Basel Committee
on Banking Supervision

# Regulatory Consistency Assessment Programme (RCAP)

# Follow-up assessment of Basel LCR regulations – Mexico

December 2023

This publication is available on the BIS website (www.bis.org).



ISBN 978-92-9259-723-8 (online)

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# Glossary

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| Banxico | Bank of Mexico (Banco de México) |
| BCBS | Basel Committee on Banking Supervision |
| BIS | Bank for International Settlements |
| C | Compliant (grade) |
| CNBV | Comisión Nacional Bancaria y de Valores |
| D-SIB | Domestic systemically important bank |
| G-SIB | Global systemically important bank |
| HQLA | High-quality liquid assets |
| LC | Largely compliant (grade) |
| LCR | Liquidity Coverage Ratio |
| LEX | Large exposures |
| MFA | Mexican Financial Authorities (Banxico and CNBV) |
| MNC | Materially non-compliant (grade) |
| NC | Non-compliant (grade) |
| NSFR | Net Stable Funding Ratio |
| RCAP | Regulatory Consistency Assessment Programme |

# Introduction

The Basel Committee on Banking Supervision (Basel Committee) places a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits from adopting Basel standards can only fully accrue if these are implemented in a full, timely and consistent manner by all member jurisdictions. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members' implementation of the Basel III framework.

Mexico adopted the Basel Liquidity Coverage Ratio (LCR) standard in December 2014 and it has been in effect since January 2015. The LCR implementation in Mexico was assessed as compliant overall and for each component grade in 2015.[1] As presented in Annex 12 of the report, three issues were identified for follow-up by future RCAP assessments teams. The RCAP Assessment Team for the Net Stable Funding Ratio (NSFR) standard and the large exposures (LEX) framework (Assessment Team) considered the list of items for follow-up and determined reassessment of the materiality of the deviation related to the definition of high-quality liquid assets (HQLA) as still relevant today and thus included the item in the scope of this assessment, in agreement with the Mexican Financial Authorities (MFA). This report summarises the finding of the Assessment Team on the follow-up item and presents a revised assessment of the overall and the relevant component assessment grades of the Mexican LCR regulations.

The Assessment Team was led by Mr Jonas Niemeyer, Senior Adviser at Sveriges Riksbank (Riksbank), and comprised four technical experts, from the European Banking Authority (EBA), the Indonesia Financial Services Authority (OJK), the Financial Stability Institute (FSI) and the US Office of the Comptroller of the Currency (OCC) (see Annex 1). The main counterparts for the assessment were the Bank of Mexico (Banxico) and Comisión Nacional Bancaria y de Valores (CNBV), comprising MFA. The work was coordinated by the Basel Committee Secretariat with support from staff of the Riksbank.

The follow-up assessment comprised (i) a reassessment by the MFA of the materiality of the deviation related to the definition of HQLA; (ii) a reassessment by the Assessment Team of the materiality of this deviation; and (iii) a review phase including a technical review of this reassessment by a separate RCAP Review Team and the Basel Committee. The assessment report ultimately reflects the view of the Basel Committee.

The Assessment Team acknowledges the cooperation received from Banxico and CNBV throughout the assessment process.

[1] See *RCAP Assessment of Basel III LCR regulations - Mexico*, March 2015, www.bis.org/bcbs/publ/d316.pdf.

# Executive summary

The Mexican framework for LCR requirements was issued in December 2014 through the publication of the General Provisions on Liquidity Requirements for Commercial Banks. The LCR applies to all commercial banking institutions in Mexico.

Overall, as of 30 September 2023, the LCR regulation in Mexico is assessed as largely compliant with the Basel LCR standard. This is one notch below the highest overall grade and represents a one notch downward adjustment of the initial LCR compliant grade assessed in 2015.

The component grade where the follow-up item is relevant – HQLA – is assessed as materially non-compliant. This two-notch downgrade from the initial compliant grade assessed in 2015 is driven by one material finding. The remaining three components (outflows, inflows and LCR disclosure requirements) are outside the scope of this follow-up assessment and are thus assumed to have remained compliant.

## Response from the Mexican authorities

The National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores - CNBV) and the Bank of Mexico (Banco de México - Banxico) would like to thank the Assessment Team, led by Mr Jonas Niemeyer, as well as the BCBS Secretariat members and supporting staff from Sveriges Riksbank, for a thorough follow-up assessment of the implementation in Mexico of the Basel LCR standard. We appreciate the discussions and exchanges held during the assessment period, which were very candid, deep and fruitful, even though the assessment was conducted remotely.

The Mexican Financial Authorities (MFA) appreciate the opportunity to comment on the follow-up assessment of Basel LCR regulations in Mexico. The MFA agree with the Assessment Team overall findings, which acknowledge that the impact of the assessed follow-up item is not likely to impact financial stability in Mexico. We would like to stress that the LCR regulation was implemented in Mexico in 2015 and was assessed as compliant in the original RCAP assessment. Since then, no material changes have been made to the regulation and, in the opinion of the MFA, it remains aligned with the Basel LCR standard. While the Mexican regulation allows for the unlimited inclusion of Mexican sovereign debt issued in foreign currencies as Level 1 HQLA (which the Basel LCR standard only allows up to a limit), banks operating in Mexico do not rely on holdings of such securities to comply with the LCR minimum requirement. In fact, banks operating in Mexico meet the LCR minimum requirement in excess, even if the aforementioned securities are not considered HQLA. Furthermore, such securities are of high quality and liquidity in the local market and they are eligible for automatically accessing liquidity from the central bank. It should also be mentioned that such securities are used by banks to comply with domestic regulations to limit the net open position (requirements to prevent an FX mismatch), which is an important component of the Mexican macroprudential framework. Thus, the MFA agree that this is not a concern for financial stability. This was discussed at length both during the original LCR RCAP assessment as well as during the current follow-up assessment.

The LCR regulation, which applies to all banks operating in Mexico, regardless of size, whether they are subsidiaries of foreign banks or not and whether they are internationally active or not, has proven useful during the stress periods experienced since its implementation, including during the Covid-19 shock and during the recent turmoil of some banking systems in other jurisdictions.

The RCAP evaluation confirms the MFA's commitment to implement prudential rules consistent with international standards, to effectively limit risk-taking by the regulated institutions.

# 1 Assessment findings

## 1.1 Assessment grades and summary of findings

Overall, as of 30 September 2023, the Assessment Team finds Mexican regulations largely compliant with the Basel LCR standard. This updates the compliant grade in the 2015 LCR RCAP assessment and reflects a material deviation from the Basel standard definition of HQLA. The change in both overall and HQLA component grades is based on the materiality assessment of the follow-up item conducted using the sample banks outlined in Annex 2. This sample consists of six domestic systemically important banks (D-SIBs). Five out of these six banks are subsidiaries of foreign banks and are therefore considered by the MFA as internationally active banks. These five banks comprise about 92% of the assets of all internationally active banks operating in Mexico. Additional considerations include the following:

- As of December 2022, foreign currency sovereign debt securities represented 6.6% and 5.5% of the total HQLA stock across sample banks and in the Mexican banking system, respectively, which indicates a low reliance on such securities to cover overall banks' liquidity needs.
- All banks in the sample would have had LCR levels, even when adjusting for this material deviation from the Basel standard, above the minimum requirement of 100% with a majority of them well above this minimum requirement.
- Even if the LCR is not intended to rely on central bank eligibility of any HQLA, it can be noted that foreign currency sovereign debt securities are eligible as collateral for receiving automatic liquidity at the standing liquidity facility of the Mexican central bank.
- All components other than HQLA were assessed as compliant in the 2015 LCR RCAP assessment and are assumed to have remained unchanged, reflecting the absence of material or potentially material findings.

While the Assessment Team finds the deviation from the Basel standard definition of HQLA to be material, given the points above, the impact on financial stability in Mexico is likely to be limited. Still, the Assessment Team is of the view that this deviation may potentially raise some concerns regarding the international level playing field and the comparability of banks' reported LCR levels. Moreover, the deviation is likely to be permanent as the MFA do not plan to remove it and banks have indicated that they plan to continue using the deviation, even if none of them rely on it to comply with the Basel minimum requirement.[2] The largely compliant overall grade ultimately reflects all of these considerations.

[2] The MFA reported that, notwithstanding the Basel requirements, they see the need to maintain non-discrimination between Mexican sovereign bonds denominated in domestic currency and those denominated in foreign currencies.

| Assessment grades | Table 1 |
|---|---|
| Component of the Basel LCR framework | Updated grade (previous grade) |
| Overall grade | LC (C) |
| High-quality liquid assets (numerator) | MNC (C) |
| Outflows (denominator) | - (C) |
| Inflows (denominator) | - (C) |
| LCR disclosure requirements | - (C) |

Assessment scale: C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).
Note that the LCR grading components have been further split since the 2015 RCAP and previous grades are mapped accordingly

### 1.1.1 High-quality liquid assets (HQLA)

This component is assessed as materially non-compliant with the Basel LCR standard.

The Assessment Team confirmed the deviation that was listed in the 2015 LCR RCAP assessment as an item for follow-up and reassessed its materiality impact from “unlikely to become material” to material. The reason for the changed assessment is that the quantitative impact of the deviation is now larger than in 2015. Details of the materiality assessment are presented in Section 1.2.1.

### 1.1.2 Outflows, inflows and disclosure requirements

The remaining components were not in the scope of the follow-up assessment and thus are still assumed to have remained compliant as reflected in the 2015 LCR RCAP assessment.

## 1.2 Detailed assessment findings

### 1.2.1 High-quality liquid assets (HQLA)

| **Section grade** | **Materially non-compliant** |
|---|---|
| Basel paragraph number | 50(e): HQLA eligibility of domestic sovereign debt securities issued in foreign currencies |
| Reference in the domestic regulation | General provisions on liquidity requirements for commercial banks, Annex 1, fraction I C |
| Finding | The Basel standard states that where the sovereign has a non-0% risk weight, domestic sovereign or central bank debt securities issued in foreign currencies are eligible as Level 1 HQLA up to the amount of the bank’s stressed net cash outflows in that specific foreign currency stemming from the bank’s operations in the jurisdiction where the bank’s liquidity risk is being taken. Additionally, FAQ 3(a) of paragraph 54 states that sovereign and central bank debt securities rated BBB+ to BBB– that are not included in the definition of level 1 assets may be included in the definition of Level 2B assets with a 50% haircut within the 15% cap for all Level 2B assets.<br>The Mexican regulations allow the inclusion of all securities issued in foreign currencies by the Bank of Mexico or the Federal Government in Level 1 HQLA without limit. The MFA have confirmed that all foreign currency securities issued or secured by the Federal Government are included as Level 1 HQLA.<br>The Assessment Team reassessed the impact of the deviation on the LCR of the six sample banks for which the MFA provided data and which are listed in Annex 2. Since the LCR can fluctuate over time, the Handbook suggests evaluations over three points in time. The Assessment Team analysed the recent three points of semiannual data to reflect the current positions of the banks, ie December 2021, June 2022 and December 2022. There are material deviations at all three points in time and the most conservative estimates result in an LCR impact of 51.9 percentage points for the most affected bank and 10.3 percentage points using an unweighted average across the sample banks.<br>While such an impact could result in a non-compliant grade, the Assessment Team, consistent with the RCAP methodology, applied both quantitative assessment and |

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| | expert judgment to determine the component and overall grades. The Assessment Team noted that all banks in the sample would have had LCR levels, even when adjusting for this deviation from the Basel standard, above the minimum requirements of 100%, with four out of six banks above 150%. Furthermore, the Assessment Team analysed the impact of the deviation on individual banks and noted that the materiality estimated above varied significantly across the six sample banks. More specifically, while the deviation has a material impact on the LCR of about half of the sample banks, the impact is significantly larger for one bank with some jurisdictional specificities. Therefore, to assess the robustness of the analysis, the Assessment Team also looked at the materiality when removing that bank from the sample and observed material impacts at all three points in time, albeit at a much lower level. The most conservative of these estimates result in an LCR impact of 10.7 percentage points for the most affected bank and 2.7 percentage points using an unweighted average across the sample banks. While the effect is significantly lower, it is still material and suggests a materially non-compliant component grade.<br>Taking both quantitative and qualitative aspects into account as well as different samples, the Assessment Team finds the deviation to be material, resulting in a materially non-compliant HQLA component grade, ie a two-notch downgrade to the previous HQLA component grade. |
| Materiality | Material |

# Annexes

## Annex 1: RCAP Assessment Team and Review Team

### Assessment Team Leader

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| Mr Jonas Niemeyer | Sveriges Riksbank |

### Assessment Team members

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|---|---|
| Mr Christian Moor | European Banking Authority |
| Mr Adityo Pamudji | Indonesia Financial Services Authority |
| Mr Vasily Pozdyshev | Financial Stability Institute |
| Ms Michelle Taylor | US Office of the Comptroller of the Currency |

### Supporting members

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| Ms Camilla Ferenius | Sveriges Riksbank |
| Mr Tobias Lindqvist | Sveriges Riksbank |
| Mr Ángel López Contreras | Sveriges Riksbank |
| Ms Irina Barakova | Basel Committee Secretariat |
| Ms Yuka Kanai | Basel Committee Secretariat |
| Mr Olivier Prato | Basel Committee Secretariat |

### Review Team members

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| Mr Jes Klausby | National Bank of Denmark |
| Ms Joanne Marsden | Basel Committee Secretariat |
| Ms Olaotse Matshane | South African Reserve Bank |
| Mr Qi Xiang | National Financial Regulatory Administration |

## Annex 2: Materiality assessment

The outcome of the LCR follow-up assessment is based on the materiality of the findings described in Section 1.2. Assessment Teams evaluate the materiality of the finding quantitatively where possible, or using expert judgment when the impact cannot be quantified.

The materiality assessment for quantifiable gaps is based on the impact of the identified deviation on the reported LCRs of banks in the RCAP sample. These banks are listed in Table A.1.

RCAP sample banks

Table A.1

| Banking group | Share of banks' assets in the total assets of the Mexican banking system (in percent) end 2022 |
|---|---|
| BBVA México S.A. | 22.00 |
| Banco Santander (México) S.A. | 13.24 |
| Banco Nacional de México S.A. (Citibanamex) | 11.68 |
| Banco Mercantil del Norte S.A. | 12.16 |
| HSBC México S.A. | 6.91 |
| Scotiabank S.A. | 6.52 |
| Total | 72.52 |

For this purpose, banking assets are based on the measure of total exposures used in the leverage ratio, which includes both on- and off-balance sheet exposures.

Source: Banxico and CNBV.