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REPORT ON THE MEXICAN BANKING SYSTEM

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ANALYSIS AND REPORTS

Banking

RECOVERY PREDICTED FOR MEXICAN BANKING AT COST TO GOVERNMENT OF UP TO $8 BILLION

MEXICO CITY — Six months after the Dec. 20 devaluation of the peso, Mexico's banking system is "in intensive care," and probably will remain there until the middle of 1996. But the patient is expected to live, even though most experts believe that it may end up costing the Mexican government somewhere in the neighborhood of $4 billion to $8 billion.

The banks' sickness is owed to ballooning past-due loans resulting from high interest rates and a deepening Mexican recession. With Mexico's economy expected to have contracted by more than 5 percent over the second quarter, six banks have tapped a short-term capitalization fund, and fully one-quarter of the system's loans are up for restructuring.

Most economists now list the health of the banking system as their chief concern, especially now that two-thirds of the short-term dollar-indexed bonds known as Tesobonos have matured without incident.

So lacking have been bank practices and accounting procedures to date that the World Bank has said that the disbursement of $500 million of a new $1.0 billion loan package to the financial sector will be conditioned on Mexico's cleaning up the banking system and bringing its accounting practices up to international standards.

And the Mexican banks received special attention during May 24 hearings of the Senate Banking Committee, when Chairman Alfonse D'Amato (R-NY) charged that "financial alchemy" was "concealing a massive hole in the banking system."

Government Support Credited

However, even cautious experts now say that the Mexican banking system, only recently reintroduced to private hands, should survive the country's economic crisis.

The banking sector is expected to consolidate over the next year, and will muddle through Mexico's deep, sharp recession, helped by fresh capital injections from existing shareholders and newly arriving foreign institutions, as well as an improving macroeconomic scene. More than anything, the banking sector will depend on aggressive government bailout measures, which have already had a considerable impact.

"In the past 50 years no bank has failed in Mexico," Victor Herrera Jr., a director with Standard & Poors based at the Mexico City subsidiary of S&P-CAVAL. "It is unlikely that, at this point in time, that would be allowed to happen. The government support has been incredible, and it has been timely."

Rescuing the banks has been a priority for the government, because it is axiomatic that a failed banking system would be disastrous for Mexico's economy. In addition, the banks have been a cause for concern among foreign investors, who have feared that a widespread collapse of the banking system would cause the central bank to relax its tight grip on the money supply, leading to higher inflation and a further drop in the value of the peso.

Potential Costs

Saving the banks could come at a cost, however, one which may eventually be borne by the Mexican government, much as the cost of the savings and loan debacle has been borne by the government of the United States.

Since late May, Mexico's bailout program for the banks has moved towards having the government buy portions of troubled banks' loan portfolios at a 2-1 ratio to new capital injections from existing shareholders or foreign buyers. The government has taken special care to purchase the loans with long-term instruments, thereby avoiding any short-term inflationary impact.

But while banks will continue to manage the loan portfolios purchased by the government, and the government hopes to recover much of the money used to buy the loans, one prominent New York analyst said that Mexico could end up eating much of the cost. If the total amount of loans purchased by the government were to reach $10 billion, a not improbable figure, and only 50 percent of the loans were collected, the total cost to the government could be around $5 billion, the analyst said.

"There's been no banking crisis in the world where the government hasn't had to ante up money," the analyst, who spoke on the condition of anonymity, told BNA. But he also noted that the 2-1 arrangement, a powerful incentive to put new capital into the system, is cheap at the price.

"It's very, very positive that the government is moving quickly to use this mechanism to get real money into the system," he said. "If you consider what the cost (of having the banking sector collapse) could be," he added, the $5 billion would not be that much.

2-1 Scheme Criticized

Gustavo Teran, a banking analyst with Bursamex, a Mexico City brokerage house, took an opposing view, saying that the 2-1 scheme would not result in significant cost to the government, because loans will be purchased at market prices, which will be determined by an independent auditor. He said the government would recover much of its investment, and could conceivably even make money on the deal if the economy picks up in the fourth quarter and beyond, as expected.

— *By John Nagel*

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But he, too, said that saving the banks would ultimately end up costing Mexico money, with net costs to the government of a loan restructuring program known as the UDI scheme, and of Fobaproa, a bank bailout fund, mounting to between $4 billion to $8 billion.

So far, the 2-for-1 mechanism has been negotiated in two cases. On May 29, Spain's Banco Bilbao Vizcaya (BBV) announced that it would be increasing its 20 percent stake in Grupo Financiero Probursa, the twelfth largest Mexican bank, to 70 percent, a $350 million investment. In exchange for the new capital, Fobaproa would buy about $780 million worth of Probursa's loan portfolio with 10-year Cetes, or treasury notes, essentially cleaning the bank's books.

On June 13, it was announced that existing stockholders in Grupo Financiero Serfin, the holding company for the third largest Mexican bank and the biggest bank in serious trouble, would be putting up $200 million in cash and issuing $150 million in bonds to provide Banca Serfin, the holding company's bank, with fresh capital. In exchange, the government agreed to buy $700 million of Serfin's loan portfolio, solving many, but not all, of Serfin's problems. At least two more troubled banks, Grupo Financiero Inverlat and Bital, are said to be in similar negotiations.

Possible Mergers, Acquisitions

Analysts say that as long as the government keeps the 2-1 incentive in place, mergers could take place between Mexican institutions such as powerhouse Bancomer and fourth-ranked Banco Mexicano. And more foreign institutions, particularly European banks like Santander, may enter the market as Mexico's economy bottoms out and share prices for banks become more attractive. Already, the Bank of Nova Scotia, a Canadian bank, is said to be in negotiations to buy Inverlat, a small but troubled Mexican institution. Others may follow.

"I'm generally optimistic about the fact that I see interest on the part of foreign institutions," said Rafael Bello, a Latin American banking analyst at Morgan Stanley "They're not saying, 'forget about Mexico,' they're saying, 'when is the time to get in?' "

And an expected improvement in the Mexican economy may eventually allow some banks to help themselves.

Until those things happen, analysts agree, other government measures should buy the banks precious time. They include Fobaproa and the UDI loan restructuring scheme, as well as a temporary capitalization program known as Procapte.

Analysts also say that Mexico can also go a long way to improving the banking system, at little cost, by making structural changes to improve the operating environment for banks, such as encouraging the establishment of common credit databases and increasing the presence of credit counseling services for consumers.

Privatization Contributes To Current Woes

Mexican banks were reintroduced to private hands beginning in 1990, after nearly a decade of government management following the nationalization of the financial system during the debt crisis of 1982.

Buyers of the banks from the government paid the high end of estimated prices, leading many institutions, run by inexperienced management, to engage in indiscriminate lending practices while they tried to quickly recoup their investments.

Also, 12 of the 18 privatized banks — a highly concentrated financial system — were purchased by holding companies dominated by brokerage houses, which have a generally higher risk tolerance than banks. That fact, combined with the emergence of several newer, smaller banks during 1994, contributed to unusually fast lending growth after years of state management.

Rapid Growth

Over the past few years, lending mounted at a rate 20 times faster than growth in Mexico's gross domestic product (GDP), leading to a corresponding decline in asset quality which was magnified by Mexico's paucity of credit bureaus. From the fourth quarter of 1993 to the fourth quarter of 1994, system-wide loans grew by 41.1 percent, from 421 billion new pesos to 594 billion new pesos. Past due loans during that period grew even faster, from 30.5 billion pesos in the fourth quarter of 1993 to 43.5 billion in the fourth quarter of 1994, an increase of 42.6 percent.

In addition, Mexican banks jealously guarded information from their credit databases, which were not particularly reliable in the first place. The idea was for banks to prevent other institutions from stealing good customers, but the result has been that not even information on bad customers was exchanged, making the overall credit picture even worse.

Those factors, and other signs that Mexico's newly privatized banks were not as healthy as they should have been, led many analysts to speak cautiously about their prospects even before the devaluation, saying that the banks' rapid expansion and poor asset quality posed considerable risk.

In a June 1994 report, Moody's Investor Service noted that a general deterioration in asset quality "will be magnified by the relative inexperience of Mexican banks with private-sector loans, by their lack of sophisticated management information systems, by opaque accounting and lender-unfriendly bankruptcy laws, as well as by the goal of becoming 'universal banks' with manifold services linked through . . . holding companies."

Finance Ministry Interventions

Turned loose after a decade of government management, Mexico's banks — part of a financial system with spotty regulation where holding companies own banks, brokerages, insurance companies and other institutions — have been inherently vulnerable to excesses, so much so that the finance ministry has been compelled to intervene in bank operations in three separate cases.

In the first case, the May 1994 intervention of leasing company Grupo Financiero Havre, the finance ministry charged senior officials with improper accounting practices and withholding important information from authorities.

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The Havre case was soon followed by the September 1994 intervention in the operations of Grupo Financiero Union-Cremi. Run by former financier and current fugitive Carlos Cabal Peniche, Banco Union and Banca Cremi made it common practice to lend hundreds of millions of dollars to shell companies which proceeded to funnel the proceeds into management's pockets.

Most recently, on March 3, operations were suspended at mid-sized Banpais when, as a result of the crisis, that bank's risk-reserve ratio fell below mandated requirements. Long whispered to be running internal loan schemes similar to those at Union-Cremi, the finance ministry cited "administrative irregularities" as a major reason for the intervention at Banpais.

Analysts such as Herrera acknowledge problems associated with the privatization process, but note the current crisis is proving a valuable education for Mexico's embattled bankers, who have had "to learn the business again."

"Privatization began with deregulation," Herrera said. "The banks had money to lend and borrowers were eager to receive credit. But the environment we have now is a good teacher. The lesson should be learned."

Crisis Turns Bad Situation Worse

Despite flaws in the bank privatization process, there is little doubt that it was the mishandled devaluation of the peso on December 20, 1994, which created the current critical situation for Mexico's commercial banking institutions, even if they were already showing signs of being in serious trouble.

"No matter what past practices were, they didn't create the current situation for the banks. The economy did," said Teran.

As Mexico's financial system quickly went into a tailspin following the devaluation, dollar-denominated certificates of deposit (CDs) still had to be repaid with a weaker Mexican currency, and high interest rates made it impossible for many borrowers to repay loans.

At its March 15 high, Mexico's interbank lending rate, known as the TIIP, hit a high of 109.7 percent, contributing to growth in past-due loans by an average of 45 percent during the first quarter of 1995. While the interbank rate has fallen considerably — to 44.05 percent on June 29 — rates for commercial credit continue to hover well above 50 percent. Credit card interest rates remain well above 60 percent, as do rates for mortgages.

As the crisis set in, payments by many borrowers, retail as well as corporate, were immediately suspended. Official figures say that past-due loans for the first quarter of 1995 made up 9.8 percent of the banking system's total portfolio, up from a past-due ratio of about 7.3 percent in the fourth quarter of 1994. But many analysts say that the true figure may be much higher because of Mexican accounting practices — the "financial alchemy" to which D'Amato referred.

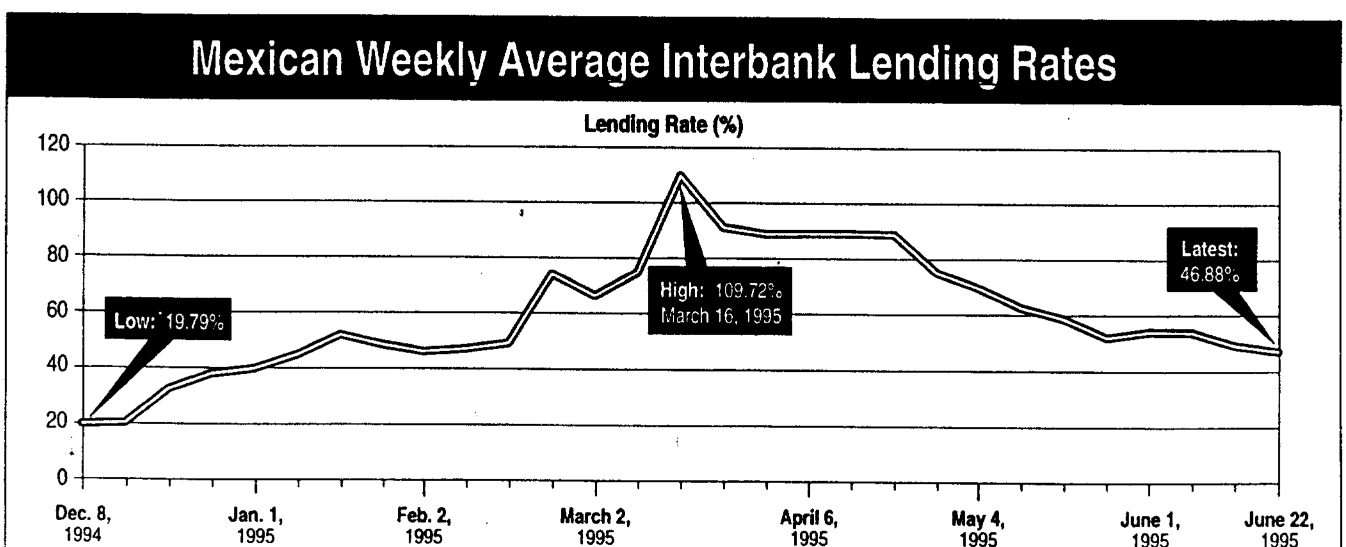
Different Accounting Standards

The central issue is that, under Mexican accounting rules, only each missed installment of a loan is declared past due.

In contrast, under U.S. Generally Accepted Accounting Principles (GAAP), an entire loan is declared past due 90 days after a single missed payment. In addition, Mexican banks are permitted to capitalize interest income accrued, but not yet received, allowing what would be a loss on U.S. books to be recorded as a gain in Mexico.

Also, some experts note that Mexican banks failed to include increases in loan-loss reserves as part of their first quarter earnings, and instead charged the February increase in reserve requirements to 60 percent against future tax credits.

All of those practices have led many analysts to assert that the true nature of Mexican banks' asset quality is unclear. They also say that, had banks conformed to U.S. accounting standards and charged loan-loss reserve through the income statement, rather than to capital, most would have reported large pre-tax losses.



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As it happened, first quarter results showed big profits for many Mexican banks, which may have been worried about scaring off investors by telling the true story.

Salomon Bros., in a controversial May 1 report, said that all Mexican banks would have lost money according to a formula created by the firms' analysts. And a May 22 report from Chemical Bank's emerging market research group said that pre-tax losses would have been reported by every bank except for Bancomer, one of the stronger banks and Mexico's second biggest after Banamex, the Banco Nacional de Mexico.

The Mexican Banking and Securities Commission, known in Spanish as the Comision Nacional Bancaria y de Valores (CNBV), has defended the banks' accounting practices, saying that including the February increase in loan-loss reserves on income statements would be a distortion, and that the reserve increases were better recorded as one-time extraordinary losses which could be partially offset against future tax credits.

However, D'Amato has said that he has asked the Securities and Exchange Commission (SEC) to investigate practices of Mexican banks traded on U.S. stock exchanges. The SEC, which is overseen by the Banking Committee, is thought likely to comply.

Things Fall Into Place

Nevertheless, the consensus is that the banks should avoid a wholesale meltdown, in spite of the fact that they are expected to report even bigger losses later in 1995. The sector should also avoid being subjected to the same type of nationalization process seen in Venezuela in 1994, a distinct possibility earlier this year.

Thomas Trebat, managing director of emerging market research for Chemical Bank, told BNA, "I think the government has a grip on the Mexican banking system, and there's such a small number of big banks, the system is so concentrated, that it's possible to do that. "

Trebat's point about the concentration of the banks is an important one. About 50 percent of the banking system's total loans at the end of 1994 were concentrated among the three largest banks — Banamex, Bancomer and Banca Serfin. Two of those banks are healthy — only Serfin was troubled, and its problems will ease somewhat from getting new capital from wealthy shareholders under the 2-1 loan purchase deal with the government. Serfin will also be the biggest beneficiary of a massive, $3 billion restructuring of debt accumulated from Mexico's toll roads. The announcement of the toll road restructuring is imminent.

There are several other reasons for tempered optimism and the return of investor confidence. Chief among them is the apparent success of government support programs to date, which have helped keep banks afloat and prevented a run on deposits.

"The system shock absorbers, as I call them, are doing the trick of maintaining investor confidence. We place a lot of short-term commercial paper for the banks, and its gotten much easier to do that lately," Trebat said.

Though adding to the government's liability, analysts say that the resources used to fund those programs have saved far more than they cost. As Teran noted, "experience has shown that it's far more expensive to bail out a failed bank than it is to try to straighten things out."

No Bad News Expected

Another factor on the side of the banks is that little in the way of bad news is expected to emerge in coming months.

Most of the worst news about banks with poor asset quality and liquidity problems is already out, or can be anticipated. "Don't be surprised if there's a big jump in past dues during the second and third quarters, because they lag behind the economy," said Herrera. "The third quarter is going to be terrible."

Other positive trends for the banks are the expected consolidation of the system as stronger banks merge with weaker ones, and improvements in the macroeconomy, including the sharp fall in interest rates and relative stabilization of the peso since March.

Many economists expect zero growth in the fourth quarter, or a even a slight recovery. Interest rates have dropped, making it likely that the rate of growth in past-due loans will slow. And recent months have seen the peso stabilize somewhat near 6.2 to the dollar, off its March 9 low against the greenback of 7.52.

In addition, noted Teran, when the crisis hit, many borrowers stopped payments on loans instinctively, either because they wanted to wait for interest rates to fall, or else they wanted to be well positioned for loan restructuring schemes. That means that some loans now counted as past dues may actually be repaid in the future.

"You had a lot of companies which refused to pay because they were protesting high rates or they were positioning for better restructuring under the UDIs (inflation-indexed units of investment)," Teran said. "A lot of those loans are viable."

Also significant is that Mexico has expanded the degree to which foreign banks can enter the local market since the crisis, which should not only bring in new capital, but also create much-needed competition to keep Mexican banks on their toes.

Government Support Measures

Government support measures for the banks, aside from the 2-1 loan purchase mechanism recently exercised by the central bank, have taken three distinct forms — Fobaproa, the bailout fund; Procapte, the capitalization fund; and the UDIs, the loan restructuring program.

The programs create a huge amount of new liability for the government, only a small amount of which is expected to be lost. In the June 19 edition of Standard and Poor's *Creditweek*, John Chambers, an S&P analyst, wrote that the total added liability of the programs for the Mexican government amounts to 12 percent of Mexico's GDP (gross domestic product), or about $30 billion to $40 billion.

The main component of the government's new liability comes from the UDI program, which will be used to restructure about $165 billion pesos, or $26 billion, in loans. That figure represents about one-quarter of the total assets of the banking system. Other liabilities will come from cleaning up the books of Serfin and Probursa, over $1 billion, and the cost of an anticipated program to restructure loans made to struggling toll-roads, at about $3 billion.

Despite the enormous added liability for the Mexican government — which S&P said was "manageable — the programs are seen as essential because of their ability to buy time for the banking system." Time, analysts agree, is what the system most needs until longer-term solutions arise in the form of fresh capital or an improved economy, whichever comes first.

"The likelihood of investors coming back quickly is very limited," said Bello. "They want to see that things are returning to something close to normal first, and that takes time."

Fobaproa Grants Credit

One of the main support programs, Fobaproa (Fondo Bancario de Proteccion de Ahorro) is the Mexican version of the Federal Deposit Insurance Corporation. Fobaproa is primarily a last ditch fund which capitalizes banks after they have been intervened. Both Grupo Financiero Union-Cremi and Banpais have been stabilized by Fobaproa, and the government is seeking to have them bought out.

But Fobaproa has also been expanded since the crisis, opening a foreign exchange credit window with funding from the Banco de Mexico, the central bank, to provide commercial banks with dollar-credit lines to pay off foreign obligations, such as certificates of deposit (CDs) and other instruments which have not been rolled over by skittish investors. Chemical Bank estimates that the rollover rate for CDs during the first quarter was as low as 23.5 percent.

A total of nearly $21 billion in dollarized obligations were scheduled to mature in 1995, and over half, or $10.7 billion, matured during the first quarter of the year. As of May 31, according to the Banco de Mexico, the balance of dollar credit granted to commercial banks by Fobaproa amounted to $2.16 billion, but some banks have been able to prepay Fobaproa's dollar loans.

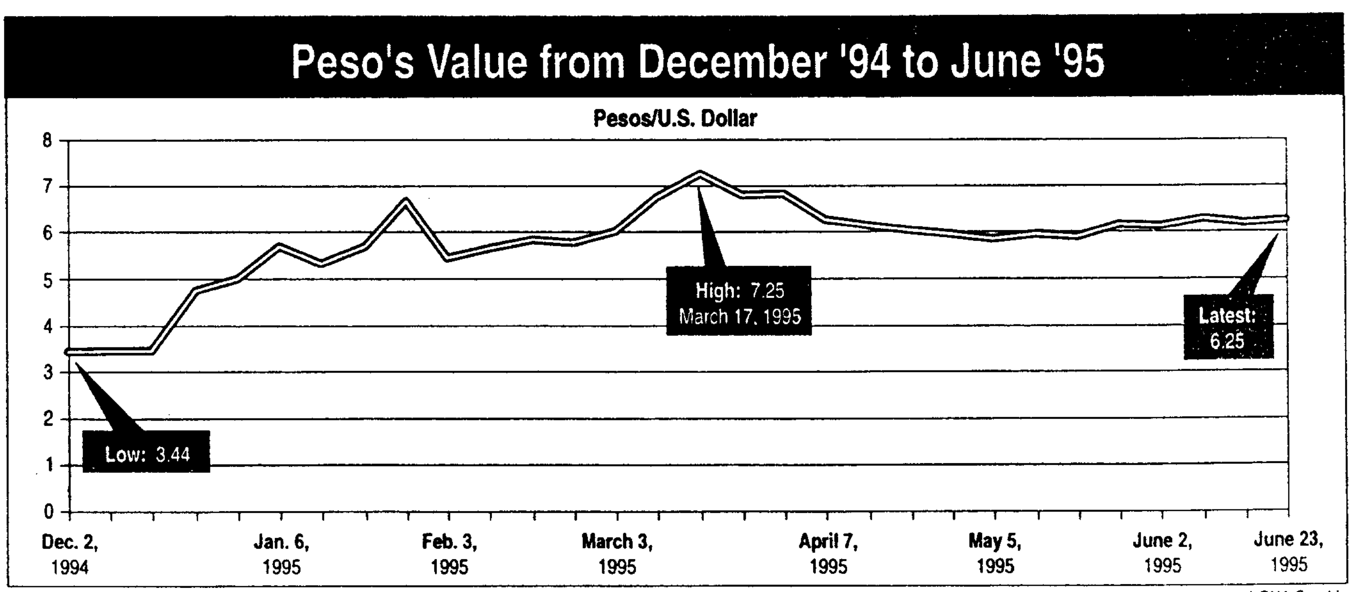
The government has increased funds available to Fobaproa by $3 billion so far this year, with the goal of bringing its capitalization up to $4 billion. Most of those funds have come from a $2 billion World Bank loan which went through earlier this year. But Fobaproa is also likely to see a good portion of $1.75 billion Inter-American Development Bank/World Bank loan package destined for the financial sector. The IADB portion of the financial sector loan package, amounts to $750 million and was approved by that organization June 21. The World Bank portion, amounting to $1.0 billion, was approved at a June 22 board meeting of the organization, and half of it will be conditioned on Mexico's making serious reforms.

Procapte — The Temporary Capitalization Program

Besides the dollar credit line, Fobaproa has also been charged with administering a temporary capitalization program — Procapte. Known in Spanish as the Programa de Capitalization Temporal, Procapte was created by the government to deal with the problem of lower capitalization resulting from the fast pace of the devaluation of the Mexican peso. Essentially, it is a stabilization fund designed to provide fresh funds to viable banks with short-term capital needs.

Banks whose capital falls below 8 percent of assets are required to issue 5-year callable, mandatory convertible subordinated debentures to Procapte. In exchange, funds to raise individual banks' capitalization are deposited with the Banco de Mexico, the central bank. The purpose of depositing Procapte funds with the central bank is to eliminate the inflationary possibility of boosting Mexico's money supply.

Procapte has been criticized by some observers as "creeping nationalization" because issued debt unrepaid after 5 years is converted into government equity in the banks. Also, Procapte provides no liquidity for



Source: Banco de Mexico

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the banks, since the money from convertible debentures sold to Procapte are converted into deposits at the Banco de Mexico. Also, participating in the program has proved a black mark for some banks and restricts their operations, making them eager to leave the program as soon as possible.

Still, Procapte has been an important means of maintaining the adequate capitalization of the banking system, and tight monitoring by finance officials has guaranteed that participating banks are staying in line.

"I think that overall, Procapte is good because it's buying the banks time," said Bello. "Obviously, under a non-devaluation scenario, it's not good. But in this situation, it's something the government did right. From a free market point of view, it would have been something to avoid, but then banks could fail and you have other problems."

As of March 31, six banks were participating in Procapte, including Banca Serfin, Banco Inverlat, Banco Internacional (Bital), Banco del Centro, Banca Confia, and Banco de Oriente, for a total of about 6.5 billion pesos ($1.04 billion). Serfin has so far been by far the biggest user of Procapte funds, at about 3.2 billion pesos ($510 million). But Serfin will be using its fresh capital obtained through the 2-1 arrangement to buy back its debentures and leave the program.

Other banks currently in Procapte may leave as they strike deals of their own, or as the economy picks up and allows them to help themselves. It is possible that, five years down the line, one or two banks which are unable to buy back their debentures will find their shares converted into government equity. In that event, the bank's shares would be sold on the open market. But before buyers can be found, the government would probably have to clean those banks' books — another potential cost.

UDIs, Or Units Of Investment

Difficult to understand and slow to be implemented, UDIs, known in Spanish as Unidades de Inversion (units of investment) are a key aspect of the government's rescue program. About 165 billion pesos, or more than $26 billion, are expected to be restructured under the UDI scheme, or about one-fourth of the total loans in the system.

The investment units are modeled on a system implemented in Chile when that country's banking system was besieged in 1982, following a devaluation of the Chilean peso. In just weeks, 17 percent of Chilean banks' loans defaulted, twice the capital base of the whole system. In response, Chilean monetary officials created Unidades de Fomento (UFs), the precursors to UDIs.

The basic mechanism of the UDIs is to create off-balance sheet trusts for credits restructured into inflation-indexed UDI terms. Credits moved into the trusts are replaced by non-indexed government securities provided by the Banco de Mexico.

UDIs allow inflation-indexed deposits and loans to be restructured to terms of over 6 years, and have long grace periods for repayment.

The UDIs are seen as a mechanism which should significantly slow growth in past-due loans by pushing the largest payments on interest and principle into the future. To a certain extent, the UDIs depend on an improvement in the Mexican economy, because the program assumes that debtors' resources will be increased to pay a principle amount which increases along with inflation.

"The UDIs will only delay problems for some borrowers, the ones that cannot pay anyway. They're most useful if you are still selling," into Mexico's contracting market, or are exporting goods, noted Herrera.

UDIs have also been criticized as slow to be implemented, which is attributable largely to their complex nature and the lack of understanding on the part of borrowers. Also, they can be inflationary, because a growing percentage of the economy becomes inflation-indexed.

The Swiss Bank Corporation, in an April 13 report, also noted that the UDIs have a cost to the government. "Implicit in the scheme, the government will subsidize interest rate differentials between interest received by UDI-priced credits and the cost of funding its long-term bonds."

Teran estimates that the UDIs could cost as much as $1.5 billion this year, and perhaps less as time passes and, hopefully, the economy recovers.

Foreign Banks' Window Of Opportunity Opens Wider

Last October, when 18 foreign banks were authorized to operate in Mexico under the North American Free Trade Agreement, each was to be limited to holding only 1.5 percent of the total Mexican market, and all foreign banks together could hold no more than 8 percent of the total market, a figure which would grow to 15 percent by the year 2000.

However, in January, the finance ministry, the Secretaria de Hacienda y Credito Publico, revamped the conditions under which banks would be able to enter Mexico. Under the new rules, foreign banks can hold majority shares of Mexican banks, and up to 49 percent of the entire banking sector. BBV's purchase of a majority share of Probursa was the action covered by the new rules.

While an important, but still not overwhelming, number of other foreign banks are expected to seek Mexican partners, their presence is seen as a significant factor in increasing the long-term competitiveness of the financial system.

By introducing new technology, procedures and management, the banks will provide strong motivation for Mexican banks to streamline their operations, or else lose market share. It is also anticipated that competition will reduce interest rate spreads. In addition, the foreign banks will be among the few institutions in Mexico able to lend in dollars to worthy Mexican companies.

A U.S. official expressed satisfaction with the opening of the market, noting that it surpasses the requirements of the North American Free Trade Agreement. "I've been pleased to see some of the responses of the government, particularly with regard to foreign banks," even if a large amount of government participation — through the 2-for-1 arrangements — is required, the official said.

Foreign banks will provide little relief for retail customers, however, since most will be concentrating on the best Mexican companies. Over the long term, however, noted Herrera, foreign banks with a strong retail presence in their home countries, like the BankAmerica Corp., may seek to provide similar services in Mexico.

Structural Changes

Many experts say that, in addition to financial assistance for the banks, there are structural changes that the government can, and should, be making to help the sector, and at little cost, particularly by encouraging the establishment of common credit databases. But some observers also note that, with a powerful banking lobby, real changes may be difficult to implement.

The New York analyst said that, "There are some structural changes that can be made in the system, like establishing a common credit bureau. One of the big problems is that they don't have the database, so its hard to judge asset quality, and you can't value new loans."

He added, "Those are things the government can do at no cost. And whether or not those things are in place is more important than the short term economic situation. If they can move quickly and show that they can implement measures like that," the government would be sending a positive message to investors.

Mexico has, in fact, made some steps towards improving credit reporting. In February, the country published regulations allowing for the creation of credit bureaus which will incorporate information on retail customers in areas such as credit card obligations, auto financing and mortgages.

The third largest U.S. credit bureau, Chicago-based TransUnion, has entered into a partnership with the majority of Mexican banks to incorporate their consumer credit information, and hopes to be fully operational by the end of 1995. Other U.S. companies, TRW and Equifax, have also established Mexican subsidiaries, and are in the process of entering the market.

The fact that TransUnion de Mexico is 70 percent owned by Mexico's banks, however, has been questioned in the name of competition. Big banks — Banamex, Bancomer and Serfin — have the preponderance of credit information and dominate the partnership. And they have been unwilling to share their information with other credit bureaus, allowing them to continue controlling credit information as they seek to avoid losing their best customers.

Controlling Information

Some observers have said that the big banks' continued practice of not sharing information will limit the extent to which overall credit reporting will be substantially improved. They also say that this practice will ultimately hurt the economy, because a lack of information will allow some borrowers to continue to overextend themselves.

The U.S. official attributed the fact that big banks will, in effect, be able to continue to control their credit information to the strength of the banking lobby. The official also took a dim view of there being short-term improvements in borrower's habits, noting that Mexico lacks a "credit culture."

"The banking lobby is just too strong," to allow the comprehensive sharing of credit information, the official said. "Also, there is a problem with not having a credit culture. In Mexico, not paying your bills is a national pastime."

Part of the problem, the official said, is that existing banks have not faced sufficient competition to motivate them to make substantial changes in how they operate. Though many banks have been wildly inefficient over the past years, they have also been extremely profitable. "There should be more banks and more competition," the official said. "The existing 18 core banks are a pretty strong business group."

Consumer Counseling

Carlos Aiza, an attorney specializing in the financial sector with the Mexico City firm of Creel, Garcia-Cuellar y Muggenburg, S.C., said that another important improvement for the banking sector would be to beef up the presence of consumer counseling agencies, which would advise debtors on sound borrowing practices and on how to restructure outstanding debt. Many borrowers, he noted, are unfamiliar with the implications of Mexico's high interest rates.

"I think consumer counseling is a very key issue which should be pushed," Aiza said. But he also noted that, as of now, consumer counseling agencies continue to be taxed as normal companies. He suggested that, since they serve the public at large, the development of such agencies could be encouraged by granting them special tax breaks.

Without getting into specifics, finance minister Guillermo Ortiz, for his part, on June 23 acknowledged the importance of the health of the banking sector to Mexico's economy. He appeared to accept the tough conditions imposed by the World Bank for receiving a $500 million installment of the $1 billion loan package destined for the financial sector.

In a statement, Ortiz said, "A banking system that is well-capitalized and solid will not only alleviate credit problems, but will also help the economy back to health."

The second installment of the World Bank loan will only be disbursed after about 9 months, officials said, after the organization has assessed Mexico's progress in reforming the banking sector.

In the interim, "1995 and 1996 will be years of consolidation — of intensive care for banks, through the second half of 1996," said Herrera.☐

End of Section