

Chart 26

Monthly average of number of new borrowers by federal state



Note: Mexico City (D.F.) has been excluded from the chart in order to present a clearer idea of the rest of the states. Source: BBVA Research with CNBV data

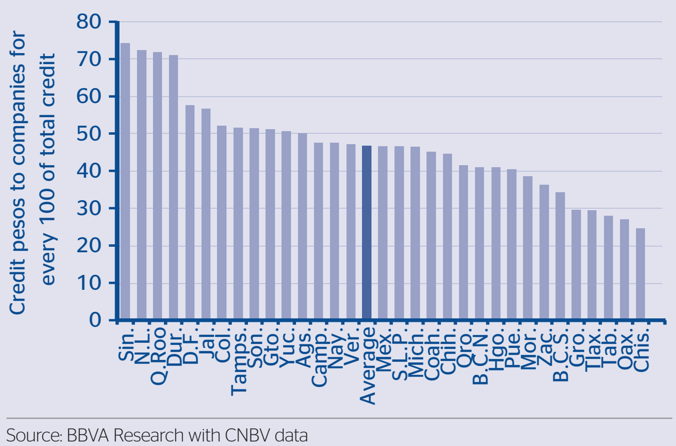
Local institutional development and corporate lending

The information published by CNBV on monthly volumes and flows of corporate lending by state can be compared with other indicators which can help to identify if the degree of credit penetration and its differences between states are associated with certain factors of supply, demand, institutional (legal) factors, or others.

One example are the indicators which have been published by the Financial Coordination Board (Consejo Coordinador Financiero, CCF) regarding the execution of corporate contracts and mortgages in the federal states of Mexico.[1] These indicators, which are published twice a year, concern credit risk and the costs of recovering credits past due when the legal system is used to enforce guarantees on the aforesaid credits. These indicators are also used to compare the institutional development at local level based on four factors: i) institutional quality; ii) duration of mercantile and mortgage proceedings; iii) efficiency in execution of sentences, and iv) sufficient and efficient application of human and material resources.

Chart 27

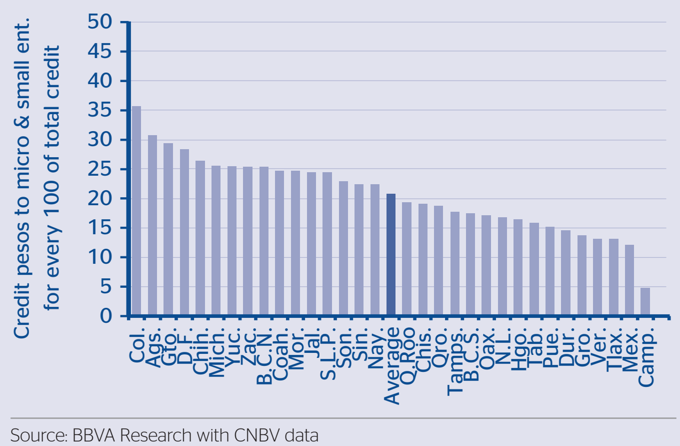
Ratio of corporate lending vs. balance of total credit to the private sector, 2010



Source: BBVA Research with CNBV data

Chart 28

Ratio of lending to micro and small enterprises vs. total credit to the private sector, 2010



Source: BBVA Research with CNBV data

1 The CCF is an institution, of which Mexico's Banking Association forms part, whose purpose is to carry out diagnostic tests to draw up recommendations for financial intermediaries and authorities to promote growth of the financial sector under competitive conditions.

In this article we analyze the CCF indicators of 2011, which report the scores of 2010 and are the most recently available. They evaluate the duration of mercantile proceedings based on a general index composed by 8 Indicators. Six of these indicators provide information on the speed of the actions and mercantile proceedings and the authority's efficiency in carrying out summons and notifications in actions related to the aforesaid procedures. The remaining two – which are not used in this analysis – provide similar information for mortgage contracts. All the indicators are expressed in scores which range from 0 to 5, where 5 is the highest score.

Since the data are limited in scope and in number, they are not appropriate for carrying out a traditional multivariate econometric analysis. Therefore, to ascertain if there is a relationship between the duration of the mercantile proceedings and the penetration and flow of corporate lending at federal state level, a simple correlation analysis is performed. Table 3 shows the correlation coefficients between the duration indicators of procedures with nine indicators of corporate lending calculated for 2010. Four of these indicators measure the degree of penetration of credit based on the balances, and five of them are measures of flows of numbers of credits and borrowers. The states of NL and DF were not included in the analysis, due to their high shares in corporate lending, they may alter the general results. In order to take into account the size of each state's economy, the correlations of the penetration indicators were weighted by the distribution of economic units, obtained from the 2009 Economic Census. For flow indicators, the distribution of GDP per state was used as a weighting factor. For each correlation, a test was carried out to determine if it is significantly different from zero.

Eight of the nine credit indicators show statistically significant coefficients but they are not above 0.5 in any case, indicating that the relations are not strong or compelling, although they do suggest a possible association between the variables. Two examples would be the credit distribution to companies (column 1) and of monthly amount of credit granted (column 7) with the inactivity of legal authorities in proceedings. In both cases, the correlations are significant and are the highest with a positive sign, indicating that the faster these proceedings by the legal authorities are, the more dynamic corporate lending will be. In order to grasp the dimension of these ratios' magni-

Table 3

Correlation between institutional indicators and credit penetration and flow indicators

Institutional indicators of length of proceedings	Indicators of credit penetration (2010)[1]				Indicators of credit flow (2010)[2]				
	1	2	3	4	5	6	7	8	9
	Distrib. of balance (%)	Distrib. of balance to micro and small enterprises (%)	Corporate lending as % of total credit to the private sector	Credit to micro and small enterprises as % of total lending to the private sector	Real annual growth of corporate loan book (%)	Real annual growth of micro and small enterprise loan book (%)	Monthly average of amount of granted credit	Monthly average of # credits granted	# new borrowers
Duration of proceedings	**0.4102***	**0.3503***	0.1709	**-0.3162***	**0.3594***	0.2053	**0.3909***	0.2064	0.2525
Speed in mercantile executive actions	0.2208	0.1764	-0.1671	**-0.3487***	0.1626	0.2119	0.2553	-0.122	0.1349
Speed in mercantile ordinary actions	0.1991	0.1621	-0.1417	-0.2812	0.2357	0.1706	0.2195	-0.1424	0.0634
Inactivity of legal authority in mercantile proceedings	**0.4350***	**0.3768***	0.1176	-0.2825	0.2209	0.2324	**0.4535***	**0.2518**	**0.3476***
Speed in execution proceedings	0.2522	0.2558	**0.3072***	-0.0122	**0.4302***	0.2053	0.1864	0.2771	0.1711
Summons & notification in mercantile executive actions	0.2402	0.1737	0.1677	-0.2636	**0.3277***	0.1391	0.2116	0.1876	0.0813
Summons & notification in mercantile ordinary actions	0.2814	0.2291	0.1841	-0.1866	**0.3324***	0.1659	0.2545	0.2184	0.1502

1 Correlations weighted by distribution of economic units by entity
2 Correlations weighted by distribution of GDP per entity
* Significant correlations at 90%
Source: BBVA Research with CNBV data

tudes, correlations were calculated with other variables which are usually relevant in assessing credit performance, such as GDP or employment. In these cases, the relations were not very clear either. For example, the correlation ratio between the distribution of corporate lending and the number of workers registered in the Mexican Social Security Institute (IMSS) by federal state is 0.90. However, this same variable compared with GDP showed a correlation of 0.17.

The general duration indicator has a significant negative correlation with credit to micro and small enterprises as a percentage of total lending to the private sector (-0.32), but a positive correlation with other variables such as: distribution of corporate lending (0.41), distribution of lending to micro and small companies (0.35), annual growth in portfolio (0.36) and monthly volume of credit granted (0.39). Further details of these relationships are shown in Charts 29 and 30. Chart 29 shows that although states such as Campeche, Tamaulipas or Edo. de México have the highest scores in duration of proceedings, lending to micro and small enterprises against total lending is lower than in states with lower scores, which is the opposite of what one would expect to happen. Chart 30 shows that generally speaking, states with the higher scores granted larger credit volumes.

As far as the detailed indicators of proceedings' duration are concerned, significant correlations are observed in four of them: i) inactivity of legal authorities in proceedings; ii) speed in execution proceedings; iii) summons and notification in mercantile executive actions; and iv) summons in mercantile ordinary actions. Charts 31 and 32 show the relationship between the first two indicators with the number of credits granted and the real growth in the corporate loan portfolio, respectively. Chart 31 indicates that a better score in inactivity of legal authorities is associated with a higher number of credits granted to companies, such as the cases of Edo. de México, Sinaloa, Coahuila and Guanajuato. Campeche would be the exception, as it shows a high score and few credits granted. Perhaps this case is more related to the low level of activity in this state or to a relatively low number of companies which received new credit. But as we have said, the nature of these data is not suitable for analyzing the impact with a larger set of explanatory variables.

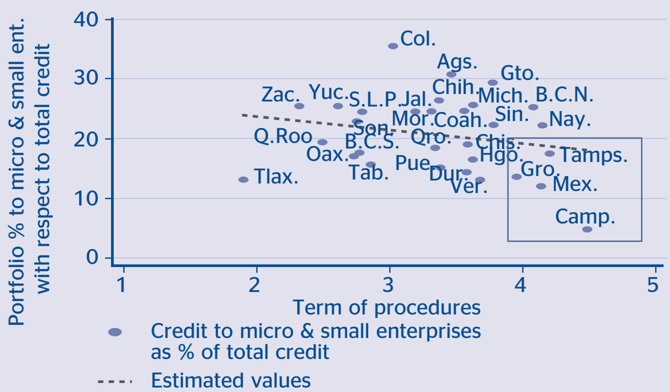
Comparison with other indicators

As we can see in the previous analysis, the evidence about the relationship between credit and institutional efficiency is not compelling, partly due to the paucity of the available data. But if we compare with other institutional indicators, such as the Doing Business Report on Mexico prepared by the World Bank, correlation ratios with similar magnitudes are obtained, reinforcing the results obtained with the CCF data.

Although these results reflect certain positive relationships between the speed of the proceedings and credit penetration and flow, this relationship is not entirely clear and in fact does not imply causality. It is noteworthy, for example, that lending to micro and small enterprises against total lending has a negative and significant correlation with two of the institutional indicators. One possible explanation is that generally speaking, banks might not take into account the institutional conditions of the state when granting credit to micro and small enterprises, given that a large proportion of the credit to this sector has guarantees from development banks. This is revealed by the fact that, according to the Banking Survey on Financing to Micro, Small and Medium-Sized Enterprises produced by CNBV in 2009, 67% of the total corporate loan book is backed by government guarantees.

Chart 29

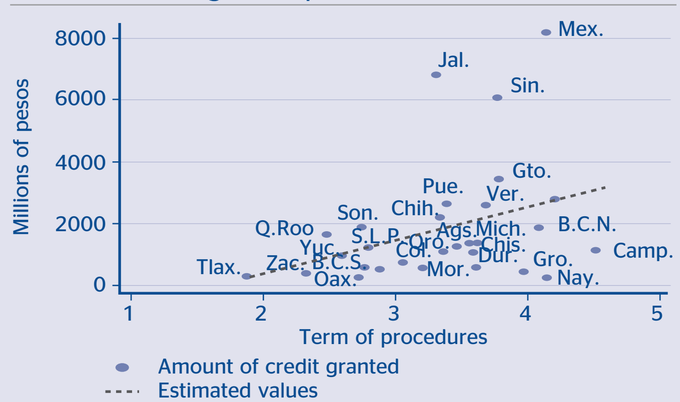
Credit to micro and small enterprises as % of volume of total lending 2010



Source: BBVA Research with CNBV data

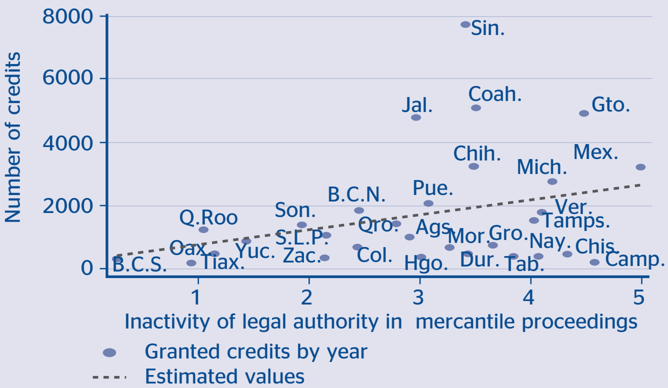
Chart 30

Volume of credit granted per state



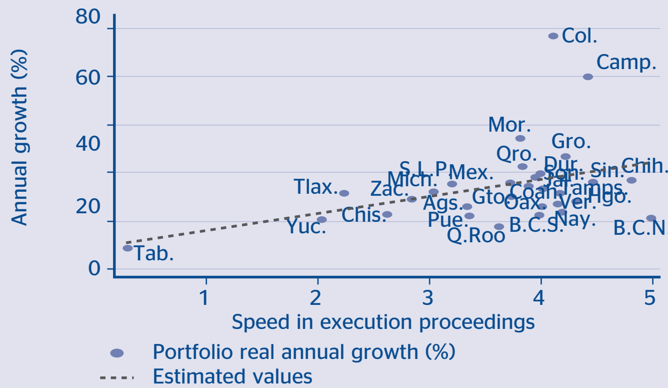
Source: BBVA Research with CNBV data

Chart 31
Monthly average of credits granted in 2010



Source: BBVA Research with CNBV data

Chart 32
Annual growth in corporate lending



Source: BBVA Research with CNBV data

Evaluation

The information of CNBV on corporate lending by federal state is useful to analyze lending patterns in different regions of Mexico. The data show that despite certain improvements in distribution and monthly flows of corporate lending, in general there is a high concentration in a small number of states. However, it is important to bear in mind that there is another limitation to this analysis' results. When a company asks for credit, this is registered in the state where the headquarters of the company are located, which may not be the place where the resources are used. This may overestimate the concentration of credit in states such as Mexico City (DF) or Nuevo León (NL). Unfortunately, there are no further data that may enable us to determine the destination of the resources.

CNBV's data can also be used to study the relationship between corporate lending with each state's socioeconomic and institutional conditions, which, according to economic theory, could affect credit patterns. In this section, the relationship between certain institutional conditions at local level and credit penetration is analyzed, using the indicators on the duration of mercantile proceedings published by the CCF.

The analysis performed shows that the duration of mercantile proceedings may be a relevant factor to be taken into account by financial institutions when they take decisions on who and where to grant corporate loans. In theory, if the local authorities are efficient and the procedures for executing unfulfilled contracts are expedite, then it is natural to assume that a financial institution has more incentives to grant a credit to a company in that location. Greater speed in execution proceedings in that state can prompt a reduction in credit risk and in transaction costs, and, therefore, an increase in credit or an improvement in its conditions when compared with another state which might not have these advantages. Therefore, we would expect that the better scores a state has in duration indicators, the higher credit penetration or flow it will have.

Consequently, we take a positive view of the initiatives of the Financial Reform geared towards improving the efficiency of contract execution procedures and strengthening guarantee schemes (for further details, see section 3.d ***The importance of improving the degree of compliance with contracts and execution of guarantees***) and could incentivize financial institutions towards granting more credit. These initiatives should also allow certain development banking resources to be reassigned towards other activities or segments with difficulties in accessing financing, as is also being proposed in the Financial Reform (for further details ,see section 3.c ***Development Banking***).

As noted above, the evidence presented is not entirely clear but it does show certain patterns which undoubtedly deserve a more in-depth analysis in the future, when more data have become available and other techniques can be applied to analyze them.

3. Special Topics

3.a Financial Reform Initiative of May 8, 2013

A few weeks ago President Enrique Peña Nieto presented a Financial Reform Initiative (Initiative) to the Senate and House of Representatives for discussion and approval. This Initiative is comprehensive in scope and has four main pillars or objectives:

- To ensure that Development Banking complements commercial banking to the benefit of Mexican families. For that purpose, the aim is to provide development banks with greater regulatory and financial flexibility.
- To promote more competition in the financial system, in order to increase the supply of credit and to reduce interest rates. A number of important measures, which include: banning sales of financial products conditional on the acquisition of other products, establishing measures to give financial services consumers greater freedom to choose and migrate their financial products to the financial institutions which grant the best conditions, and to create a Financial Institutions Bureau within the CONDUSEF so that users can easily access relevant information on those institutions.
- To achieve greater certainty in the execution of contracts and to strengthen the guarantees scheme, as necessary measures to incentivize credit supply's growth. In order to achieve this goal, the idea is to simplify the systems for granting and executing credit guarantees and to introduce improvements in the legal framework which regulates corporate bankruptcy proceedings.
- To strengthen the banking sector, in order for the sector to always grow in a sustained way. Accordingly, it is proposed to enact the rules for capital formation and quality established in the Basel III Regulatory Framework, to create a Banking Liquidity Regulation Committee, to standardize and facilitate banking bankruptcy services, and to reinforce mechanisms of coordination and cooperation between financial authorities.

In order to comply with these goals or pillars, the initiative is made up of 13 decrees through which it is proposed to modify 34 federal laws or codes (Table 4). Given the important role this Initiative may play in the banking sector's activities, the following sections of this edition of ***Mexico Banking Outlook*** present an in-depth analysis of some of the main elements and evaluations of its impact, based on statistics concerning Mexico which can enable to complete the analyses underpinning the initiative and the proposed measures.

Our initial evaluation of this Initiative is positive, as we see it contains several recommendations which we have addressed in previous reports, geared towards improving the conditions for granting credit, like promoting growth in new platforms for providing financial services such as correspondents (February 2010), improving and increasing available data from credit bureaus (March 2011), reducing times and costs for registering credit guarantees (July 2010 and November 2011), and the adoption of various prudential measures to increase the stability of the Mexican banking system (February 2010, July 2010 and June 2012).

Nevertheless, it is important to note that there are two elements which make it difficult to carry out any analysis of the Initiative's impact at the present time. First, the Initiative is a proposal which is still being analyzed by lawmakers, who in turn can adjust the decrees of the Initiative in accordance with their constitutional powers. Second, it is proposed in the Initiative that various details concerning the way in which the financial reform will operate will be defined through secondary regulation or other general provisions which financial authorities will establish until the initiative is approved and in accordance with the dates which will be defined. One important example is a transitory article of the decree for the Strengthening of the CONDUSEF which orders the Federal Competition Commission (CFC), within 120 calendar days from the publication date in the Official Gazette of the Federation, to carry out a study on the competition conditions in the financial system and to make the pertinent recommendations.

Other relevant questions are the provisions of the Banking Liquidation decree which propose that the Ministry of Finance and Public Credit (SHCP) should regularly assess the performance of multiple banking institutions with regard to "multiple banking institutions' degree of orientation and compliance with the development of their social purpose of supporting and promoting the country's productive forces and the growth in the national economy", according to guidelines determined and issued by SHCP for that end, and that financial authorities should take into account such assessments of multiple banking institutions' performance "according to each individual case, to decide on the granting of authorizations which they are responsible for granting to the aforesaid institutions" or to establish "parameters for carrying out operations with securities performed by the aforesaid institutions on their own behalf".

The next four sections are organized in accordance with the general objectives of the aforementioned Initiative. In this edition we have also included - in Box 5 - an estimate of the possible impact of the financial reform in corporate lending, which is in keeping with what is, generally speaking, our positive opinion of the initiative but subject to the limitations that were binding when this exercise was performed- as neither the definitive reform nor the appropriate data were available. Lastly, Box 6 shows certain statistics on the financing needs of micro enterprises in Mexico, which suggest demand aspects which are of relevance in promoting any financial reform.

Table 4

Components of the Financial Reform Initiative

Decree	Federal laws and codes which are the object of reforms, additions and/or repeals
1. Strengthening CONDUSEF	Financial Services User Protection and Defense Act, Transparency and Ordering of Financial Services Act, Credit Institutions Act (LIC), National Fund for Workers Consumption Institute Act.
2. Saving and popular credit correspondents	Saving and Popular Credit Act and Act for the Regulation of Activities of Cooperative Saving and Lending Societies.
3. Credit unions	Credit Unions Act.
4. Development banking	LIC, Regulatory Law of Section XIII Bis of Section B, of Article 123 of the Political Constitution of the Mexican United States, the National Financial Act, National Foreign Trade Act, National Works and Public Services Bank Act, National Bank of the Army, Air Force and Navy Act, National Savings and Financial Services Act, Federal Mortgage Society Act, Rural Funding Act, and the General Securities and Credit Transactions Act.
5. Granting and execution of guarantees	Code of Commerce, LGTOC, and Judicial Authority of the Federation Act.
6. Corporate bankruptcy proceedings	Corporate Bankruptcy Act.
7. Warehouses and SOFOMES	The General Auxiliary Credit Activity and Organization Act, and LGTOC.
8. Stock market	Securities Market Act (LMV).
9. Bank liquidation	LIC, LCM, Protection of Bank Savings Act, and LMV.
10. Investment funds	Investment Companies Act, and LMV.
11. Sanctions and foreign investment	National Banking and Securities Commission Act, Act for Regulation of Credit Information Companies, Mexico Banking Act, Savings Systems for Retirement Act, General Act of Institutions and Mutual Insurance Companies, Federal Finance Institutions Act, Insurance and Guarantee Institutions Act, Foreign Investment Act, and the Federal Criminal Proceedings Act.
12. Financial groups	Regulation of Financial Groups Act (new act).
13. Guaranteed credit	Transparency and Promotion of Competition in Guaranteed Credit Act.

Source: Ministry of Finance and Public Credit

[1] On May 20, 2013, the CFC issued a favorable ruling on the Initiative, considering that it includes various recommendations made by that authority, and recommends that it be approved without further delay. For further details, see Presidency, Ex Officio PRES-10-096-2013-054, CFC, May 20, 2013. However, the version of the reform which comes into force would be reviewed again by the CFC.

3.b. Financial Reform Initiative for Reinforcing Development Banking

Introduction

In various countries, development banking (DB) has been an important instrument used by governments to drive economic growth through the granting of credit and other programs geared towards households and companies not covered by commercial banking. This has also been the case in Mexico. Indeed, there has been sustained growth in the DB lending portfolio in recent years, at growth rates that are higher than those observed in the commercial banking portfolio.

With the increasingly more important role played by DB in the development of the Mexican financial system, it has been necessary to make certain changes to strengthen these institutions. For example, in order for the DB to be able to properly focus resources used for financing households and companies, and also to be able to support, manage and retain high level human capital or to increase transparency in their operations.

The Financial Reform Initiative (Initiative) geared towards DB covers some of these needs, and its main purpose is to provide an extra driver of growth to this sector, granting it greater clarity and precision to its mandate in order for it to cover the strategic sectors which have limitations to obtain credit. In order to understand the importance and scope of the proposal and the changes established in it with regard to DB, the first part of this section outlines the current situation of DB in terms of their size and their institutional framework; the second analyzes some of the present limitations of DB, and the third describes the main elements of the Initiative for reinforcing it.

3.b.1 Development banking: important sector for the Mexican banking sector

At the end of March 2013, the six DB which operate in Mexico[1] held assets of slightly over 1.1 billion pesos, accounting for 15.5% of the total assets of the banking system (Table 5). In March 2013, the largest of these six institutions was Banco Nacional de Obras y Servicios Públicos (BANOBRAS), which accounted for 38.7% of total assets in the sector, followed by Nacional Financiera (NAFIN) and Banco Nacional de Comercio Exterior (BANCOMEXT), with 29% and 17.1%, respectively. The three other banks –Sociedad Hipotecaria Federal (SHF), Banco Nacional del Ejército, Fuerza Aérea y Armada (BANJERCITO) and Banco del Ahorro Nacional y Servicios Financieros (BANSEFI) – are smaller, and their shares of assets are 8.5%, 4.3% and 2.4%, respectively.

According to the data of the National Banking and Securities Commission (CNBV), the lending portfolio is concentrated in four DB. At the end of March 2013, BANOBRAS had the largest share (50.5% of the total credit balance granted by DB), followed by NAFIN (23.3%), BANCOMEXT (14.8%) and SHF (7.1%). The credit granted by these four banks represented 95.7% of the total credit granted by DB. BANJERCITO (4.2%) and BANSEFI (0.1%) had very small shares in DB lending activity.

[1] In Mexico, development institutions include, in addition to the six development banks analyzed in this section, the so called development trusts. The main development trusts are the Agricultural and Rural Finance Trusts: FIRA and FINRURAL.

Table 5

Development banking assets, billion pesos of March 2013

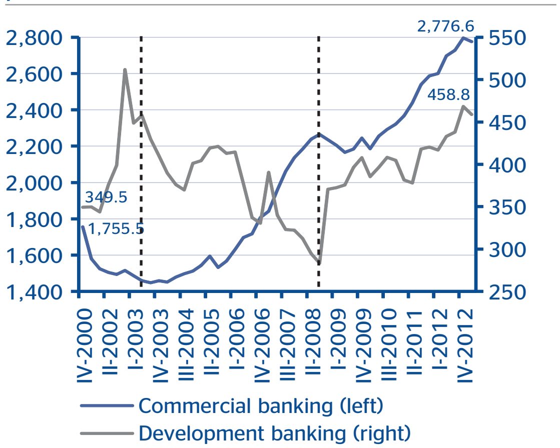
Institution	2001	2005	2009	2010	2012	Mar-12	Mar-13	% Share March 2013
BANOBRAS	402.6	308.2	323.7	325.9	360.7	367.1	324.0	38.7%
NAFIN	230.1	190.9	309.2	290.6	360.1	325.4	433.2	29.0%
BANCOMEXT	150.0	104.0	138.4	153.7	219.4	202.2	191.5	17.1%
SHF	0.0	151.9	116.9	108.3	98.1	101.8	94.5	8.5%
BANJÉRCITO	24.2	20.4	36.0	37.0	42.5	49.7	48.0	4.3%
BANSEFI	0.0	13.2	16.7	16.4	22.2	28.6	26.9	2.4%
Total	**806.9**	**788.6**	**940.9**	**931.9**	**1,102.9**	**1,074.9**	**1,118.1**	**100.0%**
Commercial banking assets	**3,711.8**	**4,374.1**	**5,379.8**	**5,662.0**	**6,107.9**	**6,042.6**	**6,099.4**	
% DB against banking system (DB + Commercial Banking)	**17.9**	**15.3**	**14.9**	**14.1**	**15.3**	**15.1**	**15.5**	

Source: BBVA Research with CNBV data

Over the last 12 years, the DB portfolio has reported mixed performances. Chart 33 shows that the volume of total lending in DB reached its highest level in 2002, and then showed a downturn until 2008. In fact, Chart 34 shows that negative growth rates were reported during that period. From December 2008 on, however, there was a change of trend, and even considering the falls registered in 2010 and 2011, the average annual growth in the DB portfolio between 2008 and 2013 was higher than that of commercial banking: 9.6% vs 5.1%.

Chart 33

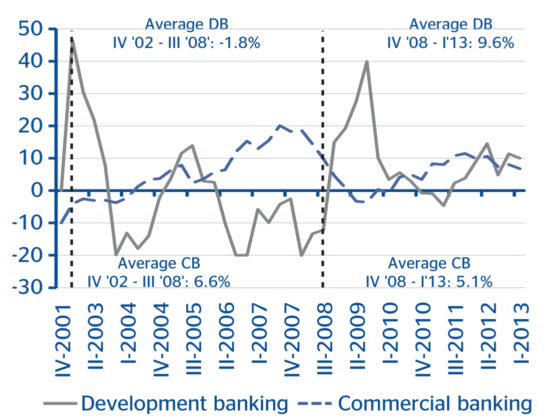
Total balance of development banking and commercial banking, balances in billions of pesos, of March 2013



NB: does not include lending portfolio as Federal Government finance agent
Source: BBVA Research with CNBV data

Chart 34

Real annual percentage growth in total portfolio, commercial and development banking



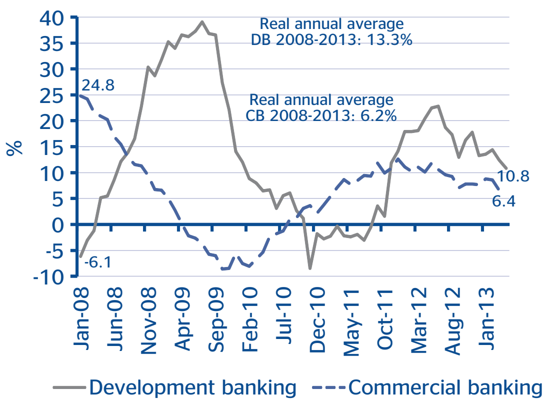
Source: BBVA Research with CNBV data

The buoyant tendency in the DB portfolio in recent years has been mainly fuelled by direct credit granted to the non-banking private sector. As shown in Chart 35, between 2008 and 2013 the portfolio to this sector has grown 13.3%, more than double the growth in the commercial banking portfolio in the same period (6.2%).

In addition to direct credit, the DB has other mechanisms to Impulse private sector's access to financing, such as second-tier guarantees and credit granted to financial intermediaries ("crédito impulsado" or promoted credit). According to the Ministry of Finance and Public Credit (SHCP), the volume of direct and promoted credit sponsored by DB has reported sustained growth and at the end of 2012 it amounted to 858.8 billion pesos (Chart 36).

Chart 35

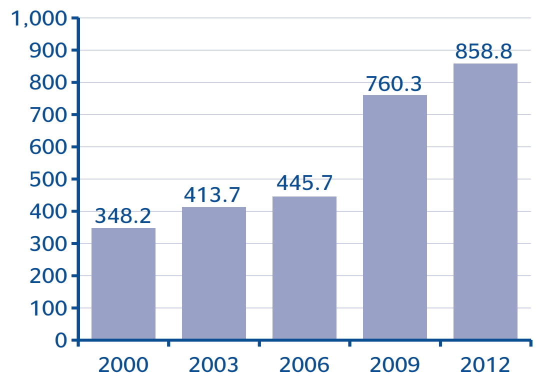
Real annual percentage growth of the portfolio to the non-banking private sector, commercial and development banking



Source: BBVA Research with CNBV data

Chart 36

Balance of direct and promoted credit by DB to the private sector, billions of pesos, of May 2013



Source: BBVA Research with SHCP data

3.b.2 Institutional framework

DB operations are regulated by the Credit Institutions Act (LIC), by the respective Organic Acts (LO) of each DB, by the rules and standards issued by the Bank of Mexico and the CNBV, and by other competent laws and standards.

The LIC contains the general provisions which regulate DB activities, while the LO specifically establish their mandate, responsibilities and structure of management bodies, as well as other matters. These are some of the main elements contained in the current regulatory framework:

- The DB are entities of the Federal Public Administration with their own legal personality and capital, and which have the main purpose of providing access to personal and corporate finance, as well as providing technical assistance and skills.
- The DB must preserve and maintain their capital, and guarantee that their operations are sustainable.
- The minimum capital of each DB is determined by the Ministry of Finance and Public Credit, and can be modified at the behest of its Governing Board and through agreement with the aforesaid Ministry.
- The Managing Director and Governing Board are responsible for managing the DB. The Managing Director is appointed by the Federal Government through the Minister for Finance and Public Credit. In turn, the Ministers of Government Ministries related to the mandate or objectives of each DB act as members of the Governing Board on a majority basis.
- Each DB has a human resources committee, which issues, gives opinion, and proposes the bases for preparing wage scales and benefits in accordance with general working conditions, applicable to both base and trusted (de confianza) workers. Such general conditions are established in the Law Regulating Heading XIII Bis of Section B of Article 123 of the Constitution.

- The DB have to prepare annual operating and financial programs in accordance with the guidelines of the National Development Plan (PND) and the National Financing for Development Program (PRONAFIDE), an annual report regarding compliance with the aforesaid annual programs and a report on their financing and guarantees.[2] The DB sends these reports to the SHCP, which in turn sends them on to the Congress.
- Every year, the SHCP has to publish two external studies carried out on DB or development trusts, with the purpose of evaluating that they: i) promote financing of sectors defined in their laws and contracts not covered by private financial intermediaries; ii) have mechanisms to channel persons who can be awarded credit by private financial intermediaries towards these intermediaries, and iii) harmonize actions with other public sector entities to make a more effective use of resources.

The institutional framework of the DB is the result of a series of reforms which took place mainly in the last two decades of the twentieth century, arising from the need to restructure and strengthen these institutions due to the financial difficulties they were facing at that time.[3] In the twenty-first century, however, there have been relatively few changes in the system and there are still certain institutional limitations. Such limitations regard, for example, the clarity of their mandate, their role in complementing or substituting commercial banking, and their transparency and accountability practices.

3.b.3 Limitations on the current institutional framework for development banking

Mandate and powers

The DB are executive arms of the Federal Government's public policy, whose activities can have a higher or lower emphasis depending on each new administration's priorities. Such dependence can give rise to a certain degree of discontinuity of activities and changing of objectives with each new government. Furthermore, such discontinuity may be worsened by the appointment of new members of the Governing Board, who, in turn, may appoint different trusted employees who will be subject to the aforesaid general contracting and remuneration conditions. There is also a latent risk of the operations in the sector causing resources to be used for electoral or other purposes, if the mandate is imprecise.[4]

On the other hand, the DB is authorized to carry out – in addition to permitted operations for all credit institutions – other operations which may be necessary to appropriately cover their sector and compliance with their functions and objectives. Like commercial banking, however, it is subject to restrictions on cross-trades which may be carried out between banking institutions to artificially increase their capital. Moreover, it faces more restrictions than commercial banking on carrying out investments in the share capital of certain kinds of company.

The DB mandates do not clearly establish that DBs have to carry out complementary activities and not compete amongst themselves. It would be ideal for the mandates to be established in such a way that the action of the DB might be focused on resolving market failures. The DB can have an important effect in counter-cyclical actions, so that when the financial system is at a low part of the cycle the DB can expand credit, and vice versa. The mandates of the DB do not contain references to this possible counter-cyclical role.

[2] All operating and financial programs require the approval of the Ministry of Finance and Public Credit.
[3] Huidobro (2012) has written a historical outline of the origin and evolution of the DB in Mexico.
[4] Brazil and India are two emerging countries where these kinds of problems have arisen and which have been analyzed by academic economists For more details refer to: on Brazil (Sakurai and Menezes-Filho, 2011) and on India (Khemani, 2004). Ebeke and Ölçer (2013), meanwhile, document the existence of economic cycles associated with government elections in low-income countries, and the mitigating effect in such cycles associated with fiscal rules or macroeconomic adjustment programs with the International Monetary Fund.

Transparency and accountability of development banking

Every year, the SHCP must request two independent evaluation studies regarding the development institutions. At the time this document went to press, only six studies were available for the period between 2009 and 2011; five of them to DB (no study has been carried out about SHF) and one about another development institution (FIRA). Given the number of development institutions operating in the country, one study - at most - is carried out on each DB or development trust every six years on average.[5] Furthermore, in these studies carried out on the DB, there has been no evaluation of whether the guarantees provided by them promote the granting of credit to people who might not have obtained it otherwise.[6]

The lack of sufficient studies on the performance of the DB limits the possibilities of the institutions themselves having some form of feedback regarding their strategic programs and plans, and makes it difficult to identify possible areas for opportunity and improvement. Moreover, the lack of objective analysis reduces the knowledge of DB programs amongst the potential beneficiary population, which is a very important factor, taking into account that only 32% of total companies in Mexico are familiar with the production chain program and 17% of them with the guarantees program, both implemented by NAFIN. The percentage of micro companies which are familiar with these programs is even less: 28% and 14% respectively.[7]

Not all the information generated by the DB is maintained in public databases, as happens with similar information requested from private banks. This is the case, for example, with information referring to its operations, and indicators which measure the services with which each institution provides its target sector. Consequently, the public information which society has regarding each one of the DBs to monitor its performance is less than that which is available for commercial banking.

In short, although DB currently have an important presence, this needs to be improved, and certain aspects of their activities have to be made more efficient. This is why the Federal Government commissioned a reform initiative on development banking. The main points of the proposed initiatives are addressed in the following section.

Reform initiative of development banking as a measure to promote greater participation in economic activity

Three of the most important aspects covered by the DB are as follows: i) redefining their mandate; ii) flexibilization and improvement of the DB's operation; and iii) attracting and retaining human resources.[8] These points are outlined in detail below.

1) **Redefinition of mandate**. It is proposed to replace the wording of "preserving and maintaining its capital, guaranteeing the sustainability of its operation" with "seeking the sustainability of the institution". It is also proposed that the mandate should include the objective of providing access to credit and financial services to those sectors which have restrictions on obtaining it.
2) **Greater flexibility in operation of development banks**. It is established that the internal compliance body (OIC)[9] of each bank will no longer take part in credit decisions - as has been the case until now- but only in administrative ones. It is proposed that restrictions on cross-trades should be eliminated in order to extend financing options granted by the DB and help to support financial entities which might need to reinforce resources during a contingency. It is also proposed to eliminate restrictions so that DB institutions can carry out investments in the share capital of other types of companies to

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[5] Consultation performed on June 5, 2013 at the following website: http://www.shcp.gob.mx/POLITICAFINANCIERA/banca_desarrollo/publicaciones/Paginas/EVALUACIONESDEBANCADEDESARROLLO.aspx

[6] In the case of FIRA, in addition to the aforementioned evaluation study, certain evaluations have been carried out regarding the impact of the programs which channel their supports. They are available at: http://www.fira.gob.mx/Nd/EstudiosOpinion.jsp#

[7] Source: National Study on Competiveness, Financing Sources and Use of Financial Services of Companies (ENAFIN), CNBV.

[8] Other proposals also addressed by the initiative are: i) to redefine the concept of financial brokerage, in order to include the operation deficit plus the net reserves; ii) redefining the powers of the Ministry of Public Affairs (SFP) and the CNBV, in order for the SFP to specialize in administrative questions and for the CNBV to cover banking operations; iii) changes in the Act of BANOBRAS for it to be able to finance infrastructure and public services projects without prior authorization of the Ministry of Finance and Public Credit; iv) and changes in the laws of the Federal Mortgage Society to give it a Federal Government guarantee as with the rest of the DB.

[9] The OIC is part of the Ministry of Public Affairs. In all Federal authorities, this is the body responsible for ensuring that administrative process such as purchases and tendering are carried out correctly. In the DB, the OIC is also currently involved in credit decisions, which in practice limits the scope of action by government employees.

which commercial banking is not subject. Lastly, the initiative proposes that greater clarity be given regarding cases in which the DB can perform investments with venture capital.

3) **Attracting and retaining human resources**. One of the factors which limit DB activities, according to the Preamble of the Initiative, appears to be the difficulty DB have in recruiting and effectively organizing the human resources with the appropriate technical profile. Therefore, the Initiative establishes measures which are gearedtowards retaining and developing human capital, including the following:

   - That the human resources committees of each DB should propose wage scales and benefits and other related matters based on the situation of the labor market in the Mexican financial system and not in accordance with the general work conditions established by the DB.
   - Having a specific manual of remuneration, retirement, rights and obligations for trusted workers, so that their functions are aligned with the institution's objectives. For that purpose, the Initiative considers revising article 43 Bis of the Credit Institutions Act and article 3 of the Law Regulating Heading XIII Bis of Section B, of Article 123 of the Political Constitution of the United States of Mexico.
   - That it should be the Governing Board and not any other government body which should approve the labor policies related to salaries, benefits and extraordinary bonuses, based on the proposals of the Human Resources Committee.

In addition to this Initiative, the Government has carried out a series of actions to promote credit from the DB to the private sector. These actions, shown in Table 6, have implied a flow of credit of 241.1 billion pesos between December 2012 and May 2013. The goal established is that the direct credit promoted by the DB should reach a volume of 1 billion pesos by the end of 2013, which represents real annual growth of 10% against the previous year. It is important to note that this expected growth is similar to the pattern reported in the direct credit portfolio to the private sector granted by the DB in recent years.

Table 6
Main actions of the DB from December 2012 to May 2013

Institution	Credits granted	Sectors benefitted	Additional actions
BANCOMEXT	55.7 billion pesos	Automobile and vehicle parts, assembly plants and tourism	Support for creation and development of industrial estates for the assembly part export industry
BANOBRAS	21 billion pesos of credits and 10 billion pesos of support through the National Infrastructure Fund	Roads, security works, electricity, transport and supply of drinking water	Currently has 622 borrower municipalities
Financiera Rural	15 billion pesos	Agricultural and livestock sector	Customer service in underprivileged and highly underprivileged municipalities
NAFIN	139.4 billion pesos	Small and medium sized companies	Continuity of guarantees and production chain programs

Source: SHCP

Evaluation

The goals for the DB established and recently announced by the Federal Government for 2013 complement the proposals of the Initiative and reinforce the role of the DB as the executive arm of the public policies geared towards increasing financial penetration in Mexico. Besides, the aforementioned measures can be considered to be prudent, given that the 10% growth expected in the DB lending portfolio is in line with what is observed in recent years. Therefore, this does not represent a risk for the financial solidity of the sector.

The Initiative contains a number of positive measures which clarify certain powers already considered in the LIC, in the LO of each BD or which were already being performed in practice. This is shown by the real annual growth of 10.2% in the DB lending portfolio from December 2008 to date.

As far as the change of mandate is concerned, the proposal makes a precision which may be deemed as necessary to increase the flexibility of DB operations. This is because in the current drafting, it may be easy mistaken the pursuit of prudent resource management as being the main objective of these institutions. With the proposed text, it is clarified that the fundamental purpose of the DB is to facilitate access to credit and financial services to individuals and firms, as well as providing them with technical assistance and skills. Furthermore, the fact that the OIC is no longer involved in lending matters will allow government employees to act with greater flexibility to reach the mandate to which they are subject. It is also proposed to clarify that in exercising its functions, the aforesaid institutions will have to ensure that the institution is sustainable, through the efficient, prudent and transparent channeling of resources and the sufficiency of the guarantees established in their favor, without being excessive. Although this is similar to that of the DB's purpose of maintaining their capital, it seems to be necessary for them to have greater operating flexibility so they can achieve the aim of expanding credit towards sectors with restrictions for obtaining it; and that, in turn, they may assume measurable risks which do not affect their sustainability.

However, probably the most important changes in the Initiative are focused on strengthening the powers of the Governing Board to establish and approve remuneration and benefit schemes which are applied to their trusted personnel, in order to allow the DB to be able to contract and maintain specialized banking employees.

On the other hand, it would be positive for the initiative to define in more detail that the DB have to play a complementary role to commercial banking, that they must be focused on resolving market failures and that they should play a counter-cyclical role. It would also be positive if the proposed measures went together with additional measures to increase transparency and accountability, in order to reinforce the favorable performance of the DB. For example, as regards the independent evaluations of DB performance – which are useful for better focusing their activities and strategies – it could be requested that an annual evaluation be made of each institution, and for the aforesaid evaluations to be broadly disseminated. It could also be established that the annual reports of the DB should explain the appraisal made of the aforesaid evaluation exercises and, as the case may be, the mechanisms to cover them through pertinent modifications in their annual operation plans and policies. Lastly, it is important to ensure that information on finance and BD operations are available in the CNBV website with the same frequency and details as that corresponding to commercial banks. To the extent that in-depth information is available on, for example, the reductions and write-offs carried on by the DB, its financial performance can be evaluated objectively. This is essential to maintain the stability of the country's financial system. In this regard, the minutes of the meetings of the Governing Boards of each DB can be published, in a similar way as at present are the minutes of the meetings of the monetary policy committee of the Bank of Mexico.

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3.c Increasing Competition and Consumer Protection in the Financial Sector

Introduction

The price of a good or service is usually the only information - or the most important one- which a user needs to either use or consume it. However, for some products, such as financial services, the price is one of many factors which may affect the appropriate use by businesses and families. In these cases, sellers should provide additional information so that consumers can choose the best product. But providing information may be costly, and in that case, a higher level of competition may not necessarily increase the incentives to offer such adequate information. In his well-known work, Joseph Stiglitz (1989) argues that the value of a product can be affected, when obtaining and processing information about it is costly, because it is more difficult to find a product that matches consumer's preferences. Besides, price may not be a clear sign of a product's quality in a competitive market either. For example: if companies which charge a high price are those which offer the highest quality and a low quality company increases the price of its product, this could send a misleading signal to the market that this company is improving its quality.

Consequently, it is desirable that public policy focuses on providing a better knowledge about financial products and adequate consumer protection, in order to promote the healthy growth of the financial system. Also, that It facilitates households' and enterprises' choices among a large variety of savings and credit products, with a broad variety of prices and qualities. Under these premises, the international community has recently directed its attention to set a framework for establishing and evaluating appropriate public policies to reinforce consumer protection. One of the efforts is set out in the document published in 2011 by G-20, together with the Organization for Economic Cooperation and Development (OECD) and the Financial Stability Board. This document proposes ten basic principles to evaluate, and, as the case may be, improve public policies geared towards protecting financial services' users. .

As shown in ***Box 3: Recent Patterns in Efficiency and Competition of the Mexican Banking System***, there is evidence that Mexico's banking system has become more efficient and competed over the last decade. However, to know the financial products available on the Mexican market, it is necessary to identify not only banking products but also those offered by various non-banking institutions. Hence, to foster the Mexican financial system's development, public policies should target all participants. In addition, certain parameters for their participation in the market should be set, in order to encourage efficiency and healthy competition. These requirements are taken into account in the Initiative presented by the Federal Government. While in ***Box 4: Modifications to the Securities Market Act*** are analyzed the main modifications proposed to promote efficiency and competition in the securities market, this section describes the main elements of the Initiative regarding user protection and outlines the main actions which have been carried out to strengthen that protection.

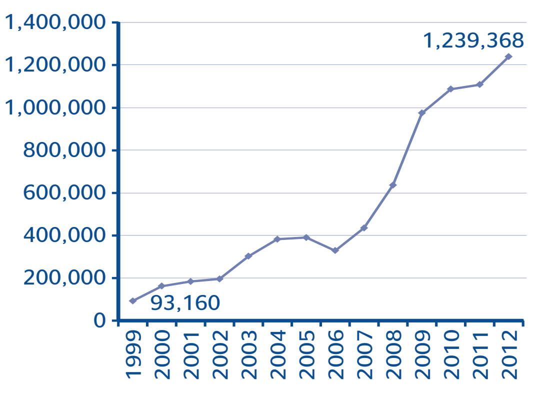
3.c.1 Progress and challenges in protecting users of financial services

In Mexico, the National Commission for the Defense and Rights of Users of Financial Services (CONDUSEF) is the authority responsible for safeguarding the rights of users of financial products and services (users).. This Commission was created in 1999 with the coming into force of the Protection and Defense of Users of Financial Services Act (CONDUSEF Act). Subsequently, its functions were strengthened by granting it powers to regulate and supervise powers, through reforms in 2009 and 2010 to the Transparency and Ordering of Financial Services Act (LTOSF) and the Credit Institutions Act (LIC). In addition to CONDUSEF, other authorities have carried out actions to promote competition in the system and the provision of transparent information by different credit suppliers. For example, it is noteworthy the power granted by the LTOSF to the Bank of Mexico since 2002 to disclose the components, calculation methodology and frequency of the total annual cost (CAT), which is a relevant benchmark to determine the real cost of a credit.

The CONDUSEF carries out different activities to comply with its objective of protecting users. First, it manages, verifies, disseminates and issues recommendations on the information provided by financial institutions (FI) operating locally, the product contracts handled by these institutions and the fees they charge. It also assesses, protects and defends users' rights, acts as an arbitrator in disputes among them and the FI, and takes part as an auditor to protect savers when an FI enters into bankruptcy proceedings. Lastly, this Commission has powers to sanction FI that fail to comply with the corresponding provisions established in CONDUSEF Act, LTOSF, LIC or the Regulation of Credit Information Companies (SICs) Act.

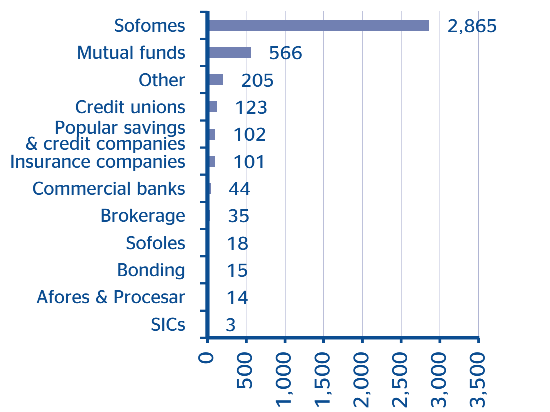
CONDUSEF's attention and regulation universe has grown in a sustained manner, due to the number of users, FI and products offered by them. Chart 37 shows that in 1999 CONDUSEF provided services to a little over 93 thousand users, while on December 2012 this figure amounted to 1.2 million. In 2006, the CONDUSEF had records of 1,194 FI, while at the end of December 2012 the number of FI registered and regulated by it was 4,091 (Chart 38).

Chart 37
Number of users attended by CONDUSEF, 1999-2012



Fuente: CONDUSEF

Chart 38
Institutions regulated by CONDUSEF, 2012



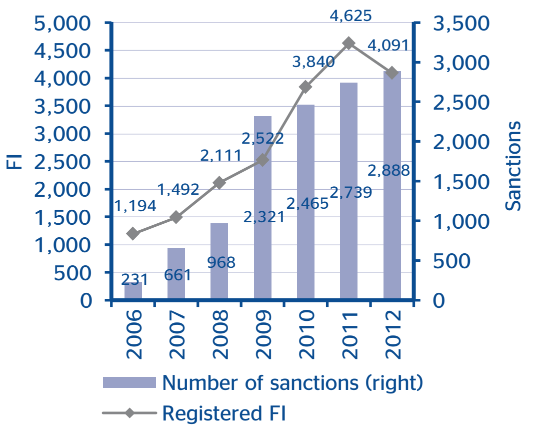
Fuente: CONDUSEF

The increase in the number of FI between 2006 and 2012 is largely due to the creation of the Multiple Object Financial Companies (SOFOM). Since 2006 different credit activities in Mexico underwent a deregulation process, with the purpose of eliminating regulatory barriers to stimulate credit growth t and increase competition among credit suppliers. This deregulation gave rise to SOFOM, which would be free from regulatory costs unless they had capital links with a multiple banking institution. Since then the number of SOFOM has grown rapidly, and by June 2013 there were 2,490 operating institutions.[1]

The number of sanctions imposed by CONDUSEF has grown at a similar pace as the number of new FI. In 2006, 231 sanctions were imposed, while in 2011 CONDUSEF imposed 2,739 sanctions (Chart 39). By type of institution, it is worth noting that in 2011 unregulated SOFOMES received the most fines, followed by banks and insurance companies (Chart 40).

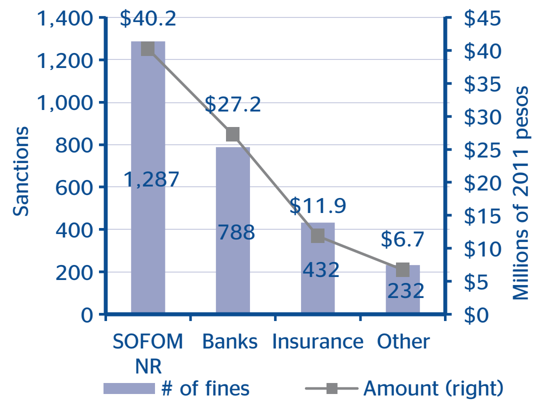
1 Source: Financial Services Providers Registration System, CONDUSEF. Consultation date: June 6, 2013

Chart 39
Institutions registered in CONDUSEF and sanctions imposed



Source: CONDUSEF

Chart 40
Number and amount of sanctions imposed, by type of institution in 2011



Source: CONDUSEF

Nevertheless, the scope of the CONDUSEF is perhaps still limited in comparison with that of other authorities in terms of financial and human resources at its disposal for carrying out its mandate.[2] This is shown by the fact that CONDUSEF has still not issued instructions for the FI to comply with Its recommendations for the FI's standard contracts to have complete information and not include abusive clauses (in other words, which could affect users' patrimony): It has not issued its guidelines to evaluate the regulatory compliance of the FI either. Such activities, for example, have been carried out in the scope of its functions by the Federal Competition Commission (CFC), in regards to the guidelines for a company to obtain a favorable CFC opinion for a merger or acquisition, or its participation in public tenders,[3] and by the Bank of Mexico, in regards to the elements considered to measure competition in different market segments.[4] Another relevant example is the low number of controversies which have been resolved through arbitration (67 cases between 2002 and 2008 and none since 2009), which might be due to shortcomings of this process pertaining its flexibility or impartiality. In terms of resources, CONDUSEF also has a low capacity, given that it has around 725 employees (including temporary ones) to monitor around 5,000 FI, verify that all their financial products comply with healthy financial practices, deal with users' complaints, and provide financial literacy.

The data show that the sustained development of the financial system in Mexico poses a series of different challenges for competition in the sector and protection of users. The most relevant questions include the reorganization of the entry of new institutions; greater powers for supervisory authorities, together with more dissuasive incentives to prevent FI from failing to comply with the regulation; and more resources for authorities to comply with their functions adequately. The Federal Government Initiative addresses some of these challenges. Its proposals include redefining the operating conditions of certain non-banking financial intermediaries, and strengthening the regulatory framework of CONDUSEF and other financial authorities.

[2] Human capital is not a restriction which only affects CONDUSEF. As a result of the new provisions to prevent money laundering and the new powers granted to the CNBV, this authority went from supervising a little over 400 institutions to over6,000, while the number of job positions it has is in the neighborhood of 1,500.
[3] See, for example, at the website of the CFC (www.cfc.gob.mx), "Instruction for notifying concentrations", "Instruction for requesting a favorable opinion to participate in the call for tender with the objective of granting the first natural gas distribution permit in the geographical area of Veracruz", or "Instruction for requesting a favorable opinion to participate in the API/ALT/TECG-TEGM/001/12 call for tender, with the objective of awarding a contract of partial assignment of rights and obligations from the concession, for the construction of a public bulk mineral terminal or a public general cargo terminal, in the port area of Altamira, Tamaulipas""
[4] See at the Bank of Mexico website (www.banxico.org.mx) the "Report on competition conditions in the credit card issue market".

3.c.2 Elements of the Initiative for strengthening protection to users of financial services and improving competition

The main proposals contained in the Initiative are as follows:

1) **To provide CONDUSEF with greater powers to protect users**. The main modifications proposed are as follows:
    - Create and maintain an Office of Financial Institutions to bring together relevant information for assessing FIs' performance in providing services.
    - Giving executive powers to its technical rulings.
    - Publish the recommendations which CONDUSEF makes to the FI.
    - Suspend misleading information on financial services and products.
    - Ordering – instead of proposing – modifications in standard contracts which do not comply with CONDUSEF provisions.
    - Regulate cases in which the CONDUSEF considers that clauses set out in FIs' adhesion contracts to be abusive.
    - Define, through secondary regulation, the activities which do not comply with healthy practices in the offering of financial services.
    - For SOFOMES, it is established that before they are constituted as a legal entity they will have to be registered at the CONDUSEF and receive its approval to be considered as such, and to be able to grant credit. Furthermore, they must show to the CONDUSEF that they are providing information to at least one credit information company.
    - SOFOMES, credit unions and the saving and popular credit institutions (popular financial companies, community financial companies and cooperative savings and loans companies) are required to register and keep updated, before the CONDUSEF, their fees information, in order to maintain their operating permit.
    - The role of the CONDUSEF as an arbitrator is reinforced through the creation of the Financial Arbitration System, which will provide users and the FI with a non-judicial mechanism for solving future disputes regarding operations and services.
2) **Greater competition in providing financial services**. Mechanisms for allowing customers to transfer their consumer credits to another financial institution are considered to increase their mobility, and FI are prohibited by law to condition the contracting of financial services to the contracting of another operation or service (tied sale). The reform also proposes additional measures geared towards increasing competition in different sectors of the financial system. For example, in the investment funds sector is established that any company which distributes shares of investment funds will be able to acquire and distribute the shares of another fund which has not contracted its services with that company. For credit unions, measures are considered to diversify their sources of funding, strengthen their capital and broaden their product offer. The saving and credit sector is allowed to have a correspondents network and to broaden its cover of services. For the SOFOMES, new criteria are added to be consider them as regulated, given that those which have capital links with SOFIPOs and SCAPs and those issuing debt on the securities market will be regulated, besides those related to banks,. A new Law is also enacted to Regulate Financial Groups, with the purpose of modernizing the corporate structure and the investments which can be made by controlling companies, to expedite administrative procedures, carry out improvements in corporate governance, and regulate the power of the President of the Republic to form boards of financial authorities to coordinate more easily measures and actions by the SHCP,, the bodies and entities of the Federal Public Administration, and the Bank of Mexico.[5]

[5] The Act to Regulate Financial Groups creates the Financial System Stability Board, initially created through the Ruling of the Federal Government on July 29, 2010, as a coordinating body between authorities for the evaluation and analysis of risks which affect financial stability.

3) **More supervision and sanction capacities**: With the Initiative, Bank of Mexico will have more powers to directly supervise financial intermediaries, while the CNBV is granted supervisory powers over investment funds and SOFOMES. In addition to these additional supervisory powers, the Initiative seeks to introduce more sanctions and inform them to the public. In this regard, the reform also classifies new types of infringement by intermediaries, updates sanction amounts and reduces prompt payment discounts; while also expressly establishes deadlines to pay fines. The purpose of these modifications is to ensure that the public is better informed about the quality of the service provided by financial intermediaries by allowing authorities to inform the public of the sanctions imposed on them and the status of the sanction, as well as discouraging the breach of the provisions in question.

In short, the measures are intended, on the one hand, to increase the supervision and regulation by authorities, and to strengthen their mechanisms for exercising regulation, and, on the other, to promote the supply of financial services, by means of organizing the entry of new institutions and providing users with greater protection.

Evaluation

Although in Mexico there already is compliance with some of the recommendations put forward by international agencies to strengthen public policies towards user protection, the Initiative seeks to reinforce some of the actions not yet considered. An example is the increase in the amount of sanctions and publicity regarding the imposition and status of these sanctions before the final ruling is reached, since these measures may help to make regulatory and supervisory mechanisms more effective. These may help to increase market discipline and the sanctioning capacity of authorities, because the simple threat of real sanction and the possible damage to the FIs' reputation incurred by their own conduct may be an important deterrent for breaches. The amount of the sanctions will have to surpass the economic benefit from infringing any provision, so that the threat of sanctions outweighs incentives to violate regulation.

Nevertheless, given that such a tightening of the legal framework can increase entry barriers to the provision of financial services, it is recommended to provide the FI with instructions or guidelines to be able to comply with the new stipulations. As stated above, this approach has been adopted by other authorities in order to fulfill their functions. On the other hand, it may be worth questioning, the inclusion and sanction of other violations which were already stipulated in other laws, such as: the ban on tied sales; given that at present when such business practice inhibits competition it can be sanctioned by the Federal Competition Act as a relative monopolistic practice.

Providing the rulings of CONDUSEF with executive powers should be combined with furnishing FI with mechanisms to appeal against such rulings, in order to prevent arbitrary actions or actions based on incomplete information.

This proposal could be completed by providing CONDUSEF with the obligation of preparing and disclosing documents which describe in detail the methodologies used by that body to assess the quality of the information on financial products and services and to issue Its ratings upon them. Indeed, the Product Classifier may be a simple and useful tool for users to take better informed decisions. In this regard, the publication earlier this year of the Supervision Operating Plan and of some models judged to be abusive clauses in various contracts, is a step forward. It could be completed, for example, with the weightings which will be given in ratings to each element assessed when reviewing contracts, publicity, statements of account, or the operation receipts.

Proposals to increase the regulatory requirements for the SOFOMES and to create the Financial Institutions Office are also intended to improve protection to financial services users. In particular, it is a positive step that SOFOMES are required to report their activities to the credit bureau, as a mechanism to prevent excessive indebtedness amongst families, as has recently occurred in other countries. The increase in regulatory requirements for these institutions can help to bring about a greater level of organization in the sector, as it prevents indiscriminate growth of companies which are constituted under this figure but which never enter operation or which might carry out other kinds of operations; and those which do operate are given more incentives to manage their credit risks efficiently and with similar guidelines to the rest of the regulated intermediaries. The Financial Institutions Office will be an important tool to ensure that users of financial services have greater information on the quality of the service provided by different financial intermediaries. However, the reasoning behind the proposal that the CONDUSEF should maintain the Financial Institutions Office, which can be consulted by users to know and to compare the different institutions and their respective products is clearer than the reasoning which says that SOFOMES, before being established as a legal entity, should be registered at the CONDUSEF. This may be due to the desire of guaranteeing that unregulated SOFOMES at least comply with user protection standards, but it raises the question of whether such a minimum protection standard is the most appropriate one.

On the other hand, following international trends, it would be advisable for the Initiative to be completed with other actions. One of them is financial literacy. While it is true that CONDUSEF carries out a number of actions in this regard, it is also a fact that the growing complexity of financial products and the rapid technological changes increase literacy requirements. In this regard, one of the recommendations of the OECD is that financial protection policies should go hand in hand with comprehensive financial literacy strategies, encompassing different age groups, levels of education and socioeconomic sectors, and that there should also be specific programs to cover the most vulnerable groups of users. An example of an action to comply with such recommendations would be enacting the Financial Literacy Board (created in 2011), which might guarantee its continuity.

Lastly, it is generally recommended that more supervisory and sanctioning powers of the authorities go hand in hand with appropriate mechanisms to foster transparency, accountability and clear rulings, along with adequate resources to enable them to perform their functions.

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Box 3: Recent Patterns in Efficiency and Competition of the Mexican Banking System

Introduction

Many economists have discussed and analyzed the efficiency and competition which prevail in the Mexican banking system. In Mexico certain events have occurred, and the government has implemented a number of policies, which, may affect banks' competition and efficiency.[1] The global financial crisis of 2008 tested the banking system and showed that the objective of greater stability has indeed been fulfilled. Nevertheless, the Mexican banking system's penetration remains lower than in other countries with a similar level of income. Consequently, a Financial Reform Initiative (Initiative) has been presented, which has several purposes, including that of increasing competition between banks.

To contribute to this analysis, Castellanos and Garza-García (2013) estimate, primarily, efficiency indicators for 38 Mexican banks in operation during the decade from 2002 to 2012 using the Data Envelopment Analysis (DEA), on the one hand, and the index proposed by Boone, Griffith and Harrison (2005) to evaluate market competition every year, on the other. Next they estimate a Tobit Panel Data Model to determine the effect on banks' efficiency of the level of competition , of other bank specific variables, such as: capitalization index ratio of total loans over total assets, ratio of past due loans over total loans or its market participation, and of other variables reflecting economic and regulatory conditions. Below, we present some results of this study about efficiency and competition in the Mexican banking system, and its performance over the last decade.

Efficiency

The DEA technique has been used to analyze banks' efficiency in a number of countries, including Mexico.[2] The first efficiency measurements for Mexican banks performed with this methodology, by Taylor, Thompson and Dharmapala (1997), were carried out for the 1989-1991 period. The average efficiency for the financial system during this period is estimated to be between 69% and 75%, a similar range to banks in the United States. Subsequently, Guerrero and Negrín (2006) reported that average cost to income for 12 banks in the system during the period from 1997 to 2001 stands in a range between 80% and 86% and that even though it fell in 1997-2001, it rose thereafter. The most recent study by Garza-García (2012), which analyzes the data sample of the largest 18 banks in the system during the period from 2001 to 2009, shows an average efficiency for the banking system between 79% and 86%, depending on the efficiency measure considered. Efficiency's trend is also increasing until 2008, and then displays a slight reduction.

Technical efficiency indicators[3] from the study by Castellanos and Garza García are obtained by means of a cost minimization model with three inputs: total deposits, capital, and total costs (personnel expenses + administrative expenses + interest rate expenses) and two products: total loans and other assets (availabilities + capital investments + derivatives operations). These variables are constructed with monthly data published by the National Banking and Securities Commission (CNBV) for a sample of 38 banks for the January 2001 to April 2012 period. The results obtained match those of Garza-García (2012)[4] and suggest that during the analysis period, technical efficiency of the banking system showed a growing trend up to the year of the global financial crisis, and fell slightly thereafter. Furthermore, in regards to the differences in efficiency between 23 local banks and 15 foreign ones, the authors note that on average the local ones show higher efficiency than foreign ones. However, foreign banks show marked differences in efficiency by investment type. The 5 foreign banks arising from the merger or acquisition (M&A) of what was formerly a local bank are, on average, more efficient than the 10 banks arising from new investment (De Novo). In fact, first group's efficiency is very similar to that of the system. Within the system, BBVA Bancomer stands out for having higher levels than the average of that group (Chart 41).

Competition

Since Adam Smith, economic theory has predicted that competition leads to efficiency. However, many analysts believe that this is not necessarily the case with the banking system

[1] Let us enumerate three of these events., Commercial banks were nationalized in 1982, and then sold back to the private sector in the early 1990s, as part of a strategy of financial liberalization geared towards increasing efficiency and competitiveness in the banking sector. In 1995, Mexico suffered the Tequila Crisis, during which many banks in the system collapsed or were taken over by the government, which sold them again towards the end of that decade, but this time without restricting their sale to foreign investors. At the same time, processes were started to improve banking regulation and supervision of institutions which had shown severe shortcomings during the crisis.

[2] At least five different approaches have been used to analyze banks' efficiency through the DEA technique. These vary in assumptions regarding the data in terms of: (a) functional form of the best practice frontier, (b) inclusion of a random error associated with temporal very high or very low production, costs or profits, and (c) if a random error is included, the type of probability distribution of the inefficiencies used. More details in Berger and Humphrey (1997).

[3] Economic efficiency has two components: technical efficiency and allocation efficiency. Technical efficiency arises when a company minimizes the use of inputs to produce a product or service, given a specific technology and input prices.

[4] In addition to the differences in the sample of banks and analysis periods, it is important to note that Garza-García (2012) obtains his technical efficiency estimates using a slightly different model in which capital does not enter as an input in the costs function.

and that, in the extreme, too much competition between banks can prompt high financial instability. On the other hand, measuring competition per se is a question in which different studies have been carried out and a number of different Indicators have been developed. The simplest ones focus on market concentration as a measure of competition degree. However, these simple indicators have been strongly criticized, especially by competition authorities, who, when analyzing market power, deem market concentration as just one of several indicators used to support their decisions.

Thus, several scientific papers and investigations for Mexico regarding the degree of competition of its banking system use a combination of concentration, regulation and/or institutional framework indicators which determine the degree of market contestability.[5] Other studies have also used the statistic proposed by Panzar and Rosse (1987).[6] Meanwhile, in their study Castellanos and Garza-García estimate the innovative competition index proposed by Boone, Griffith and Harrison (2005), previously used to analyze the competition of certain European countries' banking systems. The following equation is used to obtain the Boone competition index:

$$\pi_{it} = \alpha + \beta \ln(c_{it}) \qquad (1)$$

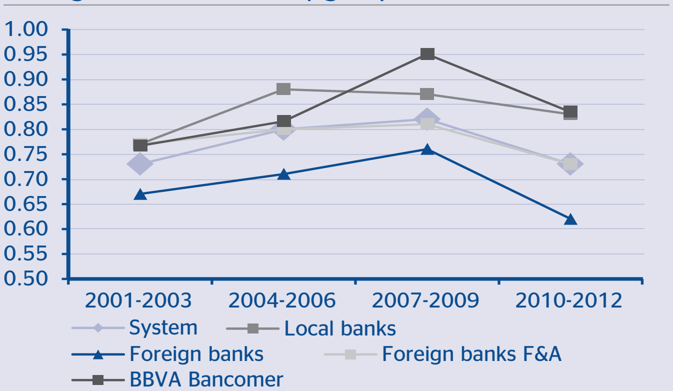
where π_{it} represents the income of bank *i* in the period *t*, c_{it} the marginal cost of bank *i* in the period *t*, and β is the Boone competition index. This model is estimated using the following regression equation:

$$\pi_{it} = \alpha_i + \sum_{t=1,\dots T} \beta_t \ln(c_{it}) + \sum_{t=1,\dots T-1} \gamma_t d_t + \upsilon_{it} \qquad (2)$$

where income π_{it} is measured as the return on assets ratio (ROA); marginal cost c_{it} is proxied with average cost, defined as the sum of administrative costs, personnel expenses and interest expenses divided by total income; variables d_t are time specific dummy variables with a value of 0 or 1 associated with each period of the sample, and υ_{it} is an estimation error term.[7] Equation 2 is estimated using a Tobit Panel Data Model with fixed effects.

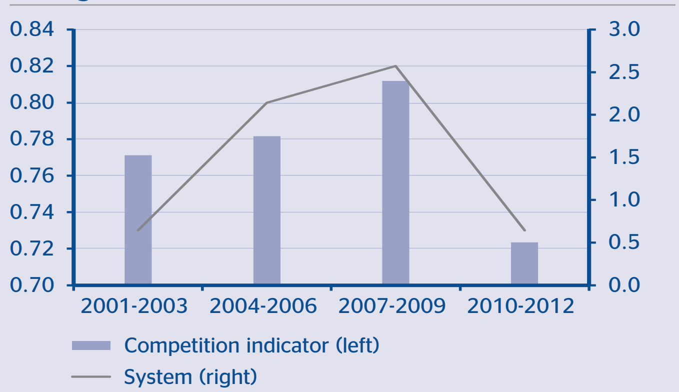
This model's hypothesis indicates that income increases over time due to reductions in marginal costs and, therefore, the level of competition increases the return of the most efficient banks against the least efficient ones. The Boone index, whose sign is negative, measures how strong this association is. In absolute values, the higher the Boone index, the higher the degree of competition. As we can see in Chart 42, during the analysis period the degree of competition also increases up to the recent crisis and then falls thereafter, following a similar pattern to that of the efficiency indicators.

Chart 41
Technical efficiency (VRS) of the Mexican banking system, 2001-2012
Averages of annual data by groups of banks



NB: The technical efficiency indicator (VRS) is obtained by minimizing a function of banks' costs in which variable returns to scale are assumed.
Source: Castellanos and Garza García (2013)

Chart 42
Boone competition index vs. technical efficiency index of the Mexican banking system, 2001-2012
Averages of annual data



NB:
1. The technical efficiency indicator (VRS) is obtained by minimizing a banks costs function in which variable returns to scale are assumed.
2. Boone iIndex expressed in absolute value.
Source: Castellanos and Garza García (2013)

[5] See, for example, Avalos and Hernandez (2006) or Negrín and O'Dogherty (2004).
[6] See, for example, Dueñas (2003)
[7] These variables are constructed with CNBV's monthly data.

Evaluation

In conclusion, the Mexican banking system is increasingly more efficient and competed, although these indicators were affected by the recent financial crisis. This is evident if we observe the recent trend of the most simple financial ratios, such as operating expenses or other accounting ratios, and the growing number of banks which operate on the market, or the pattern of estimates generated using more sophisticated economic models. Moreover, in their econometric analysis, Castellanos ¡and Garza-García do not only observe a positive relationship between these two variables, but also identify other variables which affect banks' efficiency, such as degree of capitalization, market participation, the proportion of lending portfolio against assets and some measures of regulation which reinforce banks' balance sheets and the quality of their assets. In the future, therefore, it will be very important to assess the impact that the Financial Reform, once approved, has on efficiency and competition.

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Box 4: Amendments to the Securities Market Act

Introduction

As outlined in section 3c., ***Increasing competition and consumer protection in the financial sector***, it is recommended that public policies which intend to promote competition should include all market participants and take into account the diversity of existing products and services. Accordingly, the Initiative proposes amending certain provisions of the Securities Market Act (LMV) in order to achieve two goals. First, to make the operation of the securities market more efficient, giving greater legal certainty and security to operations carried out through it. Second, to improve market institutions' performance, providing participants with greater clarity about their actions and responsibilities, including those of authorities which regulate it. The most important proposed amendments are outlined as follows.

Restricted public offering

The figure of the restricted public offering is introduced, something which, in our opinion, is a good decision. At present, Afores are legally restricted to invest only in instruments placed through public offerings.[1] Consequently, to be able to access the mass of resources managed by Afores, many placements which by their nature should be private (for example, those used for seed capital in companies) are made public. One advantage is that the Afores are able to invest in instruments with according to their investment needs (most of the pension funds in advanced economies invest in private placements). On the other hand, they have the disadvantage that, because they are public offerings, anybody can acquire the instruments. There are many situations in which unsophisticated investors, should not invest in high-risk and highly complex securities that, in contrast, may be appropriate for an institutional investor such as the Afores. The proposed legal change resolves these problems, given that the figure of restricted public offerings would allow Afores, to invest in securities which may be highly complex, but at the same time prevent unqualified investors from accessing these kinds of instruments, given that in many cases they would not be suitable for their investment profiles.

CKDs, ETFs, and FIBRAs

Furthermore, a series of instruments is introduced at Act level. These instruments will have a positive impact on financial markets in Mexico: development capital certificates (CKDs), infrastructure and real estate trusts (FIBRAs) and Exchange Traded Funds (ETFs). CKDs are investment instruments which can be used to finance infrastructure projects, real estate or as private capital for growing companies, with the objective of eventually floating them on the market (private equity).

CKDs have proven successful to channel resources in the aforementioned areas. The figure was created in 2009, and to date over 50 billion pesos have been placed in these instruments. However, these securities are defined in secondary regulation and not in the Act. This situation has prompted a series of problems due to the fact that the LMV only considers the existence of fixed income and equity instruments. The CKDs are similar to equity instruments, because they do not assure payment of the principal or of interest, and return stems only from the underlying assets affected in the issuer trust. Specifically, they grant their holders rights to the return and/or the yields of the investments made, and, as the case may be, to the yields from the disposal thereof. For that reason, they were characterized as equity instruments in the regulation. This means that they face a series of requirements which are more akin to those of a public issuer (Public Limited Company) and may not be appropriate for instruments which invest in private capital. For example, they are subject to corporate governance and disclosure requirements. Therefore, the proposal to introduce the CKD figures at Act level is fortunate, and that, from there, to design an ex profeso secondary regulation regime.

Likewise, FIBRAs are trusts in which the proprietor contributes property assets (land, buildings, industrial warehouses and shopping malls, inter alia) to the assets of that trust, in order to issue certificates on the capitals markets secured by the aforesaid real estate or infrastructure assets. In other countries, these instruments have proven to be effective to channel financing towards real estate projects, so that it is appropriate for them to be formally adopted in Law.

ETFs are investment funds which, unlike investment companies, trade on stock markets. Thus, they offer an advantage in terms of liquidity and setting of prices. It is positive that they have been included in the Act. The reason is that they will allow retail investors to access investments which follow

[1] It was originally thought that this would be more of a safeguard for workers' savings. The reason is that, in principle, public offerings are more transparent. Although this standard may have been proper when the Afores system began to operate, it should eventually be revised as the Afores build greater capacities to analyze investments, including private issues.

stock market, fixed income, or commodity indices, at lower prices and commissions. However, it will be necessary to design a regulatory regime to prevent unsophisticated investors from purchasing more complex ETFs, which may not be suitable for their investment profiles.

An important omission: Covered Bonds

The Initiative leaves out an important instrument: covered bonds. Covered bonds are debt instruments issued by a bank, and which are secured by a group of assets. The institution has the obligation of meeting the payments associated with that instrument, with independence of the performance of the assets securing it. In other words, it is an obligation registered on the bank's balance sheet. However, if the bank defaults, those assets are separated from the bankruptcy mass and holders of covered bonds have a legal recourse for them. These instruments are widely used in Europe and were not significantly affected by the global financial crisis.

In order for them to be used in Mexico, it is necessary to introduce changes in the Credit Institutions Act (LIC), which would be advisable because these securities would have the following advantages: i) they would attract resources from the capitals market to the financing of mortgages;[2] ii) they would enable the issues to obtain ratings of AAA nationwide, and, by this means, they would be able to access the large mass of resources managed by the Afores. In certain cases (mainly in those institutions which already have an AAA rating), ratings higher than the country's sovereign rating might be obtained, which would make them very appealing for foreign institutional investors; iii) they would reduce the market risk currently bared by banks linked to the funding of long term mortgages with short term liabilities; and iv) they would reinforce the debt markets through creating new instruments with a high credit rating.

Investment advisory service

The financial reform also contains a section which introduces a regulatory framework for securities sales practices. This framework already exists in regulation and its adoption in the Act is an important step forward. This is due to the fact that it is a mechanism to ensure that healthy practices are adopted in advisory services and sale of securities to non-institutional clients. This regulation requires to profile the customers who are going to invest in securities market instruments, and to design an investment portfolio for them in accordance with that profile. It also contains certain elements which would help to mitigate possible conflicts of interest which could exist (and which have materialized in certain cases) when a financial institution sells securities designed or placed by it to its non-institutional clients. The possible conflict of interest exists because it might be convenient for the financial institution to place a security amongst its clients, even if it is not appropriate for that client's investment requirements.

The reform proposal also closes an important gap in regulatory arbitration which exists today, by making independent investment advisors subject to regulation.

Evaluation

In general terms, the modifications concerning the securities market contained in the Initiative are positive and will help to create a more profound market and ensure that financial savings channeled through institutional investors - the component of financial savings which reports the most growth in Mexico - can be used to finance long term productive projects. It also means that greater protection will be given to natural persons who invest on the securities market. However, as we have stated, there is an important omission, given that covered bonds are not included.

[2] The importance of covered bonds in increasing financing to the real estate sector is commented in the October 2009 number of ***Mexico Real Estate Outlook***.

3.d The Importance of Improving the Degree of Contracts Compliance and Execution of Guarantees

Introduction

A legal and institutional framework in which commercial contracts - including credit - can be complied with and guarantees can be swiftly executed when contracts are not fulfilled is an essential element if markets are to work efficiently. This is shown in the well-known study by Djankov, La Porta, López de Silanes and Schleifer (2003), which measures and describes the procedures of parties in litigation and courts for evicting and cashing the bounced check by a tenant in default in 109 countries. Using these data, the authors construct a judicial procedure formality index in resolving commercial disputes in each country, In order to carry out comparative exercises. One of the investigators' findings is that the level of judicial procedure formalism is associated with a longer length of actions, lower consistency in court decisions, and greater corruption, particularly in developing countries. This is one of the reasons why a number of international financial institutions, such as the World Bank - which incorporated measurements using the system of Djankov et al (2003) in its indicators of the Doing Business Report (DBR),[1]- have emphasized the promotion of economic policies which can bring down times and expenses. This, in order to ensure compliance with contracts and the expedite execution of guarantees. These factors, inter alia, are important to attract investments, create productive companies and economic growth.

As was stated in the November 2011 edition of ***Mexico Banking Outlook***, according to the DBR, the indicators of time, number of procedures, and cost for the Property Registry of Mexico, are below the indicators of other Emerging And Growth-Leading Economies (EAGLEs) in this decade, identified by BBVA Research.[2][3] Furthermore, according to the same source, Mexico does not compare favorably with the other countries in the BBVA EAGLES group in the area of Compliance with Contracts either. This is due to its deficient indicators for compliance of contracts, such as: requiring 415 days to achieve compliance with a contract, carrying out 38 necessary procedures; and the disbursement of 31% of the amount claimed for costs to achieve the compliance of contracts (Table 7). With these indicators, Mexico stands in 76th place in the ranking out of 185 countries. Consequently, a wide-ranging financial reform in Mexico would not be complete without proposals for improving the institutional aspects that relate with the degree of compliance of contracts and execution of guarantees. The main proposals put forward in this field in the Initiative are outlined as follows.

3.d.1 Execution of guarantees

In order to improve guarantee execution processes, the Financial Reform proposes modifications to be made in the Code of Commerce (CC), the General Securities and Credit Operations Act (LGTOC) and the Judicial Power of the Federation Act (LOPJF).

The CC reform has three main pillars in terms of execution of guarantees (Table 8). The former considers adjustments to shorten the duration and increase legal security in corporate judicial proceedings. The second considers measures to reorder the regulatory provisions which regulate mechanisms for insu-

[1] The contract compliance indicator of Djankov et al (2003) is also used to construct the international competitiveness indices of the World Economic Forum and the IMD Business School of Lausanne. The dispute currently used in the DBR refers to a legal transaction carried out between two companies (Buyer and Seller) which are located in the country's most relevant city for carrying out business. The Seller sells to the Buyer goods for a sum equivalent to 200% of the economy's per capita income. After the goods' delivery, the Buyer does not make the appropriate payment, alleging that the goods he has received are not of the adequate quality. The Seller (the claimant) brings an action against the Buyer (defendant) to receive payment of the amount agreed in the purchase/sale contract (i.e., 200% of the per capital income).

[2] According to the most recent DBR of the World Bank, in 2012 it took 74 days to register a real estate property in Mexico, 7 proceedings and 5.3% of the value of the property, putting it in 141st position in a ranking of 185 countries, while in 2010 with the same indicators it stood in 101st position out of 183 countries.

[3] The methodology used to identify the Economies and Growth Leading Economies (BBVA EAGLES) is described in García-Herrero, Navia, and Nigrinis (2011)..

ring assets within corporate judicial proceedings. The objective of the measures set out in the third is to improve corporate executive proceedings.

Table 7

Time, number of procedures and cost for achieving contracts compliance in countries forming part of the BBVA EAGLES group[1] in 2012

Country	Time (days)	Country	Procedures (number)	Country	Cost (% amount claimed)
South Korea	230	South Korea	33	South Korea	10.3
Russia	270	Russia	36	China	11.1
China	406	Turkey	36	Russia	13.4
Mexico	**415**	China	37	Brazil	16.5
Turkey	420	**Mexico**	**38**	Taiwan	17.7
Indonesia	498	Indonesia	40	Turkey	24.9
Taiwan	510	Brazil	44	**Mexico**	**31**
Brazil	731	Taiwan	45	India	39.6
India	1420	India	46	Indonesia	139.4
EAGLES Average[2]	**396**		**38**		**38.9**

Notes:
1. The BBVA EAGLEs group currently consists of the following countries: China, India, Brazil, Indonesia, South Korea, Russia, Mexico, Taiwan and Turkey.
2. Mexico is not included.
Source: BBVA Research with data of the Doing Business Report 2013.

Table 8

Measures associated with the three pillars of the reform of the Code of Commerce

1. Reduce the duration and increase legal security in corporate judicial proceedings	• Establish that notifications always be made on the day after judges make the rulings which have to be notified. • Bring down the period established to hold the hearing for the admission of evidence from eight to five days, to speed up the pre-court preliminary processes. • Determine that if a credit has a real security, that the party bringing the claim is responsible for choosing between the pertinent channels to perform the proceedings in order to prevent confusion regarding the venue for exercising the corresponding actions. • In the mercantile oral proceedings, there is the possibility of lodging the appeal against rulings implying process determinations and when, in cases in which incidental questions cannot be concluded within the hearing, the judge continues with it and the pending questions are resolved together with the final sentence, in order not to delay the ruling of the main process.
2. Reorganize the regulatory provisions which regulate mechanisms for insuring assets within corporate judicial proceedings	• Clarify the cases in which the various administrative protective orders can be determined in corporate law. • Differentiate between the requirements for arrest to be applicable and the requirements for the provisional seizure of assets. • Establish the judge's obligation of granting the protective order in full once the respective requirements are fulfilled, in order to grant greater legal security to the party which requests the protective order and the party which is affected by it. • In the event of seizure of goods or of other fungible assets, the risk is presumed of the assets being hidden or dilapidated, for the purposes of the order.
3. Improve corporate executive proceedings	• Giving executive force to public documents notarized before a public notary in which there are enforceable obligations and the agreements entered into before the Federal Consumer Procurator and the National Commission for Protection and Defense of Users of Financial Services, so that they can be executed through this channel. • Establish the possibility of the creditor being able to have access to the seized assets so as to perform appraisals to ascertain if they are sufficient to guarantee the payment of the debt • Granting the creditor, primarily, the right to identify assets with the purpose of facilitating the collection of the claimed loan.

Source: BBVA Research, with information on the Financial Reform Initiative of May 8, 2013

An addition is proposed to the LGTOC, in order to allow the application of the securities given as a pledge for the payment of the guaranteed obligation without needing the execution procedure or judicial ruling. This modification would add an element to sustain the termination of the obligation without the loan or the guarantee entering into the priority of credits established in the Corporate Bankruptcy Act (LCM).

Lastly, an addition to the LOPJF is proposed with the purpose of creating a federal jurisdiction which is specialized in corporate law. Its most relevant aspects are as follows:

a. Regulating the powers of courts of different districts which will specialize in corporate law.

b. Maintain the existing concurrence in corporate law matters, in order to share more fairly the burden of matters between federal and local level.

c. Specify the powers of the specialized district courts to hear: i) disputes in the area of bankruptcies; ii) disputes of a mercantile kind when the claimant has not chosen to bring the action before the common judges and courts; iii) recognition and execution of commercial arbitration rulings, whichever the country where they were handed down may be, and the annulment of national or international commercial arbitration rulings when the place of arbitration is on national territory, and iv) of actions relating to collective mercantile actions.

The creation of a specialized federal jurisdiction in mercantile law stands out in the Initiative, because this is a measure which has been implemented in other countries, such as United States, Austria, Belgium, Finland, Germany and Spain. This is because it allows the quality of rulings to be improved in complex and specific cases, and also shortens the time for resolving legal proceedings, using experts in the particular field which is the object of the legal disputes. Besides, the specialized federal jurisdiction is part of a set of reforms carried out in recent years in Mexico to strengthen the justice system, such as the implementation of oral proceedings. The shorter times and greater certainty in mercantile proceedings which could be achieved if these measures are approved and implemented will help to close Mexico's gap in the compliance of contracts against other emerging countries

3.d.2 Guaranteed credit

In order to reduce costs and grant legal certainty to creditors of guaranteed credits, on the one hand, and to improve financing conditions for debtors, on the other, the Initiative considers modifications in the Act for Transparency and Promotion of Competition in Guaranteed Credit which are intended to reinforce the concept of the Subrogation of Creditor. This consists on replacing the original Creditor Entity of a Guaranteed Credit, with another, in the event that the aforesaid credit were paid in advance through contracting a new one with another Bank. Specifically, the following is proposed:

- Subrogated creditors can only be credit institutions, regulated SOFOMES, the National Housing Fund for Workers Institute (INFONAVIT), the Housing Fund of the Institute of Social Security and Services for Government Workers Fund (FOVISSSTE) or the Social Security Institute for Mexican Armed Forces (ISSFAM), which shall not be able to act as subrogators.
- As a requirement of effects against third parties, it will suffice for the subrogated creditor to register the following three documents in the Public Commerce Registry: i) one which indicates the liquid amount of the total debt; ii) one certifying the total payment of the debt of the guaranteed credit, and iii) one indicating the subrogation of the creditor. This registration shall also be without charge.
- In order for the subrogated creditor to be recognized as creditor for the pertinent legal effects, a request will have to be made in the Public Property Registry or in the special registries, as the case may be, to note the registration of the three documents mentioned in the above paragraph. This act will be sufficient for the original guarantee and its priority to remain unaltered.

In order to determine the benefits for debtors and creditors with real estate guarantees, if these measures are approved, it is important to consider that according to the DBR, most of the expense for registering a real estate property in Mexico is incurred during the procedures for the formalization of the purchase and sale contract before a public notary and the registration in the Public Property Registry. For example, for a real estate property with a value of 130,000 pesos, equivalent to 2 times the GDP per capita of Mexico, the proportions of costs associated with these two procedures amount to 37.0% and 47.3% of the value of the property, respectively (Table 9). Therefore, if this reform to simplify the subrogation of creditors is approved and appropriately implemented it means these transaction costs can be saved to the benefit of both creditors and debtors.[4]

[4] This subject will be analyzed in greater depth in the August 2013 number of ***Mexico Real Estate Outlook.***

Table 9

Details of procedures, times and costs associated with the registration of a real estate property with a value of 130,000 pesos in Mexico

No.	Procedure	Time	Associated cost**	%
* 1	The notary obtains the certificate of there being no debt with the water service.	15 days (simultaneous with procedures 2, 3, 4 & 5)	$125	0.4%
* 2	The notary obtains the certificate of land use of the property.	15 days (simultaneous with procedures 1, 3, 4 & 5)	$856	2.9%
* 3	The notary obtains the certificate of freedom from encumbrances.	7 days (simultaneous with procedures 1, 2, 4 & 5)	$466	1.6%
* 4	The notary checks that the seller is abreast of its payments of property tax.	1 days if the check is online or 2 weeks if "certificate of non-debt" is required (simultaneous with procedures 1, 2, 3 & 5)	$124 if certificate of non-debt is required; without charge if the information is verified online	0.4%
* 5	The notary requests a commercial appraisal of the property.		$3,000***	10.3%
6	The notary formalizes the purchase-sale contract.	3 days	Purchase tax according to Art 130 of the Fiscal Code of the Federal District: $5,976 Notary fees $4,799	 20.5% 16.5%
7	Registration of change of property in the Public Registry of the Federal District.	30 - 90 days	$13,772	47.3%
		Total:	**$29,118**	**100.0%**

* Occurs simultaneously with another procedure.
** Costs expressed in pesos of 2012.
*** The cost of the appraisal varies between 3,000 and 5,500 pesos.
Source: BBVA Research with data of the Doing Business Report 2013. The DBR considers a real estate property located in the main city of business of each country with a value equal to twice the national per capita income. For Mexico, this figure amounts to 130,000 pesos.

3.d.3 General deposit warehouses

General deposit warehouses (AGD) are very important in agricultural and farming activities because they are used to safeguard commodities and perishable products. They also play a role in granting loans for agricultural and farming activities because they enable the assets used as a guarantee for those credits to be safeguarded and registered. Therefore, the proposal is made in the Initiative to specify the activities carried out by the general deposit warehouses, and to create the "Single Information System of Storage of Agricultural and Farming Products" (SIIAPA) and the "Single Registry of Certificates, Warehouses and Goods" (RUCAM) (Table 10).

As far as this proposal for the operation of SIIAPA and of RUCAM to be efficient and low cost for users, it is recommended that each one of them be conceived and implemented as a single electronic database, in a similar way to the practice with credit bureaus or property registries.

Table 10

Proposals for the creation of the "Complete Information System of Storage of Agricultural and Farming Products" and the "Single Registry of Certificates, Warehouses and Goods"

Single Information System of Storage of Agricultural and Farming Products (SIIAPA)	Single Registry of Certificates, Warehouses and Goods (RUCAM)
Administered by the Ministry of Agriculture, Livestock Farming, Rural Development, Fishing and Food (SAGARPA), as a national public database, which will be integrated with the regular reports presented by the AGD, and which contain the following information: a) Physical stocks indicated in inventories; b) Incoming and outgoing goods; c) Amount and quality of stored grains; d) Details of operations carried out; e) Certificates of deposit and pledge bonds issued, cancelled or traded; f) Phytosanitary or animal health certificates, and g) Other information determined by the SAGARPA.	Administered by the Ministry of the Economy, as a national public database, which contains the following information: a) Certificates of deposit and pledge bonds issued, and the cancellations thereof; b) Goods or assets deposited and guaranteed by such titles; c) Stores of the general deposit warehouse: proprietary, leased or enabled, and d) Any act which, in accordance with the law, should be indicated in the aforesaid titles.

Source: BBVA Research, with information on the Financial Reform Initiative of May 8, 2013

3.d.4 Corporate bankruptcies

In Mexico, the LCM was enacted and the Federal Institute of Corporate Bankruptcy Specialists (IFECOM) was created in 2000. This was done with the purpose of modernizing the judicial process set out in the former Bankruptcy and Suspension of Payments Act (LQSP) to reorganize or liquidate companies facing situations of illiquidity or solvency. According to the analysis of the cases presented under the two laws between 1991 and 2005 carried out by Gamboa-Cavazos and Schneider (2007), this reform helped to bring about an average reduction in the duration of the bankruptcy process from 7.8 to 2.3 years; an average increase in the recovery rates for creditors from 19 to 32 cents per dollar; and an average decrease in the observed frequency of breaches of the creditors priority rules from 29% to 2%. This is also shown by Mexico's good position in the Insolvency Resolution Indicator in the DBR 2013 (26 out of 185 countries), as the resolution times and costs are now lower, while the recovery rates for creditors are higher than in other emerging countries (Table 11).

Table 11

Time, cost and recovery rate in bankruptcy resolution processes[1] in countries which form part of the BBVA EAGLES group[2] in 2012

Country	Time (years)	Country	Cost (% of goods)	Country	Cost (% amount claimed)
South Korea	1.5	South Korea	4	Indonesia	14.2
China	1.7	Taiwan	4	Brazil	15.9
Mexico	**1.8**	India	9	Turkey	23.6
Taiwan	1.9	Russia	9	India	26
Russia	2	Brazil	12	China	35.7
Turkey	3.3	Turkey	15	Russia	43.4
Brazil	4	Indonesia	18	**Mexico**	**67.3**
India	4.3	**Mexico**	**18**	South Korea	81.8
Indonesia	5.5	China	22	Taiwan	81.8
EAGLES Average[2]	**2.6**		**12**		**43.0**

Notes:
1. The BBVA EAGLEs group currently consists of the following countries: China, India, Brazil, Indonesia, South Korea, Russia, Mexico, Taiwan and Turkey.
2. Mexico is not included.
Source: BBVA Research with data of the Doing Business Report 2013.

Nevertheless, as stated in the Preamble of the Initiative, recent experience, particularly as the result of certain court actions arising from the financial crisis, has shed light on areas of the current legislation which could be reformed to improve their efficacy, efficiency and justice of mercantile bankruptcies. Accordingly, it is proposed to establish a classification in the LCM of certain situations in which, due to current shortcomings in that law, creditors might be unprotected. At the same time, certain provisions which regulate the times and procedures of mercantile bankruptcies are reinforced to prevent certain legal abuses which could occur by the merchant, its administrators or other bodies in the process to the detriment of the bankruptcy estate (Table 12). It is also proposed to adopt in the LCM the most modern and standardized technological and accounting mechanisms, such as electronic signature, the use of formats to request or file mercantile bankruptcy proceedings, or even the possibility of hiring an external auditor in the verification process, in order to make actions more expedite.

Table 12

Main changes in the Corporate Bankruptcies Act proposed in the Financial Reform Initiative

- **Imminence of bankruptcy proceedings**. When the generalized breach in the payment of the merchant's obligations is imminent, the merchant may apply for bankruptcy proceedings during a period prior to that currently established.
- **Joint filing for bankruptcy**. The merchant or its creditors shall be entitled, using the same procedure, to file bankruptcy for two or more companies which are controlled by another or which form part of the same economic group.
- **Contracting essential credits**. Details about their preferential payment, with the purpose of using such credits to continue the ordinary operations of the companies which are engaged in bankruptcy proceedings.
- **Reconciliation stage**. Once the current deadlines and their maximum extensions have elapsed (180 days and, if applicable, up to 2 90-day extensions), the stage of bankruptcy will be started automatically.
- **Execution of guarantees**. Opposition to it is limited. The receiver will only be entitled to prevent the execution of a guarantee on goods which are linked with the ordinary operations of the company when the transaction which is the object of the guarantee has been performed within the retroactive period.
- **Credits between related companies (intercompany).**
  - a) With regard to the declaration of bankruptcy, a rule is added so that recognized creditors classified as "intercompany debt" which represent at least 25% of the total recognized sum of credits, be subject to more stringent rules to form a sufficient majority to approve the reconciliation agreement, and
  - b) The figure of "subordinated creditors" is added; these figures consist of whoever should agree it with the merchant, those parties whose credits had not been recognized in time, or the creditors of unsecured loans granted by intercompanies.
- **Special bankruptcies**. The powers of the Government are strengthened in regards to the administration of concession companies declared bankrupt, with the aim of guaranteeing the continuity in the provision of the service or the operation of the corresponding public good.
- **Regime of liabilities of the administrators and directors of the bankrupt company**. A civil regime of liabilities and a new criminal offense are added for members of the board of directors and relevant employees of the bankrupt company in favor of the bankruptcy estate, when these persons had caused an impairment of capital and the merchant is generally failing to comply with the payment of its obligations.
- **Fraud by creditors and "Intercompany" transactions**. Greater flexibility in the burden of proof in order to extend the retroactive date. It is also acknowledged that the action of liability can be brought by: i) a fifth of the recognized creditors, ii) recognized creditors which represent, overall, at least 20% of the total amount of recognized credits, or iii) the designated auditors.

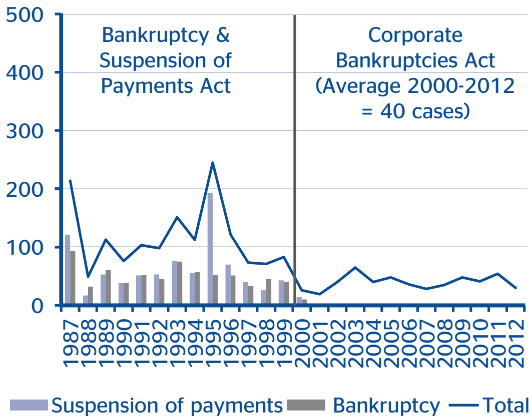
Source: BBVA Research, with information on the Financial Reform Initiative of May 8, 2013

To put these proposals in context, it is important to note that over 13 years following the coming into force of the LCM, it is observed that the number of mercantile bankruptcy processes presented every year has remained below the number of bankruptcies and suspensions of payments which occurred under the previous law (Chart 43). Furthermore, the ratio of claims started by creditors with respect to the total claims under the two regimes has remained in the neighborhood of 50% (Chart 44). These are not necessarily signs of shortcomings in the LCM. On the one hand, as stated by Gamboa and Cavazos (2007), in its early years the LCM fulfilled its objectives of reducing the duration of proceedings and better protecting creditors' rights. On the other hand, the philosophy of the LCM appears to have been to treat debtors under bankruptcy proceedings more strictly in the hope that this would be an incentive for them to reach out-of-court settlements with their creditors or through other individual court proceedings which were also reformed through the Miscellany of Guarantees of 2000 and which are less costly than mercantile bankruptcy proceedings.[5]

[5] For a more in-depth discussion, see Fisher and Castellanos (2005).

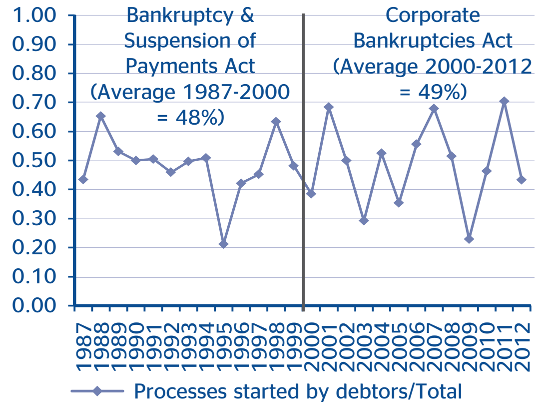
However, because the indicators of the DBR 2013 show that the cost of the process as a percentage of the assets of the bankruptcy estate is higher in Mexico than in other countries, it is pertinent to propose adjustments to the LCM for reducing the duration of proceedings and increasing protection of creditors. These improvements will reduce the various costs to the benefit of the two parties.

Chart 43
Bankruptcy proceedings in Mexico, 1987-2012: Total number of processes started



Source: BBVA Research with Gamboa and Schneider (2007) and IFECOM data.

Chart 44
Bankruptcy proceedings in Mexico, 1987-2012: Ratio of processes started by creditors over total number



Source: BBVA Research with Gamboa and Schneider (2007) and IFECOM data.

Evaluation

A financial reform which seeks to increase the supply of credit cannot afford to overlook the importance of improving conditions to ensure that contracts are complied with in Mexico, and, in the event of a breach, to ensure that creditors are able to recover the guarantees given by the debtor to cover such a contingency. Accordingly, the Initiative contains measures to reinforce the four aforesaid institutions. It should be added that the implementation of these kinds of measures not only reduces credit risk and improves conditions for granting credit, but has the potential to improve the environment for doing business in Mexico, while also attracting investment.

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3.e Reforms to strengthen the banking system

Introduction

The measures within the Initiative aimed at strengthening the banking system are concentrated in the Decree Reforming, Adding to and Repealing Various Provisions of the Credit Institutions Act, the Business Insolvency Proceedings Act, the Protection of Bank Savings Act and the Securities Market Act. One of the aims of this Decree is to create a special regime for bank resolution and to incorporate within the institutional framework other aspects related to the international agenda regulating financial stability. Among these aspects is the definition of the action parameters for the lender of last resort, the obligation for banks to have contingency, resolution and self-correction plans, the strengthening of prudential measures applicable to banks whose parent companies abroad face insolvency problems, and the creation of a Bank Liquidity Regulation Committee.

3.e.1 Resolution and liquidation of multiple banking institutions: changes to improve the process

In Mexico a system of early corrective actions was introduced in 2004 and a procedure for bank resolution in 2006. However, a bankruptcy process for banks still had to be established as the third and final stage of the framework for dealing with distressed banks. Although in the opinion of the financial authorities the present system for bank resolution in Mexico already complied with several of the Key Attributes of Effective Resolution Regimes for Financial Institutions (KA) published by the Financial Stability Board (FSB), it was considered that important points still had to be dealt with, such as giving the authorities powers to require that banks prepare contingency plans for recovery and to require them to provide the information needed to prepare resolution plans.[1] As a result, this component of the initiative is wide-ranging and detailed with respect to the different stages or phases of the process.

First, the initiative defines the resolution of a banking institution as a set of actions or procedures that the competent financial authorities implement in a bank that has solvency or liquidity problems which affect its financial viability. This mechanism aims to provide an orderly and swift liquidation of a bank, or exceptionally its rehabilitation. It establishes that the resolution of a bank will take place when determined by the Banking Stability Committee (formerly the Financial Stability Committee) or when the National Banking and Securities Commission (CNBV) has revoked the bank's authorization to incorporate and operate as a bank. In both cases the Institute for the Protection of Bank Savings (IPAB) intervenes to determine what actions will be carried out to liquidate the institution. At the same time, it determines whether to proceed with the restructuring of the institution, or to pay or transfer the assets and liabilities to another institution, which may be a bank meeting the capitalization levels required, or an institution operated and incorporated by the IPAB itself.

The conventional winding-up and liquidation of a multiple banking institution is understood to occur when a shareholders' meeting takes place, requests authorization to continue operation to be revoked and appoints an administrator (to be supervised by the CNBV). In this case the bank should not have obligations (deposits) guaranteed by the IPAB and the shareholders' meeting must approve the institution's financial statements.

In addition, judicial liquidation of multiple banking institutions refers to the case where authorization granted to incorporate and operate as such an institution has been revoked on the grounds of "capital extinction". This occurs when the assets of an institution are not sufficient to cover its liabilities, as established by a decision based on the institution's financial information. In this case, the IPAB becomes the bank's administrator.

[1] See, for example, the Annual Report on the State of the Stability of the Financial System in Mexico and the Activities of the Financial System Stability Board (CESF), CESF, March 2013.

If financial support is considered for an institution that has received protection under the conditional operation regime,[2] this support will have to be given by the purchase of shares of the bank in question. In this case, the IPAB will call a shareholders' meeting to agree on the capital contributions necessary to achieve the required capital ratio. Once the institution has been capitalized, the IPAB must sell the shares it owns in the bank.

The financial restructuring of multiple banking institutions through loans will only be applied to institutions that are not in the conditional operation regime or that did not comply with the repayment of loans of last resort granted by the Bank of Mexico (Banxico). In this case the precautionary administrator appointed must arrange a loan with the IPAB in the name of the bank it represents for an amount equal to that needed to comply with the capitalization ratio required. Payment of the loan will be guaranteed by using all the bank's shares as collateral. In addition, the administrator will call a shareholders' meeting to agree a capital increase up to the amount required to repay the IPAB loan. If the IPAB loan is not repaid, the IPAB will be assigned the shares pledged as collateral and will value them. Once the shares have been assigned, the IPAB will call a shareholders' meeting to agree on the capital contributions necessary and ensure the bank complies with the required capitalization ratio.

The initiative establishes that the IPAB and the affected banks will try to pay savers and other creditors as soon as possible, while obtaining the maximum recovery value for the assets of these banks. The Initiative establishes an order of seniority for repaying the Institution's debt (Table 13).

Table 13

Order of seniority for payment of the debt of institutions in the process of bank liquidation

i) Secured loans;
ii) Employee claims, other than those in favor of workers for wages or salaries paid in the last year and for compensation payments;
iii) Loans that according to the law in force have special privileges;
iv) Claims derived from payment of guaranteed obligations under the Law on the Protection Bank Savings (LPAB);
v) Claims derived from guaranteed obligations under the LPAB for the balance exceeding the limit of 400,000 UDIs as established by the LPAB;
vi) Claims derived from obligations other than those stipulated in the above items;
vii) Claims derived from preference subordinate obligations, pursuant to the LPAB;
viii) Claims derived from non-preference subordinate obligations; and
ix) Any other claims that may remain will be submitted to the owners of the shares representing the share capital.

Source: BBVA Research, with information on the Financial Reform Initiative of May 8, 2013

When the IPAB finds that it is not possible to carry out or conclude the liquidation of an institution agreement by the shareholders' meeting, it will make this known to the judge, who will order the cancellation of the entity's registration in the Public Commercial Registry. In the judgment declaring judicial liquidation it will state that the IPAB will act as judicial administrator and the CNBV and CONDUSEF will act as representatives of the collective interests of the institution's creditors. The judicial administrator must conclude any operations pending started by the administrator, and once the process is complete, present a report on the case to the judge, who will in turn make a ruling declaring the termination of the judicial liquidation process.

3.e.2 Loans to institutions from the lender of last resort

Access to finance, including finance provided by the central bank as a lender of last resort, may determine a bank's situation of illiquidity or insolvency. That is why the Initiative establishes that if a multiple banking institution receives a loan from Banxico as a lender of last resort, the guarantees on the ordinary shares in these institutions must be set up as an irrevocable pledge of securities in favor of Banxico. The CEO of the bank receiving the loan must indicate that 100% of its shares are transferred to the account designated by Banxico. This guarantee will be concluded through the legal delivery of shares that will be understood

[2] The initiative also lays down that the conditional operation regime requires a trust to be set up for fiduciary assignment of the bank's shares.

complete when they are registered as a deposit in the account designated by the central bank. The guarantee will remain in force until the obligations deriving from the loan are complied with. It is also proposed that when a bank receives a loan from Banxico as lender of last resort, it will be subject to restrictions on its operations similar to those established for the case in which an institution does not meet the capital requirements, until the bank completes repayment of the loan (Table 14). In the case of non-compliance, Banxico may exercise the corporate and property rights inherent in the shares.

Table 14

Some operations that are restricted for banks that receive a loan from Banxico as lender of last resort

- Suspension of dividend payments to shareholders and of programs for the repurchase of shares in the bank and its financial group
- Prohibition against increasing credit with related persons
- Suspension of payment of extraordinary bonds to the CEO and public officers of up to two lower hierarchical levels

Source: BBVA Research, with information on the Financial Reform Initiative of May 8, 2013

3.e.3 Already existing prudential and corrective measures that are incorporated into the Law

The Initiative also reinforces some prudential and corrective measures. For example, those that may arise as a result of the stress tests carried out by the banks. Banks must evaluate, at least once a year, whether the capital they have would be sufficient to cover possible losses derived from the risks these institutions could incur under a variety of scenarios, in accordance with the general provisions established for this purpose by the CNBV. The institutions whose capital is not sufficient to cover the losses that the CNBV may estimate must accompany the results of their tests with a plan of actions designed to increase their capital and cover estimated losses. The outline of this plan will also be established by the CNBV through general provisions.[3]

3.e.4 Obligation on the banks to maintain contingency plans, resolution plans and self-correction programs

In accordance with other FSB guidelines with respect to institutions of systemic importance, the Initiative establishes the obligation for banking institutions to have a contingency plan in place that sets out the actions to be taken to re-establish their financial position in case of adverse scenarios that may affect their solvency or liquidity. This plan must be approved by the CNBV, following opinions submitted by the SHCP, Banxico and the IPAB. The CNBV will decide on the requirements that these plans must comply with. In addition, the CNBV may request tests to be carried out and require the necessary adaptations resulting from them to be made.

It is also proposed that the banks, and other regulated financial intermediaries, may submit self-correction programs for approval to the CNBV, the CONDUSEF and the IPAB when they or their audit committees detect irregularities or non-compliance with the LIC, provided that the non-compliance is not serious or has not been detected previously by one of the three authorities. These programs will be subject to the general provisions issued by the CNBV, the IPAB and CONDUSEF. While the plan approved is in force, the authorities shall refrain from imposing penalties; but if the irregularities are not made good, they may not be the object of a subsequent new program, and the authorities may impose the corresponding penalty.

With respect to the resolution plans, it is proposed that the IPAB, with the participation of the CNBV, Banxico and the SHCP, prepare resolution plans for banking institutions that specify the form and terms under which they may be resolved in a swift and orderly manner. The IPAB shall set out guidelines to determine the programs and timetables, as well as the content and scope of these plans. To this end, the IPAB may request all the information it requires from the institution in question. The IPAB shall also request the institution to carry out practice executions of the resolution plans.

[3] It is important to note that the results of the stress tests carried out by the banks since 2011 and the recommended measures or observations for banking institutions have been made public through the Annual Report on the State of Stability of the Financial System in Mexico and on the Activities Carried out by the Committee for the Stability of the Financial System.

3.e.5 Liquidity ratio and treatment of systemic banks with liquidity problems

The Initiative proposes creating a Bank Liquidity Regulation Committee (Committee) made up of six high-level officials from the SHCP, CNBV and Banxico. The Committee will in turn draw up the guidelines aimed to ensure that the institutions can meet their payment obligations under various deadlines and different scenarios. At the same time, it is proposed that the multiple banking institutions comply with the liquidity requirements issued jointly by the CNBV and Banxico by way of general provisions based on the Committee's guidelines. Inspection and oversight of compliance with these requirements will be the responsibility of the CNBV, which may, in case of non-compliance, suspend or limit the bank's operations. With respect to the liquidity requirements for banks, it is worth recalling that the liquidity ratio proposed in this initiative follows the recommendations on the Liquidity Coverage Ratio (LCR) as published by the Basel Committee in 2013. This must be introduced in 2015 and rise gradually to reach 100% in 2019 in accordance with this Committee. It is also worth recalling that at the start of 2013 the CNBV distributed among banks a draft of the modifications it planned to carry out in this matter.

3.e.6 Clarifying the conditions for foreign government stakes in banking institutions

Various questions were raised in 2010 with respect to whether, under Mexican law in force at the time, due to the bank bailout measures in the United States (U.S.) a review was needed of Citibank's stake in the share capital of Banamex. In particular, whether Citibank should be asked to sell its stake. The Mexican authorities decided not to make the request, given that the U.S. government's stake in Citigroup was not intended to gain control over it. Against this background, the Initiative proposes that foreign governments may not participate in the share capital of multiple banking institutions either directly or indirectly, with three exceptions: i) for prudential reasons and as a temporary measure; ii) when they do so through official corporate entities (for example, development funds); and iii) when the stake is indirect and does not imply that the government is in control of the institution. In addition, official corporate entities shall be allowed to hold stakes provided that these entities do not exercise functions of authority and their decision-making bodies operate independently of the foreign government in question.

3.e.7 Basel III capital regime

Adjustments have been introduced to the LIC in order to implement the Basel III capital regime. It is worth noting that this regime has already been reflected in regulation. However, the way in which it has been incorporated presented some problems, because the corresponding changes had not been made to the LIC. In particular, in some circumstances, arbitrary adjustments to the bank capital ratio would have to be made, which is not desirable in terms of market transparency.

Evaluation

Among the measures in the Initiative aimed at strengthening the banking system is the creation of a specialized regime to carry out the orderly liquidation of banking institutions. The aim is for Mexican legislation to comply better with the KA published by the FSB. These provisions are detailed and have the advantage of trying to establish clearly the different stages to be followed when carrying out the resolution of a bank. This makes the process transparent and helps it to be carried out swiftly. It also clarifies the costs for institutions if they obtain loans of last resort from the central bank or loans issued by the IPAB.

The form in which the Basel capital regime has been incorporated is positive, as it solves some of the limitations in the secondary regulation. However, at the same time this regime was introduced in a general form, so that its broad flexibility allows capital requirement adjustments to be made in the future without the need for changes in the law.

With respect to contingency plans, it is worth mentioning that the current legislation included in the Single Bank Circular (CUB) issued by the CNBV already mentions that the banks must have such contingency plans. The fact that these measures are included in the Law and that it is the CNBV that lays down the requirements for their formulation strengthens this obligation and is also in line with the FSB's KA. In reality, the drafting about these adjustments in the LIC still specifies that it is through the general provisions that the CNBV shall determine faculty to establish or increase these requirements. Similarly, a specialized committee has been set up to lay down the main guidelines for the liquidity measures aimed to ensure that institutions may comply with their payment obligations.[4]

However, some of the measures included in the Initiative are not based on the analysis of the international working groups on banking regulation. Given that all regulation is costly, any measures that exceed minimum international standards should have a clear associated benefit. With respect to the importance for lending activity of the correct measurement of risk, which the Initiative aims to support in various ways, the proposals for the Performance Evaluation of Multiple Banking Institutions are well intentioned, but could be difficult to implement; and if they are implemented wrongly, they may be counter-productive for financial stability and economic growth. The practical obstacles for their implementation include measurement of the contribution to economic growth of the different segments and the identification of private credit or financial restrictions as the key barrier to growth and productivity. This is commented in more detail in ***Box 6: What does ENAMIN tell us about the need for bank credit among microenterprises in Mexico?*** The international evidence available so far supports the idea that financial regulation promoting transparency and competition among private financial institutions promotes financial inclusion and economic growth; and that measures that ensure credit flows for political ends may reduce the quality of financial services while increasing their cost, as well as giving rise to corruption in credit allocation.[5]

Lastly, the clarification with respect to the participation of foreign governments in banks is welcome, as the current drafting establishes in a very general way that "Foreign corporate entities that exercise functions of authority may not participate in any way in the share capital of multiple banking institutions." The proposed drafting therefore will avoid future controversy, such as that arising when the U.S. government participated as a shareholder in some banks as a result of the 2008 crisis.

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[4] It is important to note that the results of the stress tests carried out by the banks since 2011 and the recommended measures or observations for the banking institutions have been made public through the Annual Report on the State of Stability of the Financial System in Mexico and on the Activities Carried out by the Stability Committee of the Financial System.

[5] See, for example, Levine (2011)

Box 5: Bank Lending to Companies: How Much Can It Grow with An Ideal Financial Reform?

As mentioned above, the financial reform initiative ("Initiative") presented by the Federal Government aims to increase credit supply and improve its conditions. Many details of the Initiative that will determine its final impact on lending will be defined after the legislative process ends and authorities have issued the secondary regulation, which will be necessary to comply with the new requirements. However, in order to assess the Initiative's impact, it is possible to construct scenarios that estimate the potential impact of what may be termed the "Ideal Financial Reform" ("Ideal Reform") to help assess the size of the Initiative's impact. We consider the Ideal Reform to be one which achieves the goal of improving conditions so that the supply satisfies the potential demand for credit in the country.

The data that the Bank of Mexico (Banxico) publishes every quarter on the various sources of credit and finance to the private sector is useful to measure the size of the current penetration of financing in Mexico. The data show that at the end of 2012 lending to companies by commercial and development banks accounted for 7.7% and 1% of GDP, respectively. In other words, at the end of 2012 lending to companies in the private sector by these banks totaled 8.7% of GDP.

We have estimated the potential increase of credit to companies as a proportion of GDP if the Ideal Reform is enacted and improves the credit supply conditions by making them more attractive to the companies that need finance. The exercise we performed is based on two assumptions: i) all the companies in the country that need loans and have not obtained them apply for them and obtain them from banks; and ii) the amounts of the new bank loans obtained by these companies are equal to the average amounts of loans that the companies obtained in 2012.

This exercise combines information from two sources. The first is the 2009 Economic Census ("Census"). As analyzed in more detail in the November 2011 issue of ***Mexico Banking Outlook***, it contains data on 3,437,645 economic units of private and public sectors operating in 2008, disaggregated by firm size (micro, small, medium and large, according to the number of workers) and their access to finance (had bank credit, had non-bank financing only, without credit or financing due to lack of interest or trust in banks and, finally, without credit or financing because they were not attracted by the credit conditions)[1] (columns 3, 4, 5 and 6, respectively, of Table 15).

The categories of companies according to access to finance in the November 2011 issue of ***Mexico Banking Outlook*** were used to estimate the potential bank credit market. In other words the number of companies that could apply for a loan, based on the total number of companies that obtained non-bank financing and those that did not obtain financing because they were not attracted by the credit supply conditions. The 792,270 companies with non-bank financing (column 4 of Table 15) and the 762,966 companies without financing because they did not like the credit conditions (column 6 of Table 15) suggests that there is a potential market for bank credit of 1,555,236 companies of different sizes.

The second source of information is the average amount per borrower of the loan granted, calculated using monthly information published by the National Banking and Securities Commission (CNBV) on the total amount of new lending (or credit marginally withdrawn) granted to companies and the number of borrowers by size of company (a more detailed explanation of these data can be found in the November 2012 issue of ***Mexico Banking Outlook***). As indicated in column 7 of Table 15, in 2012 the average amount of bank credit received by a borrower identified as a microenterprise was 672,000 pesos, while large companies received an average amount of credit of over 39 million pesos in the same year. These figures suggest a close relationship between the average amount of credit granted to each company in 2012 and its size.

Using this information, the Census data were combined with the average amount of credit by company size. If credit supply conditions were improved for the 1,555,236 companies so that they could have incentives to apply for bank loans as a result of the positive impact expected from the Ideal Reform, then the result would be an increase in the balance of bank credit to companies of around 1,151,115 million pesos (column 8 of Table 15), which is equivalent to 7.4 percentage points (pp) of 2012 GDP (column 9 of Table 15).

[1] The reasons reported by the Census for companies in this category by order of importance are: i) bank interest rates are high; ii) belief that they did not meet the requirements; iii) distrust of banks; iv) not knowing the procedure for applying; v) institutions located far away; vi) they applied but it was not granted; and vii) other reasons. Source: 2009 Economic Census, INEGI.

Table 15

Potential for new bank credit penetration among companies as proportion of GDP
Companies that could request new bank credit
Assumed average bank credit amounts per borrower according to the CNBV in 2012 and 2009 Census data

	Economic Census 2009: Companies by access to finance in 2008						CNBV		
	1	2	3	4	5	6	7	8	9
Economic units (companies), by size	Total	%	Have bank credit	Only have non-bank financing	Without credit or financing due to lack of interest or trust in banks	No credit or financing for other reasons	Average amount of credit in 2012, according to CNBV: millions of pesos	Amount of potential new credit = (4+6) *7 (total and by size of company, millions of pesos)	Balance of new credit as proportion of 2012 GDP: Credit / GDP, %
Domestic total	3,437,645	100.0	167,358	792,270	1,715,051	762,966			
Micro (1-10 wks *)	3,287,048	95.6	136,128	757,523	1,638,006	755,391	0.672	**1,016,749**	6.6
Small (11-50 wks)	124,165	3.6	23,164	28,670	65,083	7,248	1.527	**54,854**	0.4
Average (51-250 wks)	21,447	0.6	6,587	4,820	9,613	427	5.805	**30,460**	0.2
Large (251 & more wks)	5,085	0.1	1,479	1,257	2,349	-	39.023	**49,052**	0.3
Total new credit by size of company								**1,151,115**	7.4

* wks = workers employed by company
Note: The CNBV classifies companies by size according to criteria of workers, economic activity and annual sales.
Source: BBVA Research, with data from the 2009 Economic Census, INEGI and CNBV.

Table 15 shows that the largest contribution to growth in credit penetration through the Ideal Reform is by microenterprises, of 6.6 pp of GDP. This is because microenterprises account for the vast majority of companies, and also because they lag behind the most in terms of bank credit. In the case of small and medium companies, if they were granted credit according to the assumptions of this exercise, the penetration of credit in the country would increase by 0.4 pp and 0.2 pp, respectively. In the case of large companies the increase would be 0.3 pp.

Therefore, in the proposed scenario, the increase in credit penetration would come from more credit penetration among microenterprises. This is because nowadays these are the most common type of companies in Mexico, accounting for 95.6% of economic units.

It may be thought that the average amount of credit granted per borrower is low and that it could increase by extending credit penetration in the country. However, some measures of business performance could correct those mistaken public perceptions, since: i) average amount of fixed assets; ii) profit margin; and iii) productivity. These measures show that a higher amount of credit may not be financially viable for companies applying for bank credit for the first time after the implementation of the Ideal Reform.

According to the analysis of those variables presented in the November 2011 issue of ***Mexico Banking Outlook***, companies that already have bank credit exhibit the best performance among all types of companies, in terms of their access to financing. Such companies showed the highest values for the three variables, which means that companies with bank credit have a greater payment capacity than other potential applicants for this type of financing. One possible explanation is that companies that already have credit, in particular microenterprises and small companies, have fixed assets of greater value that they can use as collateral (Table 16), generate greater profits which provide more funds to pay loans (Chart 45), are more productive companies, and thus can take better advantage of the financing obtained (Chart 46) than others.

Table 16

Total value of fixed assets per worker paid in fixed salaries and wages December 2008 data, thousands of current pesos

Economic units (companies) that:	Size of economic units			
	0 - 10 wks*	11- 50 wks	51-250 wks	251 and more wks
1) Had bank credit	254	207	316	501
2) Had non-bank financing only	233	193	332	1,095
3) Without credit or financing for other reasons	205	158	336	766
4) Without credit or financing due to lack of interest or trust	203	150	253	355

* wks = workers employed by company
Source: BBVA Research with 2009 Economic Census data.

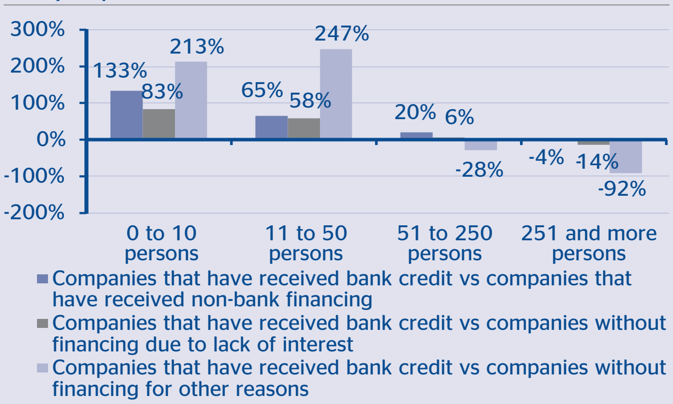
As a complement to the exercise described, in the Ideal Reform is also assumed an additional increase in the amount of credit granted. This is a plausible assumption, since the actual Initiative promotes a reduction in the costs of recovering guarantees and greater competition between institutions offering credit. This scenario would imply that the numbers of credit penetration shown above have to be completed with an estimated amount of additional credit granted to companies applying for bank loans, as a result of the benefits of the Ideal Reform. At present we do not have any indicator that allows us to make such estimate, but to the extent that the Ideal Reform reduces credit risk, it is expected that the average amount of credit granted increase, or that loans are granted at lower interest rates.

Limitations to the exercise carried out

The exercise described above has some limitations that should be noted. The first assumption was that companies that apply for credit have the same payment capacity as companies that have already received bank credit (or, as pointed out above, that as a result of the Ideal Reform the amount of average credit per company increases, with all the other variables remaining constant). However, if companies that are new credit applicants have a lower payment capacity due to their own problems or characteristics (bad management, weak demand for products, and lower productivity and generation of cash flows, among others), the increase in credit penetration could be below the estimate of 7.4%.

Chart 45

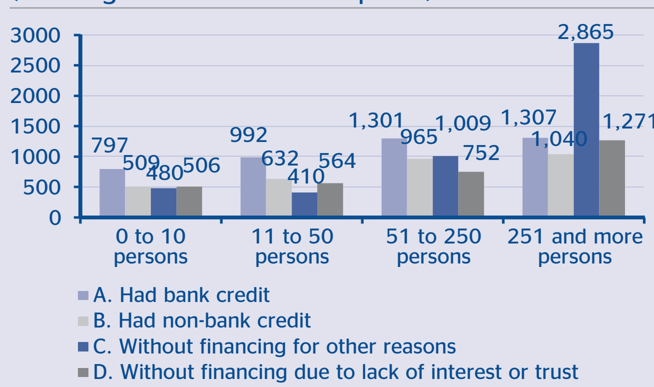
Companies that have received bank credit: difference between profit margins with respect to other types of company



Source: BBVA Research with 2009 Economic Census data.

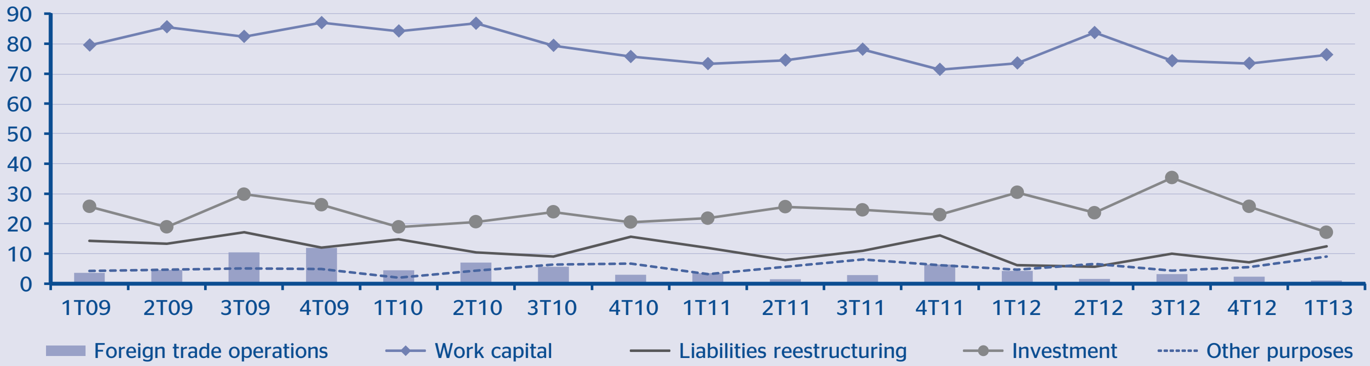
Chart 46

Comparison of income per worker remunerated with fixed wages or salaries according to whether the company was or was not granted bank credit (2008 figures in thousands of pesos)



Fuente: BBVA Research con datos del Censo Económico 2009.

Chart 47
Use of bank credit grated to companies: percentage responses; %*



*The responses total more than 100% because there may have been more than one use of bank credit
Source: Bank of Mexico

A second limitation of the exercise is that it does not include the companies that, according to the Census, did not apply for credit due to lack of interest or because they did not trust banks (column 6 of Table 15). These companies are mainly microenterprises and represent 49.9% of the total number of operating companies in Mexico. Although the Census information does not ask about the reasons that explain the lack of interest in credit, one possible reason could be the lack of profitable projects that would require financing to carry them out.

Another limitation to the exercise is that it assumes that the Ideal Reform only improves bank credit supply conditions. But as we explain in sections 3.c and 3.d, the Federal Government's Initiative also contains measures designed to strengthen other financial intermediaries that offer credit to companies, such as credit unions, Sofomes and development banks. Commercial banking may contribute with a significant proportion of the estimated growth in credit penetration of 7.4 pp of GDP, as it has done so far, but at the moment we do not have all the elements to calculate the size of this fraction.

Effect of the Ideal Reform on the economy's growth rate

An estimate of the impact of the Ideal Reform on Mexico's growth rate faces additional difficulties, such as gathering appropriate data. On the one hand, evidence on credit as a channel for growth in Mexico is limited. And on the other, although the questionnaire in the 2014 Economic Census could (if prepared properly) provide data about growth of profits and wages in companies broken down by their access to finance in 2008, it will not be ready before 2015. Nevertheless, these shortcomings do not prevent from making qualitative estimates about the Initiative's effects.

As the Ideal Reform allows all companies that need credit to obtain it under better conditions, it will represent an important step towards supporting companies and expanding economic activity. However, if the channel for transmitting credit to sustained long-term economic growth is mainly through investment projects or gross fixed capital formation in the country, then the effects of the Initiative in credit penetration may not be significant in the short term.

This is because available surveys (Chart 47) and Census data suggest, that currently a high percentage of bank credit is channeled to working capital, while the proportion targeted at investment projects is much lower. For the Ideal Reform to have a bigger effect on the economic growth potential of the country a greater proportion of bank credit has to be channeled to finance investment.

The above analysis suggests that in the short term the Ideal Reform is a necessary but not sufficient condition for the country's economy to grow faster. Hence, it should be implemented at the same time as other reforms that favor the emergence of new and more profitable opportunities for investment for companies, such as the recently approved reforms in telecommunications (see ***Mexico Economic Outlook***, Second Quarter 2013) and the energy and fiscal reforms that are being prepared (see ***Mexico Economic Outlook***, First Quarter 2013 and ***Mexico Regional Sectorial Outlook***, June 2013.

Conclusions

In this analysis we estimated that bank credit penetration among companies could increase by 7.4 pp of GDP as a result of the Ideal Reform.This increase in credit penetration would take place provided that the reform ensured that companies that received non-bank financing replaced it with bank credit, and that companies that said they had no bank credit because they considered its conditions to be unattractive now applied for it as a result of improvements in the conditions. More extensive bank credit would have the largest impact on microenterprises, given the large number of productive units of this size that could use it.

The factors limiting the expansion of credit that could result from an Ideal Reform are the large number of small companies that could take out bank credit and thus obtain relatively small loans. From a long-term perspective, therefore, another factor that could lead to the expansion of bank credit is if a significant number of microenterprises increased their size, became small, then medium and finally large companies; and also, if a larger number of those small companies decided to obtain a loan and the financial reform allowed them to do so.

It should be pointed out that the initiative proposed by the Federal Government, which was presented here as the Ideal Reform, is aimed primarily to resolve limitations on credit on the supply side. It is clear that in Mexico there are also limiting factors on the demand side, as can be seen in the number of companies that declare they do not want credit. It is therefore important to design policies aimed at promoting the demand for credit. In particular, we think that a reform that increases formality in the Mexican economy (as announced by the Ministry of Finance, which it will submit to Congress) could achieve this objective.

Finally, we should mention that the financial reform entering into force in Mexico will operate through various stages. First, it has to enter into operation and then its benefits and scope will gradually become clear. Once the potential credit applicants and users realize that the financial reform indeed reduced credit risk and made possible for credit to flow to companies under better conditions, then it will have become a tool that offers greater support to the long-term process of economic growth in the country.

Box 6: What Does ENAMIN Tell Us about Bank Credit Needs among Microenterprises in Mexico?

Introduction

Economic theory has modeled entrepreneurs in various ways in order to understand their role as creators of jobs or engines for economic growth. They may be individuals who are: (i) innovators who make the oldest production technologies obsolete (Schumpeter, 1942); (ii) risk takers (Knight, 1921; Kihlstrom and Laffont, 1979); (iii) jacks-of-all-trades, in the sense of having a broad range of talents (Lazear, 2005); or (iv) risk tolerant and patient (Doepke and Zilibotti, 2013).

However, some recent studies suggest that there are significant gaps between the entrepreneurs as they exist in economic models and the owners of the small and medium-sized enterprises or microenterprises that exist in real life. For example, Hurst and Pugsley (2011) report that in the United States (i) most small businesses have little desire to grow and innovate, as they also aim to offer goods or products that already exist in the market; and that this behavior is in line with the characteristics of the industries where small businesses predominate; and (ii) non-monetary benefits play a key role in the decision to create a business. Peña, Ríos and Salazar (2012) analyze the National Microenterprise Survey (ENAMIN)[1] in Mexico and find that starting up a microenterprise is not a first choice for many owners, but rather that they appear to be temporary choices until they find a job, or arise due to the needs of the moment. Thus the logic of business decisions may mean that businesses have different expectations for the future and different appetites for finance.

This line of research suggests that the importance of business talent and financial frictions in explaining the size of companies could be over-estimated; or at least that establishing their importance and designing adequate economic policies probably requires a profound analysis of the subject. With the aim of contributing to this analysis, this section of ***Mexico Banking Outlook*** reviews the results of the last ENAMIN surveys in 2008 and 2010 with respect to some strategic indicators about the number and composition of microenterprises, the reasons why people in Mexico set them up, why they apply for and/or obtain loans, and what they use them for. The end of this section comments some of the implications that these figures have for the design and implementation of public policy.

Number and composition of microenterprises

According to ENAMIN, in 2010 there were nearly 8.4 million microenterprises in the country; around 240,000 more than in 2008 (Chart 48). It is worth noting that the 2008 figure in this survey is more than the 3.3 million establishments with 10 or less employees in the private and state sector operating in 2008 and included in the last Economic Census. This is because the Census does not take into account economic units that do not have a commercial establishment and that operate at their customers' establishment or in another location, such as on the street.[2]

The question of business establishment or premises is relevant, as the proportion of microenterprises with no establishment out of the total is high, though it fell by one percentage point between 2008 and 2010 from 66% to 65%. This happened despite the fact that the proportion of microenterprises with an establishment has grown at a faster pace (6%) than microenterprises without an establishment (2%). In other words, the vast majority of microenterprises do not have an establishment or fixed premises. This factor may make the provision of credit to these productive units more difficult or expensive, because the lack of an establishment may mean the lack of a registered residence, which makes it difficult for creditors to collect loan repayments.

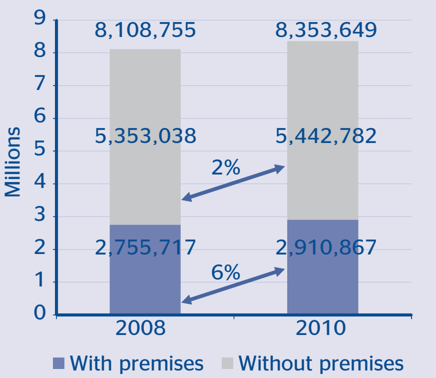
In terms of type of owner, the proportion of self-employed workers fell from 87% to 85%, due to the stronger growth in the proportion of employers compared with the self-employed (21.7% and 0.3%, respectively) (Chart 49). The proportion of microenterprises employing between 1 and 15 workers increased from 31.1% to 35.3%, while the proportion of microenterprises in which only the owners work fell from 68.8% to 64.7%.[3] The segment of microenterprises employing between 6 and 15 workers grew the most, although the starting figure was low: it more than quadrupled its share from 0.2% to 0.9%. Among the microenterprises in which only the owner worked, the proportion of microenterprises that have never employed workers grew from 43% to 44%.

[1] INEGI defines microenterprises as economic units of up to six employees (including the owners and workers, whether paid or not), in the following business activities: mining and construction industries, retail trade, services and transport; and units of up to 16 people (including the owners and workers, whether paid or not) in the manufacturing sector. For more details, see: http://www.inegi.org.mx/est/contenidos/espanol/proyectos/metadatos/encuestas/enm_233.asp?s=est&c=1464&e=28 y http://www.inegi.org.mx/est/contenidos/proyectos/encuestas/hogares/modulos/enamin2010/enamin_nota_2010.pdf.

[2] This clarification is important because the publication mentioned above commented that the Economic Census figure did not include economic units that do not have a commercial establishment and that operate in the owner's home. However, according to the plan for preparing the Economic Census in 2014, if the persons carrying out the survey find homes where economic activities are being carried out, they are instructed to ask these homes to fill out the census questionnaire as well.

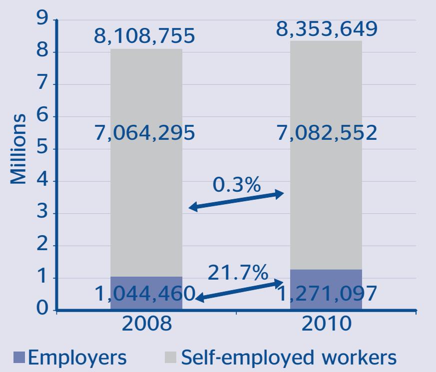
[3] The category of microenterprises in which only the owners worked includes microenterprises that did not employ workers in 2010 or that have never employed workers. This group that had never employed workers accounted for 43% of microenterprises in 2008 and 44% in 2010.

Chart 48
Microenterprises by availability of premises



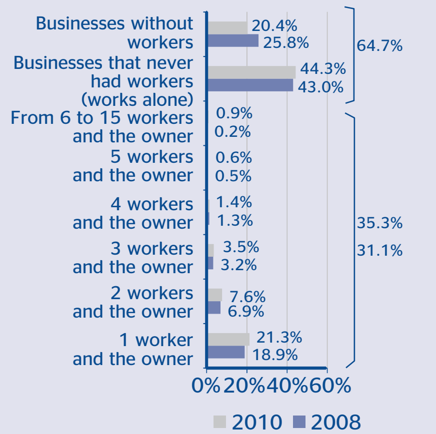
Source: ENAMIN (INEGI)

Chart 49
Microenterprises by type of owner



Source: ENAMIN (INEGI)

Chart 50
Microenterprises by number of workers employed, %



Source: ENAMIN (INEGI)

Motivation for setting up microenterprises and their main problems

The ENAMIN survey indicates that most of the microenterprises in Mexico have never tried to grow or never had appropriate conditions for doing so, as their owners have never employed workers. There is also a very small group of companies that do grow, which is in line with what has been reported by Hurst and Pugsley (2011) about small businesses in the United States. Although the ENAMIN survey does not investigate the desires of microenterprises to innovate or expand, it does contain some questions regarding the owners' reasons for starting their businesses.

Around 80% of microenterprises in Mexico are started by their owners themselves or in association with a family member; or they are started up by spouses or other family members (Chart 51). The main monetary and non-monetary reasons for starting a business in 2010 were, in order of importance:

1) to add to the family income (28.7%);

2) other (includes wanting to be independent, 28%); and

3) to get a higher income than as a salaried worker (18.9%; this reason increases its importance significantly in 2010 with respect to 2008) (Chart 52).

In contrast, the proportion of businesses started because a good business opportunity was found is relatively low (7.7%), as happens in the United States. It is also worth adding that in 2010 only 14% of the owners of these businesses had higher education, while 48% only had complete or incomplete primary education. In the year of the study, 65% of the microenterprises reported not keeping an account book for their business, or refused to answer, and only 16% uses a ledger. These data also suggest that there could be many needs to satisfy in this sector before dealing with those regarding access to financing, such as increasing skills and business management. In addition, the fact that microenterprises are not set up because of a good business opportunity may be negatively related to growth plans, which are a decisive factor in the demand for credit.

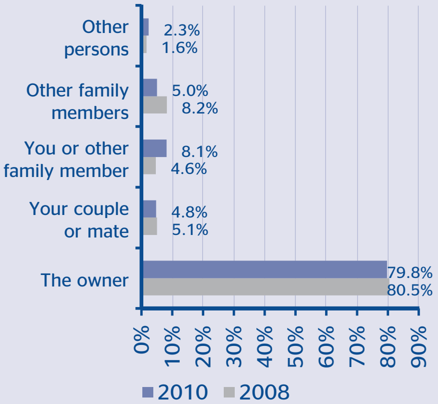
In terms of the main problems for business operation, neither in 2008, when there was a slowdown in economic activity in Mexico, nor in 2010, when growth recovered, was the lack of credit or finance among the most important factors preventing business activity.

A high proportion of enterprises report their main problems to be: 1) low sales, 2) excessive competition, and 3) others, including problems with the authorities. These factors affecting microenterprises have response percentages of over 15%, which is 5 times the frequency reported for the problem of lack of credit or financing. (Chart 53).

The existence of these problems may not only affect the operation of microenterprises; it may also prevent them from growing and thus demanding credit. Low sales and excessive competition generally imply limited margins in business operations, which difficult the capacity for repaying a loan.

Chart 51

Microenterprises by founder of activity or business



Source: ENAMIN (INEGI)

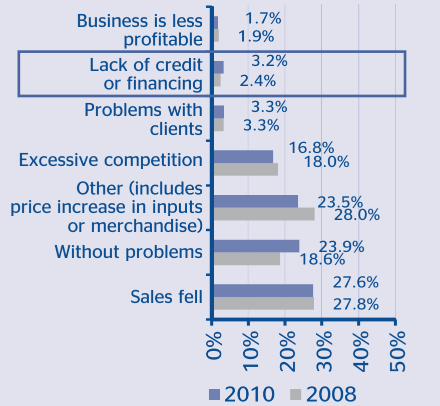
Chart 52

Microenterprises by reason for starting business, %

Source: ENAMIN (INEGI)

Chart 53

Microenterprises by main business problem reported, %



Source: ENAMIN (INEGI)

Applying for and receiving a loan or financing

According to ENAMIN the number of applications for loans made after starting a business remained at around 18% in 2008 and 2010, while the proportions of loans actually obtained increased by nearly four percentage points during these years (Charts 54 and 55). In addition, the increased proportion of companies obtaining the loans they requested occurred despite the fact that the average monthly earnings of microenterprises fell in most sectors of economic activity (Chart 56). The proportion of microenterprises reporting that they earned up to 5 times the minimum wage increased by 6 percentage points on 2008 from 58% to 64% (Chart 57).

The loans obtained after starting the business were used more for purposes related to working capital (buying or acquiring goods or paying business debts) than for productive investment (such as buying premises, vehicles, machinery, equipment or tools, or extending, adapting or repairing premises or vehicles) (Chart 58).

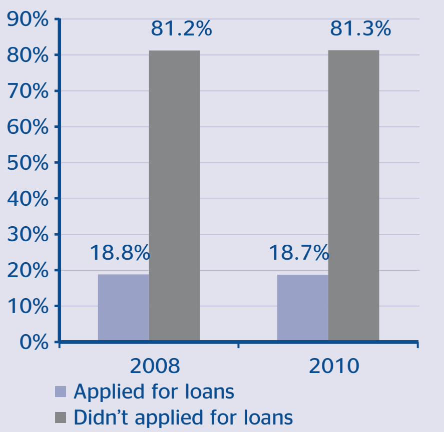
The ENAMIN survey indicates that personal savings are the most significant sources of financing when starting a business, followed by loans from family and friends and severance payments from previous jobs. Finance from government programs and credit from suppliers remained constant in 2008 and 2010 at 1% and 5% respectively, while the importance of sources of financing from a banking institution, savings bank or lender increased from 11% in 2008 to 13% in 2010. Unfortunately, it is not possible to distinguish between credit from banks and other participants in this category (Chart 59).[4]

Evaluation

ENAMIN is the main survey in Mexico covering the characteristics of microenterprises, which form a larger group than the one of retail establishments. With respect to conditions of access to and use of finance, this survey probably raises more questions than answers in the light of studies that document the importance of the reasons given by owners for starting their businesses, in variables as relevant as continuance of business, the number of people they hire and demand for financing. Some data in the survey suggest that for microeterprises, access to loans after starting operations has increased, but internal sources of financing continue to be more important than external sources for starting microenterprises. However, it is undoubtedly a good idea to construct surveys that allow us to have better knowledge of this sector's needs, particularly since the questions on financing do not distinguish between many sources. This information could be useful for monitoring the resources obtained from different intermediaries. The recent National Survey on Competitiveness, Sources of Finance and Use of Financial Services prepared by the National Banking and Securities Commission and the Inter-American Development Bank in 2010 is a good step forward, but the survey did not take into account in its sample businesses with 5 or fewer workers, which are the most numerous businesses in Mexico.

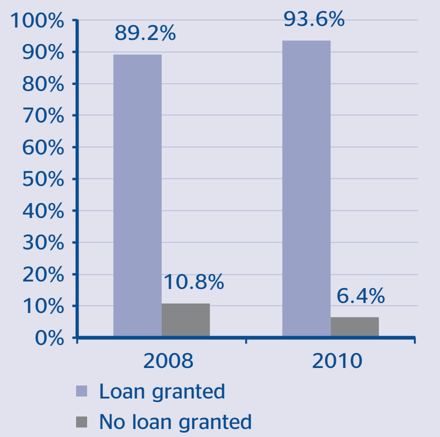
[4] In their analysis of the costs of starting microenterprises in Mexico, based on ENAMIN data for the 1990s, McKenzie and Woodruff (2006) claim that the technologies of production used in many of the economic sectors are such that they are associated with relatively low financing requirements, below USD 200, and that is why they can be satisfied through various sources. However, they warn of the possibility that the microenterprises encountering difficulties in obtaining finance for greater amounts.

Chart 54
Microenterprises and loan applications after start of business



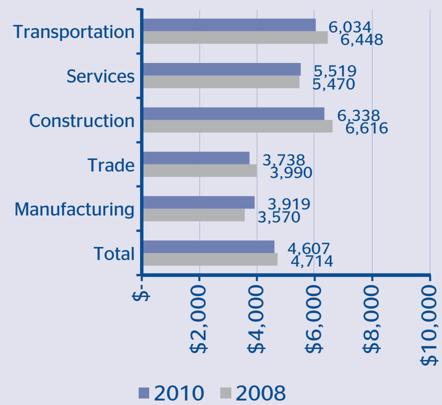
Source: ENAMIN (INEGI)

Chart 55
Microenterprises and loans granted after start of business in 2008 & 2010



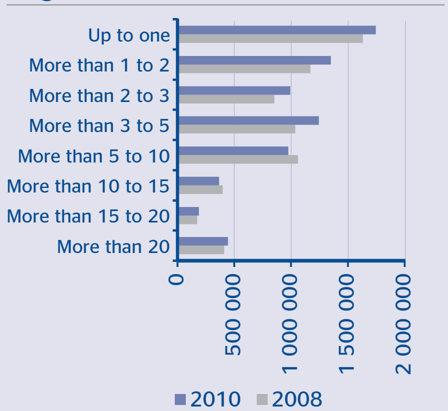
Source: ENAMIN (INEGI)

Chart 56
Microenterprises by average monthly earnings and sector of economic activity, Dec. 09 pesos



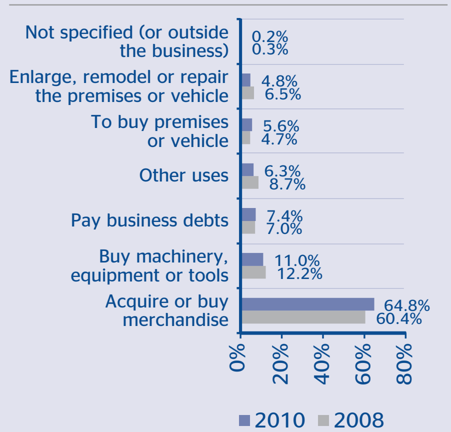
Source: ENAMIN (INEGI)

Chart 57
Microenterprises by income level per month, as number of times minimum wage



Source: ENAMIN (INEGI)

Chart 58
Use of loans obtained by microenterprises after setting up business, %



Source: ENAMIN (INEGI)

Chart 59
Microenterprises by source of loan applied for after setting up business

Source: ENAMIN (INEGI)

In addition, currently there are not enough elements available to forecast whether the size of this sector will continue to increase at the observed rate. This is relevant for estimating its potential needs. Due to the number of reasons for starting businesses that are linked to the labor market, the question arises as to whether the new Federal Labor Law, which is intended to make labor market conditions more flexible, may contribute to a reduction in the number of microenterprises, considering that many of such businesses are in reality self-employed workers who have not been able to find attractive job opportunities. The answer to this question becomes more difficult if we consider the new integrated business development programs announced by the Federal Government, which include skills training and financing, as well as other initiatives aimed at opening up private participation in more economic segments or improving competition in the markets. This in turn could create incentives for setting up new businesses.

What can be inferred from studying the results of the ENAMIN survey is that demand factors explain a significant part of the low level of credit penetration in Mexico among microenterprises. Now that INEGI has announced that the ENAMIN survey will be carried out every two years, it will undoubtedly be useful to analyze subsequent surveys to check their development; and also to try to supplement them with analyses of other surveys, such as the National Survey on Jobs and Employment and the National Survey on Employment, Wages, Technology and Skills in the Manufacturing sector, which aim to investigate the characteristics, behavior and needs of his diverse and complex segment of productive entities in the country in more depth. These businesses are of great importance because, among other aspects, they combine productive activity with job creation.

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4. Statistical Appendix

Table 17

Financial savings: Balances in billions of May 2013 pesos

	IV 02	IV 03	IV 04	IV 05	IV 06	IV 07	IV 08	IV 09	IV 10	IV 11	IV 12	I 13	Struc % I 13
M4a	5,106	5,582	5,946	6,609	7,180	7,696	8,435	8,640	9,268	10,326	11,409	11,506	
- Bills and coins held by the public	356	388	422	456	508	540	583	611	653	699	744	690	
= Financial savings *	4,751	5,194	5,525	6,153	6,672	7,156	7,853	8,029	8,615	9,626	10,665	10,816	100.0
I. Depository institutions	2,102	2,225	2,345	2,513	2,518	2,744	3,073	3,090	3,234	3,427	3,614	3,455	31.9
Resident commercial banks (demand + term)	1,668	1,794	1,907	1,997	2,061	2,280	2,578	2,565	2,692	2,849	2,992	2,867	26.5
Demand	849	926	961	1,081	1,177	1,291	1,335	1,397	1,530	1,669	1,757	1,665	15.4
Term	819	867	946	916	884	989	1,243	1,168	1,162	1,180	1,235	1,202	11.1
Foreign agencies of commercial banks	67	48	55	57	67	91	99	84	93	109	112	92	0.9
Savings & Loan Associations (S&L)	11	13	16	19	22	24	25	54	59	61	65	64	0.6
Development banks	356	370	368	440	368	349	371	386	391	409	445	432	4.0
II. Securities issued by the public sector	2,005	2,218	2,358	2,757	3,179	3,378	3,471	3,633	4,029	4,762	5,604	5,884	54.4
III. Securities issued by private companies	202	258	286	290	324	374	363	349	362	402	397	415	3.8
IV. SAR outside of Siefores	441	492	536	593	651	660	946	956	990	1,035	1,049	1,061	9.8
Financial savings = I + II + III + IV	4,751	5,194	5,525	6,153	6,672	7,156	7,853	8,029	8,615	9,626	10,665	10,816	100.0
Instruments included in financial savings													
TOTAL SAR = Siefores + SAR outside of Siefores	938	1,084	1,206	1,388	1,588	1,700	2,048	2,238	2,477	2,657	2,941	3,093	
Siefores	497	592	671	795	937	1,040	1,102	1,282	1,487	1,621	1,892	2,031	
SAR outside of Siefores	441	492	536	593	651	660	946	956	990	1,035	1,049	1,061	
Financial savings without SAR total	3,813	4,110	4,318	4,765	5,084	5,456	5,804	5,790	6,138	6,970	7,723	7,786	
Debt mutual funds	443	455	459	587	764	880	794	908	1,109	1,111	1,240	1,254	
Real annual percentage change,%													
M4a	4.4	9.3	6.5	11.1	8.6	7.2	9.6	2.4	7.3	11.4	10.5	9.1	
- Bills and coins held by the public	10.4	9.2	8.6	8.0	11.4	6.4	7.9	4.9	6.9	7.0	6.4	3.2	
= Financial savings *	4.0	9.3	6.4	11.4	8.4	7.2	9.7	2.2	7.3	11.7	10.8	9.5	
I. Depository institutions	-4.2	5.9	5.4	7.2	0.2	9.0	12.0	0.5	4.7	6.0	5.5	1.0	
Resident commercial banks (demand + term)	-5.5	7.5	6.3	4.7	3.2	10.6	13.1	-0.5	4.9	5.8	5.0	2.1	
Demand	5.0	9.1	3.8	12.4	8.9	9.7	3.4	4.7	9.5	9.1	5.2	1.5	
Term	-14.4	5.9	9.0	-3.1	-3.5	11.9	25.7	-6.0	-0.5	1.5	4.7	3.0	
Foreign agencies of commercial banks	-15.2	-28.4	13.4	4.4	18.3	34.7	9.0	-15.1	10.5	17.0	3.5	-17.5	
Savings & Loan Associations (S&L)	12.4	21.5	19.4	19.0	16.6	9.3	2.4	115.8	9.3	4.0	5.4	3.9	
Development banks	4.5	4.1	-0.7	19.8	-16.4	-5.1	6.4	4.1	1.1	4.6	9.0	-1.6	
II. Securities issued by the public sector	11.6	10.6	6.3	16.9	15.3	6.3	2.7	4.7	10.9	18.2	17.7	17.9	
III. Securities issued by private companies	35.6	27.9	10.7	1.2	11.7	15.4	-2.9	-3.7	3.6	11.2	-1.3	-1.8	
IV. SAR outside of Siefores	3.3	11.5	8.8	10.6	9.9	1.3	43.4	1.1	3.5	4.6	1.4	1.5	
Financial savings = I + II + III + IV	4.0	9.3	6.4	11.4	8.4	7.2	9.7	2.2	7.3	11.7	10.8	9.5	
Instruments included in financial savings													
SAR TOTAL = Siefores + SAR outside of Siefores	13.2	15.5	11.3	15.1	14.5	7.0	20.5	9.3	10.7	7.2	10.7	11.0	
Siefores	23.6	19.1	13.4	18.6	17.9	11.0	6.0	16.3	16.0	9.0	16.7	16.9	
SAR outside of Siefores	3.3	11.5	8.8	10.6	9.9	1.3	43.4	1.1	3.5	4.6	1.4	1.5	
Financial savings without SAR Total	2.0	7.8	5.1	10.3	6.7	7.3	6.4	-0.2	6.0	13.5	10.8	8.9	
Debt mutual funds	6.2	2.8	0.9	27.8	30.1	15.2	-9.7	14.4	22.2	0.1	11.6	12.5	
Percentage of GDP													
Financial savings = I + II + III + IV	44.5	46.7	46.0	49.1	49.3	48.1	55.9	59.1	60.5	63.7	67.9	69.5	
I. Depository institutions	19.7	20.0	19.5	20.0	18.6	18.4	21.9	22.7	22.6	22.6	22.9	22.1	
Resident commercial banks	15.6	16.1	15.9	15.9	15.2	15.3	18.4	18.9	18.9	18.8	19.0	18.4	
Development banks	3.3	3.3	3.1	3.5	2.7	2.3	2.6	2.8	2.7	2.7	2.8	2.8	
I Rest (Agencies abroad + S&L)	0.7	0.5	0.6	0.6	0.6	0.7	0.9	1.0	1.0	1.1	1.1	0.9	
II. Securities issued by the public sector	18.8	19.9	19.6	22.0	23.5	22.7	24.7	26.7	28.3	31.5	35.7	37.8	
III. Securities issued by companies	1.9	2.3	2.4	2.3	2.4	2.5	2.6	2.6	2.5	2.7	2.5	2.7	
IV. SAR outside of Siefores	4.1	4.4	4.5	4.7	4.8	4.4	6.7	7.0	6.9	6.8	6.7	6.8	
Percentage of GDP, other concepts included in financial savings, %													
Total SAR	8.8	9.7	10.0	11.1	11.7	11.4	14.2	16.4	17.3	17.5	18.7	19.4	
Siefores	4.7	5.3	5.6	6.3	6.9	7.0	7.9	9.4	10.4	10.7	12.6	12.6	

Source: Banco de Mexico (broad monetary aggregates) and INEGI

Table 18

Credit and Financing to the Private Sector: Balances in billions of May 2013 pesos

	IV 02	IV 03	IV 04	IV 05	IV 06	IV 07	IV 08	IV 09	IV 10	IV 11	IV 12	I 13	Str. % I 13
Total: All categories	3,463	3,602	3,848	4,069	4,177	4,914	5,541	5,262	5,380	6,269	6,449	6,362	100.0
Bank	1,088	1,048	1,086	1,232	1,545	1,895	2,030	1,942	2,030	2,292	2,479	2,464	38.7
Non-bank	2,375	2,554	2,762	2,837	2,632	3,019	3,510	3,320	3,350	3,977	3,969	3,898	61.3
Total consumer	223	263	361	501	634	724	685	600	602	685	765	766	12.0
Bank	135	181	255	373	510	618	577	466	465	554	639	641	10.1
Non-bank	89	82	106	128	124	106	108	134	138	131	126	125	2.0
Total housing	826	869	933	987	1,085	1,295	1,310	1,333	1,387	1,464	1,532	1,549	24.4
Bank	245	205	197	246	318	364	385	405	431	449	475	474	7.5
Non-bank	581	663	736	741	767	931	925	928	956	1,014	1,058	1,075	16.9
Total companies	2,414	2,470	2,554	2,581	2,458	2,896	3,546	3,330	3,391	4,121	4,151	4,047	63.6
Bank	708	662	634	613	718	914	1,069	1,072	1,134	1,288	1,365	1,349	21.2
Non-bank	1,706	1,809	1,919	1,968	1,740	1,982	2,477	2,258	2,256	2,832	2,786	2,698	42.4
Real annual percentage change, %													
Total: All categories	4.2	4.0	6.8	5.8	2.6	17.6	12.7	-5.0	2.2	16.5	2.9	3.1	
Bank	-3.4	-3.7	3.7	13.4	25.4	22.6	7.1	-4.3	4.5	12.9	8.2	7.2	
Non-bank	8.1	7.5	8.1	2.7	-7.2	14.7	16.3	-5.4	0.9	18.7	-0.2	0.8	
Total consumer	33.1	17.9	37.2	38.7	26.6	14.1	-5.5	-12.4	0.4	13.6	11.7	11.1	
Bank	28.0	34.4	41.0	46.1	36.9	21.1	-6.6	-19.2	-0.2	19.2	15.4	13.0	
Non-bank	41.8	-7.2	28.9	21.0	-3.2	-14.3	1.4	24.1	2.8	-5.1	-3.8	2.2	
Total housing	5.8	5.2	7.4	5.8	9.9	19.3	1.2	1.8	4.1	5.5	4.7	2.2	
Bank	-11.9	-16.2	-4.0	25.1	28.9	14.6	5.7	5.2	6.5	4.2	5.6	3.3	
Non-bank	15.6	14.2	11.0	0.6	3.6	21.3	-0.6	0.3	3.0	6.1	4.3	1.8	
Total companies	1.7	2.3	3.4	1.1	-4.8	17.8	22.5	-6.1	1.8	21.5	0.7	2.1	
Bank	-4.6	-6.6	-4.2	-3.3	17.0	27.3	17.0	0.2	5.9	13.6	6.0	6.0	
Non-bank	4.5	6.0	6.1	2.5	-11.6	13.9	25.0	-8.8	-0.1	25.5	-1.6	0.3	
Percentage of GDP, %													
Total: All categories	32.4	32.4	32.0	32.4	30.9	33.0	39.5	38.7	37.8	41.5	41.0	40.9	
Bank	10.2	9.4	9.0	9.8	11.4	12.7	14.5	14.3	14.3	15.2	15.8	15.8	
Non-bank	22.2	22.9	23.0	22.6	19.5	20.3	25.0	24.4	23.5	26.3	25.3	25.0	
Total consumer	2.1	2.4	3.0	4.0	4.7	4.9	4.9	4.4	4.2	4.5	4.9	4.9	
Bank	1.3	1.6	2.1	3.0	3.8	4.1	4.1	3.4	3.3	3.7	4.1	4.1	
Non-bank	0.8	0.7	0.9	1.0	0.9	0.7	0.8	1.0	1.0	0.9	0.8	0.8	
Total housing	7.7	7.8	7.8	7.9	8.0	8.7	9.3	9.8	9.7	9.7	9.8	9.9	
Bank	2.3	1.8	1.6	2.0	2.3	2.4	2.7	3.0	3.0	3.0	3.0	3.0	
Non-bank	5.4	6.0	6.1	5.9	5.7	6.3	6.6	6.8	6.7	6.7	6.7	6.9	
Total companies	22.6	22.2	21.3	20.6	18.2	19.5	25.3	24.5	23.8	27.3	26.4	26.0	
Bank	6.6	5.9	5.3	4.9	5.3	6.1	7.6	7.9	8.0	8.5	8.7	8.7	
Non-bank	16.0	16.2	16.0	15.7	12.9	13.3	17.6	16.6	15.8	18.7	17.7	17.3	

Infrastructure and Number of Bank Cards - Units

	IV 02	IV 03	IV 04	IV 05	IV 06	IV 07	IV 08	IV 09	IV 10	IV 11	IV 12	I 13
ATMs	17,011	17,758	20,416	22,900	25,687	29,333	31,932	33,905	35,936	36,448	40,540	40,075
POS terminals	129,971	146,029	160,289	201,852	305,144	418,128	446,025	446,792	482,299	547,708	621,628	629,923
Branches*	7,849	7,768	7,788	7,972	8,404	9,230	10,722	10,731	11,291	11,789	12,413	12,475
Number of current cards at the end of the quarter (figures in millions)												
Credit	7.8	9.4	11.6	14.7	21.4	24.8	25.2	22.1	22.4	24.7	25.4	25.1
Debit	32.4	32.2	31.8	36.1	51.7	51.9	56.9	60.8	75.2	85.6	93.3	96.3

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Credit and Financing to the Public Sector: Balances in billions of May 2013 pesos

	IV 02	IV 03	IV 04	IV 05	IV 06	IV 07	IV 08	IV 09	IV 10	IV 11	IV 12	I 13	Str. % IV 12
Commercial bank credit	377	370	293	294	218	213	186	307	341	358	395		5.3
Federal government	307	271	119	75	40	37	26	37	47	37	13		0.2
States and Municipalities	23	38	74	82	70	80	103	158	207	222	277		3.7
Decentralized gov't agen.	47	62	99	137	107	96	57	112	87	98	105		1.4
Development bank credit	214	174	173	178	167	161	166	130	135	131	151		2.0
Federal government	117	89	90	102	86	102	106	53	58	26	33		0.4
States and Municipalities	14	15	34	33	35	35	30	46	51	82	101		1.4
Decentralized gov't agen.	82	70	49	43	47	24	30	31	26	23	18		0.2
Debt issued in the country	2,129	2,438	2,603	2,987	3,479	3,741	3,916	4,259	4,475	5,157	5,670		76.5
Federal government	1,216	1,410	1,456	1,590	2,045	2,255	2,382	2,707	2,784	3,026	3,301		44.5
States and Municipalities	8	21	28	29	47	56	61	63	65	70	72		1.0
Decentralized gov't agen.	-	22	67	138	173	163	151	164	201	251	259		3.5
IPAB	353	455	536	669	773	866	854	868	850	878	865		11.7
Banco de Mexico	398	342	326	352	224	227	295	282	400	757	997		13.5
FARAC	153	189	190	209	216	173	174	175	175	175	176		2.4
External financing	1,025	1,160	1,109	975	697	668	794	1,057	1,134	1,263	1,195		16.1
Credit and financing TOTAL	3,745	4,143	4,178	4,437	4,571	4,809	5,084	5,753	6,085	6,909	7,410		100.0
Real annual percentage change in the balance, %													
Commercial bank credit	9.6	-1.7	-21.0	0.4	-25.8	-2.0	-13.0	65.3	11.2	4.8	10.4		
Federal government	3.8	-11.7	-56.0	-37.4	-46.0	-8.9	-28.8	41.5	27.0	-20.2	-64.9		
States and Municipalities	34.6	64.6	96.1	10.6	-14.4	14.4	27.7	54.0	31.0	7.4	24.4		
Decentralized gov't agen.	50.4	30.9	60.4	38.1	-21.8	-10.2	-40.9	96.5	-22.1	12.0	7.4		
Development bank credit	13.6	-18.7	-0.6	3.4	-6.3	-3.5	3.0	-22.1	4.5	-3.3	15.4		
Federal government	-5.5	-24.0	0.7	14.3	-16.2	19.2	3.5	-50.1	9.7	-54.3	22.9		
States and Municipalities	17.6	4.1	128.4	-4.4	4.9	1.2	-13.2	50.3	12.8	59.2	23.3		
Decentralized gov't agen.	57.8	-15.3	-30.1	-11.4	8.7	-48.4	24.5	3.4	-16.4	-13.7	-22.2		
Debt issued in the country	19.4	14.5	6.8	14.8	16.4	7.5	4.7	8.8	5.1	15.2	9.9		
Federal government	9.9	15.9	3.3	9.3	28.6	10.2	5.7	13.7	2.8	8.7	9.1		
States and Municipalities	5610.1	147.6	37.7	0.8	65.7	18.1	8.5	3.6	2.9	8.0	2.8		
Decentralized gov't agen.	0.0	0.0	200.6	107.1	24.8	-5.4	-7.3	8.1	22.5	25.1	3.0		
IPAB	44.0	28.7	17.8	25.0	15.5	12.0	-1.4	1.6	-2.1	3.3	-1.4		
Banco de Mexico	20.9	-14.1	-4.7	7.9	-36.4	1.6	29.5	-4.2	42.0	88.9	31.8		
FARAC	51.3	23.3	0.7	9.6	3.8	-19.9	0.3	1.0	-0.1	-0.2	0.4		
External financing	7.9	13.2	-4.4	-12.0	-28.5	-4.1	18.7	33.2	7.3	11.5	-5.4		
Credit and financing TOTAL	14.7	10.6	0.9	6.2	3.0	5.2	5.7	13.2	5.8	13.5	7.3		
Credit and Financing: Percentage of GDP, %													
Commercial bank credit	3.5	3.3	2.4	2.3	1.6	1.4	1.3	2.3	2.4	2.4	2.5		
Federal government	2.9	2.4	1.0	0.6	0.3	0.2	0.2	0.3	0.3	0.2	0.1		
States and Municipalities	0.2	0.3	0.6	0.7	0.5	0.5	0.7	1.2	1.5	1.5	1.8		
Decentralized gov't agen.	0.4	0.6	0.8	1.1	0.8	0.6	0.4	0.8	0.6	0.6	0.7		
Development bank credit	2.0	1.6	1.4	1.4	1.2	1.1	1.2	1.0	1.0	0.9	1.0		
Federal government	1.1	0.8	0.7	0.8	0.6	0.7	0.8	0.4	0.4	0.2	0.2		
States and Municipalities	0.1	0.1	0.3	0.3	0.3	0.2	0.2	0.3	0.4	0.5	0.6		
Decentralized gov't agen.	0.8	0.6	0.4	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.1		
Debt issued in the country	19.9	21.9	21.7	23.8	25.7	25.1	27.9	31.4	31.4	34.1	36.1		
Federal government	11.4	12.7	12.1	12.7	15.1	15.1	17.0	19.9	19.5	20.0	21.0		
States and Municipalities	0.1	0.2	0.2	0.2	0.4	0.4	0.4	0.5	0.5	0.5	0.5		
Decentralized gov't agen.	0.0	0.2	0.6	1.1	1.3	1.1	1.1	1.2	1.4	1.7	1.6		
IPAB	3.3	4.1	4.5	5.3	5.7	5.8	6.1	6.4	6.0	5.8	5.5		
Banco de Mexico	3.7	3.1	2.7	2.8	1.7	1.5	2.1	2.1	2.8	5.0	6.3		
FARAC	1.4	1.7	1.6	1.7	1.6	1.2	1.2	1.3	1.2	1.2	1.1		
External financing	9.6	10.4	9.2	7.8	5.2	4.5	5.7	7.8	8.0	8.4	7.6		
Credit and financing TOTAL	35.1	37.2	34.8	35.4	33.8	32.3	36.2	42.4	42.7	45.7	47.2		

Source: Banco de México and National Banking and Securities Commission

5. Reforms to the Law and Regulatory Framework Applicable to Multiple Banking

Table 19
Reforms to the law and regulatory framework applicable to multiple banking: December 2012 - May 2013

Subject	Scope of the Reform	Regulations Modified (Date of publication in the Official Gazette of the Federation)
1. RESOLUTION PUBLISHING THE COEFFICIENTS FOR MARKET RISK CHARGE APPLICABLE BY CREDIT INSTITUTIONS IN 2013	Pursuant to the provisions of Article 3 Bis 118 of the "General provisions applicable to credit institutions" published in the Official Gazette of the Federation, dated December 2, 2005, and subsequent amendments, credit institutions must in 2013 apply the coefficients for market risk charge stipulated in the tables included in the Resolution.	National Banking and Securities Commission (CNBV). SINGLE BANK CIRCULAR (CUB). General provisions applicable to credit institutions. (31-Jan-2013)
2. RESOLUTION MODIFYING THE GENERAL PROVISIONS APPLICABLE TO THE INSTITUTIONS (EXTERNAL AUDITOR)	In addition to the information currently presented by the External Auditor to the Commission, it will have to submit a report on any illicit conduct or prohibited operations that may have been detected and that damage the credit institution's capital; as well as a report stipulating that any documentation that may have been presented to the Secretariat of Finance and Public Credit, the Bank of Mexico, and the Commission itself, is in accordance with the accounting records of the credit institution. The aim is to ensure better supervision by the Commission with respect to financial intermediaries, while promoting transparency in disclosure of operations by credit institutions.	CNBV. SINGLE BANK CIRCULAR (CUB). General provisions applicable to credit Institutions. (31-Jan-2013)
3. GENERAL PROVISIONS APPLICABLE TO DISCLOSURE REQUIREMENTS MADE BY THE AUTHORITIES AND REFERRED TO BY ARTICLE 117 OF THE LAW ON CREDIT INSTITUTIONS, ARTICLE 34 OF THE LAW ON SAVING AND POPULAR CREDIT, ARTICLE 44 OF THE LAW ON CREDIT UNIONS AND ARTICLE 69 OF THE LAW REGULATING THE ACTIVITY OF SAVINGS AND LOAN COOPERATIVES	These provisions aim to establish the requirements that must be met by the requests for information and documentation submitted to the CNBV by the legal, tax, federal and administrative authorities referred to in Article 117 of the Law on Credit Institutions, Article 34 of the Law on Saving and Popular Credit, Article 44 of the Law on Credit Unions, and Article 69 of the Law Regulating the Activities of Savings and Loan Co-operatives, with respect to transactions and services carried out with their partners by financial institutions such as credit unions, popular financial companies, community financial companies or savings and loan cooperatives; and by credit institutions with customers and users. The aim is for these entities to be capable of identifying, locating and submitting the information and documentation requested.	CNBV. SINGLE BANK CIRCULAR (CUB). General provisions applicable to credit Institutions. (12-Feb-2013)
4. AMOUNT OF FINAL PAYMENTS MADE BY MULTIPLE BANKING INSTITUTIONS AS ORDINARY CONTRIBUTIONS CORRESPONDING TO THE PERIOD BETWEEN OCTOBER 1 AND DECEMBER 31, 2012	The Institute for the Protection of Bank Savings (IPAB) has published the amount of payments made by multiple banking institutions to this Institute for contributions corresponding to the period between October 1, 2012 and December 31, 2012. This Resolution addresses the verification procedures of Level 2 accounts linked to cell phones or other equivalent devices.	IPAB. Publication of the amount of final payments made by multiple banking institutions for ordinary contributions. (8-Mar-2013)
5. RESOLUTION REFORMING THE GENERAL PROVISIONS REFERRED TO IN ARTICLE 115 OF THE LAW ON CREDIT INSTITUTIONS	This Resolution states that in the case of accounts of this kind, entities must validate the CURP obtained and the cell phone number provided, in accordance with the procedures authorized by the CNBV, with approval from the SHCP.	SHCP. General provisions applicable to credit Institutions. (13-Mar-2013)
6. LEGAL PROTECTION LAW	Most important aspects of the Legal Protection Law: • •Replaces the concept of "legal interest" with that of "legitimate interest", which makes it more flexible and allows greater access to legal protection • Establishes the possibility of accessing legal protection to defend "collective" or "diffuse rights". • Modifies the process to allow some actions within the legal protection proceedings to be made in digital format. • Various additional legal situations are specified with respect to suspension, in which suspension is not applicable as it affects the interests of society and contravenes public order. It is important to note that there is no suspension in case of intervention of entities in the financial system • The traditional legal concept of "accountable authority" has been changed to allow individuals to be designated as accountable in legal protection cases when they take actions that unilaterally, directly and immediately affect fundamental rights, provided that such functions are included in a general law • The transparency and publicity given to the Judiciary's rulings and decision-making sessions have been strengthened. • The Judiciary has been given more powers to enforce resolutions dealing with the suspension and execution of rulings granted by legal protection.	DECREE implementing the Legal Protection Law, implementing Articles 103 and 107 of the Political Constitution of the United States of Mexico; various provisions are reformed and added to in the Organic Law on the Judiciary, the Law implementing fractions I and II of Article 105 of the Political Constitution of the United States of Mexico, the Organic Law on the Federal Public Administration, the Organic Law on the General Congress of the United States of Mexico and the Organic Law on the Office of the Mexican Attorney-General. (2-Apr-2013)

Table 19 (cont.)

Reforms to the law and regulatory framework applicable to multiple banking: December 2012 - May 2013

Subject	Scope of the Reform	Regulations Modified (Date of publication in the Official Gazette of the Federation)
7. RESOLUTION MODIFYING THE "GENERAL PROVISIONS APPLICABLE TO CREDIT INSTITUTIONS" AND THE "RESOLUTION MODIFYING THE GENERAL PROVISIONS APPLICABLE TO CREDIT INSTITUTIONS" PUBLISHED IN THE OFFICIAL GAZETTE OF THE FEDERATION ON NOVEMBER 28, 2012	The new provisions make amounts and periods for issuing subordinated debt convertible into shares more flexible; and make it possible for such debt to count as capital without the need to be traded on the Mexican Stock Market.	CNBV. SINGLE BANK CIRCULAR (CUB). General provisions applicable to credit institutions. (16-Apr-2013)
8. RESOLUTION MODIFYING THE GENERAL PROVISIONS ESTABLISHING ACCOUNTING CRITERIA APPLICABLE TO PARTICIPANTS IN THE MARKET OF FUTURES AND OPTIONS TRADED ON THE STOCK MARKET.	This resolution incorporates the valuation rules for shares and other financial instruments forming part of the general balance sheet of settlement partners and clearing houses. It stipulates that the valuation of these shares and other financial instruments must be at fair value, to ensure consistency with the accounting rules applicable to other financial institutions supervised by the CNBV, and to ensure that the integration and disclosure of information provided by both the clearance houses and settlement partners may by the object of better analysis by the authorities, the public and the derivatives market, in virtue of the specialized transactions that such entities carry out.	CNBV. SINGLE BANK CIRCULAR (CUB). General provisions applicable to credit institutions. (19-Apr-2013)
9. GENERAL PROVISIONS APPLICABLE TO BROKERAGE HOUSES AND CREDIT INSTITUTIONS RELATING TO INVESTMENT SERVICES.	Limits to conflicts of interest • Maintain the limit of 0% for instruments that can be considered for purposes of capital integration and 20% for related securities, except in the case of private offers • Make an exception of the 40% limit to issues of securities with a rating equivalent to AAA and AA, following authorization by the committee responsible for analyzing the financial product of the entity involved, as well as private offers; and • The limit of 40% will not be applicable to structured securities with maturity equal to or less than a year and with protected capital Available for sale securities • Corporate securities have been added to this category, including structured notes with protected capital, with maturity of under a year and a rating equivalent to AAA • A clarification has been introduced to the effect that instruments in bank securities accounts, all short term, must have IPAB protection or a rating equivalent to AAA Entry into Force • A scaled transitional system has been established to comply with the different types of obligations • These provisions shall enter into force on **September 30, 2013**, except for those established by Transitional Articles Three and Four referring to: i) The designation of the person responsible for supervising compliance with the Investment Services Circular (for purposes of supervising internal control and current obligations); ii) Training of promoters; and iii) Internal control mechanisms, shall enter into force in December 2013 i) Obligations requiring customer acceptance; ii) Systems, registries and files; iii) Remuneration system; and iv) Regulatory reports, shall enter into force June 30, 2014	CNBV. SINGLE BANK CIRCULAR (CUB). General provisions applicable to credit institutions. (24-Apr-2013)
10. RESOLUTION MODIFYING THE GENERAL PROVISIONS APPLICABLE TO CREDIT INSTITUTIONS (BROKERS)	In accordance with the experience obtained by this Commission derived from supervising the contracting by credit institutions of fees with third parties, and given various consultations and applications made by the sector, it has concluded that it is essential to adjust the applicable regulation to institutions operating and providing these services to the public, to assist in its implementation	CNBV. SINGLE BANK CIRCULAR (CUB). General provisions applicable to credit institutions. (3-May-2013)
11. REGISTRY OF FINANCIAL SERVICES PROVIDERS	These Rules establish guidelines on how financial institutions should update their information online within the Registry for Financial Service Providers (**SIPRES**) run by CONDUSEF. These Rules also govern the organization and operation of this Registry, with the aim of making the service offered by CONDUSEF more efficient and providing users with timely and truthful information	CONDUSEF. RULES governing the Registry of Financial Services Providers (31-May-2013)

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