Policy responses to the banking crisis in Mexico

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Introduction

The Mexican banking system went through major changes during the last fifteen years. After a long period of remarkable growth and stability, the banks were nationalised in 1982, at the beginning of the debt crisis. There were about 60 institutions in Mexico when the nationalisation took place; by the early 1990s, after a decade of mergers, the system consisted of 18 banks. These banks were privatised in 1991–92. A rapid process of expansion subsequently led to the establishment of new banks and other financial intermediaries.

This process came to a sudden end with the abrupt devaluation of the Mexican peso in December 1994. Banks were badly hurt by the peso crisis, and as a result of interventions, mergers and consolidations, the group of 18 banks privatised has been reduced to 10 banks, only half of which remain under the control of the original shareholders. The group of 10 banks accounts for 86% of total assets, with the three largest, all majority locally owned, accounting for 57%.

This paper reviews the experience of Mexico in bank restructuring after the 1994 crisis. After a brief summary of the causes of the crisis, the paper focuses on a description of the main programmes implemented by the authorities to deal with the acute banking problems. The last section shows the estimated fiscal cost of restructuring and outlines some reflections on the effectiveness of the programmes to deal with the banking crisis.

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Background and origins of the banking crisis

Macroeconomic, microeconomic and institutional factors combined to produce increasingly difficult problems for Mexican banks even before the December 1994 devaluation.[1] The sharp contraction of the economy that followed the devaluation made these problems worse.

Macroeconomic boom before 1994 (new funds)

After the "lost decade" of the 1980s, during which per-capita GDP in Mexico hardly expanded, the capital inflows which poured into the country in the early 1990s fed into the banking system. Mexican banks tapped the international markets in large amounts. The debt of domestic banks to international banks increased from $8 billion in 1991 to $16.5 billion in 1994. In the same period, the stock of outstanding international bonds expanded from $1.0 billion to $3.8 billion.[2] Bank credit to GDP increased from little more than 20% of GDP in 1987 to more than 40% only seven years later (Table 1).

The most dynamic components of this expansion are shown in Table 2. Lending to activities in which banks had no previous experience, such as housing and consumption, grew very rapidly. Credit to traditional sectors also increased.

Rapid and expensive privatisation (new owners)

When banks were privatised in 1991–92, investors paid an average price of 3.34 times their book value[3]. Investors wanting to recover their investments were prone to undertake risky business. And some of the investors who bought the banks had no previous experience of banking.

Fiscal contraction (new borrowers)

The correction of the fiscal imbalance was large and rapid. The consolidated public sector balance moved from a deficit of 8% of GDP

[1] See Gil-Díaz (1998) for a more detailed account of the origins of the crisis.
[2] By the end of 1994 the stock of other short-term international money market instruments issued by Mexican banks was $5.1 billion. This stock had declined by $1 billion in the course of 1994.
[3] Or 45% above the market value according to one estimate (Unal and Navarro (1997)). As a reference, these same authors show that the average price-to-book-value ratio was 1.89 for mergers in the US industry between 1984–87.

Table 1
Mexican commercial banking system: salient features

Year	Credit (% of GDP)[1]		Indices[1]		
	Total	Private sector	Capitali-sation	NPL (% of total loans)	Provisions (% of NPLs)
Early 1980s	35.0	16.6			
1988	22.1	12.2		1.6	
1989	26.7	18.1		2.1	
1990	29.8	21.9		3.1	
1991	32.8	25.5		3.8	
1992	33.8	30.8	7.5	5.3	
1993	35.9	34.6	9.5	7.1	
1994	45.1	43.2	9.3	7.3	48.6
1995[2]	44.1	41.6	12.1 (7.2)	6.9 (16.9)	72.6 (54.1)
1996[2]	35.8	33.9	13.2 (7.7)	5.8 (18.8)	119.9 (74.4)
1997-Jan[2,3]			13.9 (6.9)	12.2 (35.4)	58.7 (37.7)
1997	31.1	28.8	17.0	11.3	62.8
1998	27.9	25.7	17.5	11.4	66.0

[1] Unless otherwise shown, figures correspond to the end of the year. [2] The figures in parentheses include the NPLs sold to FOBAPROA. [3] In January 1997 new accounting principles were adopted requiring banks to recognise the full amount of a delinquent loan as non-performing, instead of the earlier standard of recognising only the portion due but not paid.

Sources: Banco de México; OECD.

in 1987 to a surplus of 1% in 1993. Accordingly, the banking sector credit to the public sector decreased from 14% of GDP in 1987 to nearly 2% in 1993. This shift released funds for lending that were quickly passed on to the private sector (Table 1).[4]

Financial liberalisation coupled with deficient supervision and regulation

Many years of "financial repression" meant that Mexican banks did not develop necessary market and credit risk capabilities. For example, caps on interest rates (removed in 1989 allowing banks to compete for deposits), and credit allocation regulation were in place. Moreover, a liquidity requirement of 30% (which replaced a reserve

[4] The shift of resources from the public to the private sector reflects as well the privatisation of many public entities (including the banks themselves) during this period.

Table 2
Commerical bank lending by sector (% of GDP)

	1989	1994
Agricultural sector	3.6	4.0
Industry	7.4	12.4
Services	2.2	7.8
Commerce	3.7	8.7
Housing	1.6	7.4
Consumption	1.5	3.1
Total	20.0	43.2

Note: Data on bank lending to public and financial sectors are not included.

Source: CBNV.

requirement ratio), forced banks to buy treasury bills. This requirement was eliminated in 1992. When banks had new owners, new customers, and new resources to lend, they started to get into trouble. Nor did the authorities' capacity to supervise develop as needed.

Banks extended large amounts of loans without sufficient credit analysis. They also found ways to increase credit according to borrowers' needs. A good example of this is provided by Guerra (1997). He noted that when interest rates are high, borrowers with mortgages may be unable to service their debts. The practice of Mexican banks to address this was to offer loans with interest payments determined according to their payment capacities (salaries), which meant that not all accrued interest was paid, but was instead capitalised. This process leads to an increase of the real value of the debt, at least in the early years of the loan. This behaviour, coupled with the stagnation of real estate prices observed in Mexico prior to the crisis, proved very dangerous and indeed led to many situations where the value of the mortgage loan exceeded the price of the house or land purchased (negative equity).

The share of NPLs in total loans began to rise well before the 1994 crisis (Table 1). In addition, the discovery of fraud led the authorities to take-over two banks in late 1994.

The devaluation in December 1994

The already weak situation of the banking system was aggravated by the devaluation of the peso and its effects on interest rates, inflation and output. At first, in early 1995, the central bank considered that the potential direct impact of the devaluation would be limited, for two reasons. First, the central bank had imposed a ceiling such that the foreign currency denominated liabilities of a bank could not exceed 20% of total liabilities. Second, banks' net open foreign currency positions were subject to a ceiling of 15% of bank's capital. Yet, as Garber (1996) has shown, Mexican banks were able to circumvent the regulation by using derivative instruments to increase their net open positions. When the exchange rate collapsed, the magnitude of the exposure of Mexican banks proved to be much larger than expected by the authorities. Even when banks had covered direct exchange rate risk, they remained exposed to credit risk when those borrowers that had taken foreign currency denominated loans were in many cases unable to service their debts after the devaluation. In effect, exchange rate risk was converted into credit risk.

The effects of the devaluation on interest rates, inflation and output were the main channels through which the banks were affected. With the increase of inflation and nominal interest rates, and falling real income, debtors found it increasingly difficult to service their debts. In order to avoid a collapse of the banking system, the authorities implemented several programmes.

Objectives of programmes of support

The acute crisis at the beginning of 1995 forced the authorities to act rapidly. According to the National Commission of Banking Supervision (CNBV) and the Banco de México, the following principles have guided their actions[5]:

- reduce the risk of a bank run;
- support the greatest number of families and firms, by promoting a "re-payment culture". Any benefit should be targeted to reach those debtors that keep up their payments or, having been in arrears, return to current standing;
- banks and the federal government will share the costs of the programmes. Minimise the fiscal impact and spread it over time. Programmes should not lead to an expansion of domestic credit by the central bank;
- support institutions, not shareholders;
- enhance competitiveness by promoting the participation of foreign banks;
- the programmes should build in incentives for banks to grand additional credit to those sectors which they are designed to help, thus contributing towards economic recovery.

The steps taken are described in this section. For analytical reasons the various programmes can be classified into three groups: those that were applied immediately to prevent a collapse; those aimed to support banks; and those aimed to support debtors.

Programmes of immediate action

Two priorities in early 1995 were to prevent a drastic fall in international lending to Mexico and to keep banks' capital ratios above minimum levels.

Dollar liquidity facility

In early 1995, banks found it increasingly difficult to rollover their debt with international banks. The high stock of external debt and domestic dollar-linked government debt (tesobonos) held by non-residents coupled with the low level of international reserves raised concerns about the capacity of the Mexican borrowers, including the banks, to service their foreign obligations. To help banks service their foreign debt, a top priority for the government, a special dollar credit window at the central bank was therefore established. Loans were advanced to 17 commercial banks, and the outstanding amount peaked at $4 billion in April 1995. Part of the resources granted to Mexico by the United States, the IMF and other IFIs and governments were used for this purpose. These loans were extended at penal interest rates: 25% and 17.5%, with the lower rate applicable to outstanding balances below a certain threshold.[6] By September 1995, all banks had repaid their loans in full.

[5] CNBV (1988): Banco de México, Annual Report (various issues).

[6] Dziobeck (1998).

Loans from the government covered only a proportion of the external debt of Mexican commercial banks, which stood at nearly $25 billion by end-1994; (75% with a short-term maturity).[7] It appears that the emergency foreign exchange lending by the central bank was priced well above rates that a number of Mexican borrowers would have had to pay in the markets. For instance, spreads on the international sovereign bonds averaged 1,000 basis points during the first few months of 1995 and decreased to 500 b.p. in September. Another comparison is that Banamex, the largest Mexican bank that was the first bank to issue an international bond after the devaluation (in early May 1995), paid a spread of 300 b.p. to issue a 3-year bond of over $200 million.

Temporary Capitalisation Programme

An immediate effect of the devaluation was to increase the peso-value of loans denominated in foreign exchange. Official sources show that the capital-asset ratio for the whole banking system fell from 9.3% by end-1994 to below 8% two months later; the ratio for half of the commercial banks fell below the 8% minimum. To meet the minimum capital ratio, banks were required to issue subordinated debt that was acquired by FOBAPROA (the government agency responsible for dealing with bank insolvencies). The debt was convertible into common shares and were callable to allow banks that could restore their capital ratios to re-acquire them. The debt would become capital if not paid back before five years, or if the capital-asset ratio fell below certain parameters.[8] FOBAPROA funded the acquisition of the subordinated debt with a credit by the central bank. By requiring commercial banks to deposit the resources thus obtained in the central bank, an unwarranted expansion of overall liquidity was prevented. At the same time, the mechanism gave some breathing space to banks to find a more permanent solution. In March 1995 six banks obtained this support, amounting to 7 billion pesos ($1 billion approximately). By June 1996 the stock of debt had decreased to 2.9 billion pesos, with only two banks

[7] National figures. BIS statistics show a similar picture: banks' debt with international banks amounted to $16.4 billion while the stock of internationally traded bonds and other money market instruments issued by Mexican banks stood at nearly $9 billion. Some of the latter might have been held by international banks and so may be already included in the $16.4 billion.

[8] If the participating banks' Tier 1 capital ratio fell below 2% of or if it was 25% or less of the average of the banks participating in the programme.

remaining under the programme. However, the amount of resources required by one of these banks increased substantially in 1996, thus bringing the total outstanding balance to 12 billion pesos at end-1996. By end-June 1997 both banks had liquidated their debts. Of the six banks that required such support, only two remained under their original shareholders; three were later taken over by the authorities (see below) and the other was taken over by another bank.

Programmes of support for banks

Capitalisation and loan purchase mechanism

The government, through to FOBAPROA, provided support for banks to deal with their NPLs and to re-capitalise. The programme had the following steps:

1. The government bought NPLs from the banks above market value and imposed the condition that shareholders inject new capital.[9] A formula was established: two pesos of loans of commercial banks were bought for every peso of new capital injected by the stockholders.
2. The government bought the NPLs with promissory notes issued by FOBAPROA. These notes substituted the NPLs in the asset side of banks' balance sheets. They are zero-coupon bonds with long-term maturity (about ten years), bear an interest rate equivalent to that on 3-months Treasury bills when denominated in pesos and LIBOR plus 400 basis points when denominated in US dollars (below normal lending rates) and are non-tradable.
3. Banks created special off-balance sheet trusts for their NPLs, retaining the responsibility for administering them. Income arising from payments by debtors on these loans are to be used to cancel FOBAPROA's paper in an equivalent amount.
4. When the FOBAPROA paper becomes due (after 10 years), the amount not recovered from the NPL constitutes a loss. A general rule established that banks will bear 20–30% of this loss, with the government covering the remainder.

[9] In more precise legal terms FOBAPROA acquired the right on the amount collected on each particular loan that banks continue collecting.

Twelve of those banks not intervened (see below) participated in this scheme. The situation of some banks did not improve after a first round agreement with FOBAPROA and they had to sell additional loans in a second round. Between 1995 and 1996 banks sold 114 billion pesos to FOBAPROA and injected 53 billion pesos of new capital.[10] The loans sold to FOBAPROA represented approximately 30% of these banks' total loans.

This is perhaps the most controversial support programme implemented by the authorities for several reasons. First, there is conflicting evidence as whether banks have incentives to recover the loans passed on to FOBAPROA. On the one hand, they may not make much effort to recover some loans since their share of the losses may be lower than the costs of recovery. At the same time they face other associated costs of keeping the FOBAPROA's promissory notes in the balance sheets: the paper cannot be sold, and does not accrue income flow (interest is capitalised), so banks become highly illiquid and profits remain weak. Secondly, the banks were able to select the worst loans for transfer and purchase. FOBAPROA bought NPL at their nominal value (net of provisions). The authorities considered that if NPL had been bought at market value, banks' capital would have decreased to very low levels due to the need to create provisions. Thirdly, the fact that a minority of contracts accounted for a large share of the total amount purchased provoked a political problem. Indeed, so controversial was this issue that Congress debated throughout 1998 whether to recognise the promissory notes issued by FOBAPROA as public debt. An agreement was finally reached in late 1998, creating a new deposit insurance agency that will deal with the NPLs absorbed by FOBAPROA.

Bank interventions

The authorities were forced to intervene in those banks that could not continue operating as solvent entities despite the support granted to them and their debtors. They took over twelve banks between the end-1994 and August 1997; the outstanding stock of credit of

[10] At constant prices of August 1996. Equivalent approximately to $15.2 and $7.1 billion.

these banks by September 1997 represented 19% of the industry's total. There are some salient features of these interventions. First, the capitalisation level of some of the institutions had already fallen below the minimum required by regulation, suggesting that interventions came late.[11] Secondly, interventions in smaller banks were carried out more quickly. Late interventions could increase the costs for the government, as banks may attempt to conduct more risky investments to restore the bank's value (i.e. "gambling for resurrection").

The typical situation following an intervention was to negotiate with potential buyers the terms of the acquisition.[12] In most cases these banks were re-sold after being re-capitalised and "cleaned up" of their NPLs portfolio by FOBAPROA. Some of these banks, however, received official support before being taken over by authorities or a third party. In almost all cases, the management was replaced and share-holders' capital was exhausted before public resources were injected. Out of 18 privatised institutions in 1991–92, only 5 remain under control of their original shareholders. Five banks are still under intervention.

The lack of domestic resources to re-capitalise the banking industry after the crisis led the authorities to remove some restrictions on the foreign ownership of banks.[13] There were two main methods of entry of foreign banks: some banks acquired minority stakes in existing banks, while others acquired banks that had been intervened by the authorities. As explained before, the terms of the acquisitions in the latter case, were negotiated with the authorities on a case-by-case basis.

FOBAPROA has therefore acquired banks' NPLs through the two programmes just described. An important issue is how FOBAPROA will sell these assets. A loan workout subsidiary of FOBAPROA (VVA) was created in April 1996 to sell the loans acquired. The first auction of assets was conducted in July 1997. Assets worth $135 million were sold at an average of 50% of the nominal value. However, VVA was liquidated one month later.

[11] *Institutional Investor,* Vol. 18, No. 2, February 1993.

[12] In only one case (Banpais) there was a formal tender for the sale of the "good" assets and branch network.

[13] The implementation of the NAFTA was the first step in this direction.

Programmes of support for debtors

Restructuring of Loans in Investment Units (UDIs)

High inflation causes an accelerated amortisation of credits in real terms especially when the contract allows for the frequent revision of interest rates. A typical mortgage loan before 1994, as well as other type of credits granted by banks, specified a quarterly (and in some cases monthly) revision of interest rates. In the first quarter of 1995, interest rates reached 70% while inflation reached more than 50% in 1995 and around 30% in the subsequent year. A debtor that was able to service his debt would have seen the real value of the credit fell by more than 70% in real terms, a highly improbable rate of repayment.

To deal with this problem, the government introduced a new unit of account, the UDI, for denominating credits. The peso-value of the UDI follows the consumer price index with a short lag, so it has a constant real value. Payments on credits restructured in UDIs therefore remain practically constant in real terms during the term of the loan.

The government provided support to banks and borrowers to restructure the debts in UDIs. First, as re-denominating loans in UDIs without a corresponding transformation on the liability side would entail a mismatch in interest rates for banks, the government provided banks with loans in UDIs. Hence the government absorbed the interest rate risk.[14] Second, as explained below, those adhering to the UDIs restructuring programme obtained other benefits.

Support Programme for Banks Debtors

In September 1995, the government introduced a one-time relief programme targeted to credit card, small business, agricultural and mortgage borrowers. One of the benefits under this programme was an interest rate subsidy for one year, which in most cases applied from September 1995 to September 1996. Other non-monetary benefits were the standardisation of restructuring procedures and a temporary

[14] More precisely, banks created off-balance sheet trusts in which they transferred the UDI-denominated loans. These were substituted by treasury bonds in the asset side of the balance sheets. By setting the amount of UDI-denominated loans to the banks, the government initially determined the amount of UDI loans that the banks could restructure. Later on, banks started attracting deposits in UDIs giving them extra resources to denominate credits in UDIs.

halting of foreclosure proceedings against defaulting debtors. By end-1996, nearly two million contracts (73% of those eligible) had been restructured, amounting to 200 billion pesos.

Programme of Additional Benefits for Mortgage Loan Debtors

This programme, announced in May 1996, was targeted to mortgagees that had borrowed before this date and were to restructure their credits in UDIs before end-September 1996.[15] This programme was designed to help the many borrowers who either could not or had little incentive to remain current in their payments. First, monthly payments were absorbing a large proportion of the income of a large percentage of mortgagees (even if the loans had already been restructured in UDIs). And, second, the weak real estate market had resulted in many cases where the value of the collateral (properties) had fallen below the outstanding principal of the UDI-denominated credits.

Borrowers benefited from a scheme of reductions on payments scheduled for the following 10 years, starting at 30% during 1996 and decreasing progressively to reach 5% by 2005. The discounts were applied only to the first 500,000 UDIs (approximately $140,000) of each loan. The cost of the programme is borne by the Federal Government. The programme established a further 10% discount for payments brought forward before 31 May 1999.

However, the announcement of further support in late 1998, suggests that mortgagees continued to face problems remaining current in their payments; some of them may have stopped servicing their debts in the expectation of more favourable terms. The government offered a reduction on the loan capital (50% on the first 165,000 UDIs, or $38,000 approximately).[16]

Sector-specific programmes

The agricultural and fishery sectors and the small and medium-sized firms received special incentives to keep servicing their debts. Clear-cut

[15] Later on the date-limit to restructure the credits was prolonged until end-1997 and debtors that had not restructured their credits in UDIs but were current in their payments were also eligible.

[16] The sharp increase of nominal interest rates in Mexico following the Russian crisis did not affect those mortgage loans already denominated in UDIs since these contain fixed real interest rates and account for 60–70% of mortgages held by major banks.

rules were established to limit this support to debtors who were servicing their debts. Debt payments were reduced, with the cost of the programme borne by the federal government and the banks. A particularly interesting and novel feature of this scheme is that the share in total costs assumed by the government increases in proportion to new credits that banks give to these sectors. The government share can reach a maximum of 50% of the total cost and it will be distributed over the next 15 years. It was originally announced in June 1996 and, as with the mortgagees, further support was announced in late 1998, in the form of an increase in the discounts formerly agreed.

Other actions

Co-ordinating Unit for Corporate Loans

The objective of this unit was to foster the restructuring of syndicated corporate loans. The unit acts as a facilitator in bringing back into negotiation with banks all those firms that voluntarily submitted to mediation. 31 loans have been restructured, for a total value of $2.6 billion.

Legislative reforms of the financial system

In 1995 a new provisioning regulation was implemented in order to prepare banks for the expected rise in NPL. This regulation required banks to provision 60% of past due loans, or 4% of the total portfolio, whichever was larger. The banks had to make considerable efforts to meet the new requirement since at the time provisions represented 43% of NPL.

In order to facilitate capital injections into the banking system, legal steps were taken to allow reform the ownership structure of banks increasing the limits on ownership by both individuals and foreign investors. Market share ceilings previously established under NAFTA negotiations were liberalised. This change, however, did not allow foreign majority control of banks having a domestic market share larger than 6%. In practice, this meant a limitation on foreign majority ownership of the three largest banks in the country, and was set to a maximum of 20% of paid-in capital. This last restriction was reformed in late 1998

Table 3

Fiscal cost of support programmes for banks and debtors

	% of GDP*
Debt restructuring in UDIs	
Original programme	0.9
Additional programme for mortgage loans	1.2
Support to small debtors	0.2
Sector-specific programmes	
Agricultural and fishery	0.5
Small and medium-sized firms	0.2
Total debtor support programmes	3.0
Loans purchased for capitalisation schemes	2.6
Bank interventions	8.3
Restructuring of toll roads	0.5
Total bank support programmes	11.4
Total support programmes	14.4

* February 1998 estimates (as a percentage of 1998 estimated GDP).
Source: CNBV (August 1998).

giving the three banks the option to seek foreign partners, but did not allow foreigners to bid for these banks in the coming five years.

In December 1998, Congress approved legislation creating limited deposit insurance to be gradually introduced (over the next 7 years). More recently, the government submitted to Congress a revision of the Law on Guarantees that will make the procedures for seizing collateral by banks more efficient and less costly.

Costs and consolidation

Fiscal cost

Over time the government has revised upwards its calculation of the fiscal costs of support programmes. The latest estimates (made in February 1998) put the total cost at 14.4% of GDP[17] (Table 3). As can

[17] As a reference, this cost compares with a net public debt of 21.9% of GDP in 1994, before the crisis erupted.

be seen, more than half of the total cost arises from the operations of those banks intervened by the authorities. These banks accounted for a fifth of the industry's assets before the crisis. Many of these interventions were delayed and this may have led to large (and more expensive) problems. The capitalisation and loan purchase mechanism is the second most expensive programme, and its amount is sensitive to the expected recovery value of the assets that were transferred to FOBAPROA. The figures in Table 3 were estimated based on the assumption of an average of 30% recovery rate across all categories of loans and of an average real interest rate of 6.5%.

The banking system four years later

Table 4 lists the banks both before the banking crisis (first column) and those that remain (last column). The columns in-between give account of which banks participated in the different programmes of support implemented by the authorities,[18] which banks were intervened by the authorities, and which banks were acquired or merged with other banks. In the second block of banks, to give an example for illustration, it can be seen that Bancomer, Promex and Union were three independent banks in 1994. None of them took part on the temporary capitalisation programme, while the first two participated in the capitalisation and loan purchase programme; indeed Promex went on two occasions to FOBAPROA. Union was taken over by the authorities in November 1994 after fraud was found. Promex then bought the branch network of Union, while FOBAPROA retained both the assets and liabilities. Later on, Promex was acquired by Bancomer, which in turn had sold 16% of shares to Bank of Montreal.

This table summarises some salient features of the Mexican restructuring of banks. First, official support was not generally channelled to banks that were subsequently taken over by the authorities; one exception was support of BANCEN. Secondly, the authorities intervened in the management of many small banks. According to the data provided in the first column of Table 4, the assets of these banks accounted for 12.2% of the total of the system in 1994. It has proved to be very difficult to create efficient administrations for so many banks simultane-

[18] There is no reference to the debtor support programmes because they were applicable to all banks.

Table 4

Mergers, acquisitions and government support

Banks in 1994[1]	Government support		Government intervention		Acquisitions[3]	Banks in 1998[1]
	Temporary capitalisation	Capitalisation and loan purchase[2]	Capitalisation problems	Fraud		
Banamex (20%)		x			Banamex (21%)	
Bancomer (17.2%)		x			Bank Montreal acquired 16%	Bancomer (21%)
Promex (2.3%)		xx			Merged with Bancomer	
Union (2.7%)				Nov. 1.994	Promex acquired b.n.	
Serfin (12.1%)	x	xx			HSBC acquired 20%	Serfin (13%)
Bital (5.2%)	x	xx			Central Hispano acquired 20%	Bital (8.4%)
Sureste (0.4%)			May 1996		Bital acquired b.n.	
Atlantico (5.5%)		xx			Merged with Bital	
Interestatal (0.1%)			Sep. 1995		Atlantico acquired b.n.	
Banorte (2.1%)		xx				Banorte (7.4%)
Banpais (3.5%)				Feb. 1995	Banorte acquired b.n.	
Bancen (2.0%)	x		Jun. 1995		Banorte acquired b.n. and A&L	
Banoro (0.5%)					Banorte acquired b.n.	
Probursa		xx			Acquired by BBV (70%)	BBV (5.7%)
Oriente (0.5%)	x		Dec. 1994		Probursa acquired b.n.	
Cremi (2.3%)				Nov. 1994	Probursa acquired b.n.	
Inverlat (5.6%)	x				Scotiabank acquired 55%[4]	Scotiabank

Table 4 (cont.)

Banks in 1994[1]	Government support		Government intervention		Acquisitions[3]	Banks in 1998[1]
	Temporary capitalisation	Capitalisation and loan purchase[2]	Capitalisation problems	Fraud		
Mexicano (6.4%)		x			Acquired by Santander (75%)	Santander (6.4%)
Confia (2.1%)	x	x			Acquired by Citibank (100%)	Citibank (2.3%)
Bancrecer (2.7%)						Bancrecer
Afirme (-)						Afirme (0.5%)
Obrero (0.4%)			Mar. 1995		Afirme acquired b.n.	
Capital (0.1%)			May 1996			Intervened by the authorities. For sale or liquidation
Pronorte (0.03%)			Oct. 1996			
Anahuac (-)			Nov. 1996			
Industrial (0.2%)			Feb. 1998			
Rest[5]						Rest[6]

[1] The percentage in parentheses after each bank name represents the share of the bank in the industry's total assets. [2] "xx" means that the bank completed two rounds of the support programme with the authorities. [3] b.n. = branch network. The acquisitions of Atlántico (by Bital) and Promex (by Bancomer) are not yet completed. [4] With an option to acquire a further 45%. [5] In addition to the banks shown in the list there were other small banks accounting for 4% of the market, some of them with majority participation by foreign banks. [6] In addition to the banks shown in the list there were 9 other small Mexican banks with a market share of 5.3%, and 17 foreign-owned small banks with a market share of 2% in 1998.

ously, and this may have led to some reticence to undertake further interventions. Thirdly, none of the intervened banks was liquidated by the authorities, since the costs of legal procedures would have been very

high. Finally, majority-owned foreign banks now account for 20% of the market, up from 4% before the crisis.

The recovery of the system

The policies of bank restructuring adopted in Mexico succeeded in avoiding a bank run even in the context of very acute problems of the banking system. As problems appeared, successive programmes were implemented (or extended in their amounts or duration) to reassure investors' confidence in the stability of the system. Because it was difficult for the authorities to evaluate at the start the full impact of the crisis on the quality of banks' portfolios, policy-makers chose a gradual approach. The main drawback was that the gradual approach may have created a "wait-and-see" attitude on the parts of the debtors (OECD (1997), p. 58).

Banks and government have shared the cost of restructuring. Only a few banks remain with the shareholders who had acquired them at the beginning of the 1990s. And even in these cases, the owners have had to reinvest profits into capital (and/or provisions) for an amount equivalent to 1.9 times the price originally paid by the banks when they were acquired, at constant (November 1997) prices (CNBV (1998), p. 37).

The Mexican banking system remains weak. Credit to the private sector is still well below its pre-crisis level despite strong economic growth during the past three years. Banks have not contributed much to the recovery, leaving firms to finance themselves internally, from suppliers or from abroad, and households through major manufacturers (such as car manufacturers) and retailers. Credit has not expanded because banks have tightened credit standards and the supervisory commission (CNBV) now requires banks to establish reserves for 100% of those loans granted to debtors with a bad credit record.

The authorities have also indicated the need to further increase the capital of banks from the current level of 12%. There are good reasons for this: first, although banks have made considerable efforts to both reduce the share of NPLs in their loan portfolio and increase provisions, full provision for NPLs has still not been made: non-provisioned NPLs amount to almost a third of the capital base.[19] Second, under the current

[19] See Table 7 of the overview paper in this publication.

agreement with FOBAPROA, and as explained above, banks will have to share with the government eventual losses for those loans not fully recovered. Finally, the quality of capital – 37.5% of which is made up by subordinated debt and deferred tax credits – will need to be improved in the years ahead.

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