



निक्षेप बीमा और प्रत्यय गारंटी निगम

DEPOSIT INSURANCE AND CREDIT GUARANTEE CORPORATION

(भारतीय रिज़र्व बैंक की संपूर्ण स्वामित्ववाली सहयोगी Wholly owned subsidiary of the Reserve Bank of India)



# Lessons from Financial Crisis for Bank Resolution: Mexico and Latin America's Experience

José Luis Ochoa

November 13, 2011  
JODHPUR, INDIA



## Mexico – Institute for the Protection of Banking Savings

- I. Mexico's previous experience in banking crisis**
- II. Current situation of Banks in Mexico**
- III. Overview – DIS in Mexico**
- IV. Challenges of DIS in Latin America**
- V. Banking Resolution's Framework**
- VI. Financial Safety Net**
- VII. Improvements – DIS in Mexico**
- VIII. Conclusions**

# I. Previous experience in banking crisis

INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



## Introduction

- During the current financial crisis, the Mexican financial and banking systems has maintained **a solid and stable position. No bank has failed.**
- The observed stability in México, is mainly due to a **gradual strengthening of the banking regulation and supervision**, performed by the **Mexican Government during the last 15 years.**
- However, the mid-nineties crisis in Mexico, one of the most important in recent history, provided with **great lessons** that helped us improve our savings protection system.
- This crisis severely affected the banking system's solvency, which almost generated the collapse of the financial system.

# I. Previous experience in banking crisis

INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



## 1994-1995 Crisis Causes

- i. Significant growth in bank lending and non-performing loans;
- ii. Poor bank management;
- iii. Inadequate supervisory and regulatory framework;
- iv. Overpriced MXP-USD exchange rate;
- v. Mexican Central Bank experienced significant international reserve loss
- vi. High volatility in the stock market.

# I. Previous experience in banking crisis

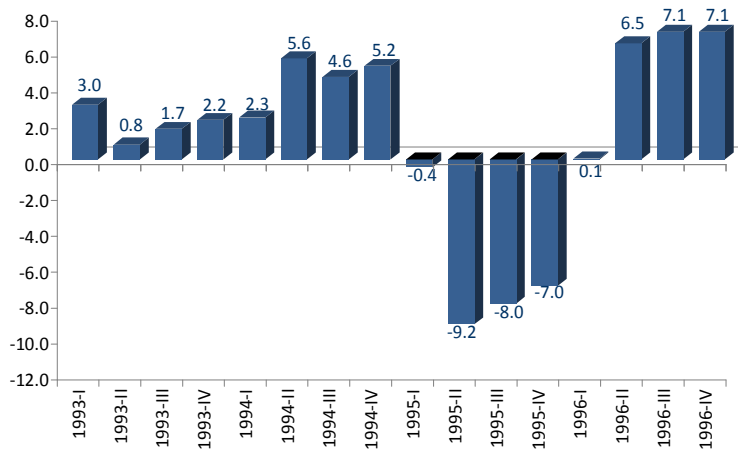
INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



## 1994-1995 Crisis - Effects

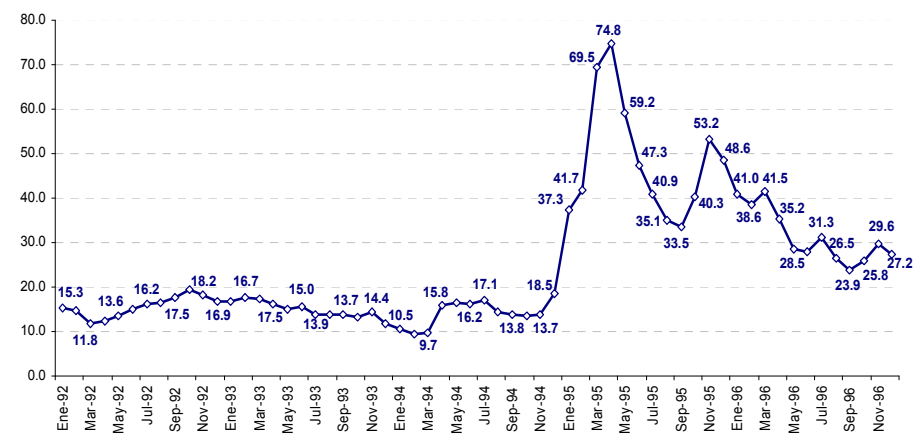
- i. GDP dropped from 5.2% in the 4Q1994 to -7.0% in the 4Q1995;
- ii. Peso devaluated from \$3.4 to \$7.6 pesos per US dollar (Dec.1994 to Dec.1995);
- iii. Interest rate raised from 13.7% (Nov. 1994) to 74.8% (Apr. 1995);
- iv. International reserves dropped from USD \$25 billion to USD \$6.1 billion (1-jan-1994 to 31-dec-1994).

**Quarterly GDP  
Annual percentage change.  
(1993-1996)**



Source: INEGI

**Interest rate  
(cetes 28 days)**



Source: Mexico's Central Bank.

# I. Previous experience in banking crisis

## 1994-1995 Crisis – Effects in Banking Sector

- **Severe capital deterioration** in the banking sector; financial assistance programs were established to benefit 21 out of the 34 banks that operated in 1994. Ten banks were placed under receivership and then liquidated.
- These programs were intended **to help banks to fulfill their obligations** and to prevent the collapse of the payment system.
- **In the middle of the crisis**, it was necessary to design **legal, administrative and operational procedures** to deal with bank failures.
- Due to the lack of procedures, the liquidation of such banks lasted **more than a decade**.
- A substantial non-public debt, payable by IPAB through federal budget allocations, was generated. This is still outstanding debt, although the amount has reduced as a proportion of GDP.

# I. Previous experience in banking crisis

INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



## 1994-1995 Crisis – Lessons learned

- **The experience achieved during this crisis**, contributed to build an effective **regulatory framework which improved the soundness** of the banking system in Mexico. Today all banks have adequate capitalization levels.
- As a result of the crisis, Mexican financial authorities developed a wide expertise regarding banking resolutions, that ultimately led to the strengthening of the financial regulation and supervision framework.
- Additionally, the crisis showed the importance of improving information sharing and coordination agreements among Financial Safety Net members.
- After the crisis Mexico achieved and maintained the following structural strengths: (i) fiscal discipline; (ii) credit access to international financial markets; (iii) adequate inflation rate, and (iv) bank's capital ratio above the minimum required by Basel capital standards.

## II. Current situation of banks

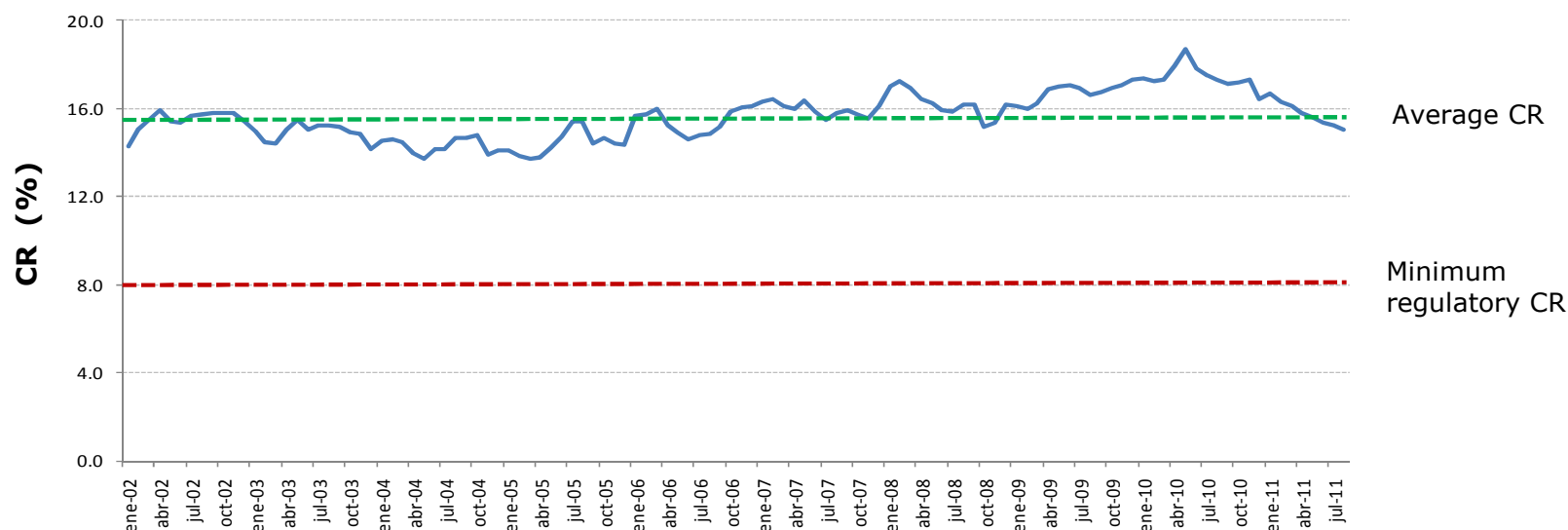
INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



### Solvency of Banks in Mexico

#### Capital Ratio (CR) of Commercial Banks

(as of August 31, 2011)



Source: DGIAI with data from Mexico's Central Bank.

- **Average CR of 15.7 percent**, far above the minimum 8 percent level established in Basel II.
- Mexican banks have not invested in assets tied to the US housing market.
- Bank loans were mainly financed internally and in local currency.



## II. Current situation of banks

Additionally, the Federal Government and the Central Bank have implemented several measures to mitigate the effects of the current crisis, with the following objectives in mind:

- Guarantee the liquidity of the financial system.
- Boost economic activity and infrastructure development.
- Promote and preserve sources of employment.
- Provide support for the development of small and medium size companies.

## Objectives

- The Institute for the Protection of Banking Savings (**IPAB**) is a public agency created in 1999, responsible for:
  - **Guarantee and execute primarily the payout of low and middle income depositors.**
  - **Resolve banks with solvency problems at the least possible cost.**
  - Provide certainty to depositors through an explicit guarantee of deposits up to the coverage limit.
  - Help to preserve the stability of the financial system and the effective functioning of the payments system.

### III. Overview – DIS in Mexico

INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



#### Coverage

- **Coverage Limit\*:** equivalent to **USD \$136,812** as of October 25, 2011.
- **Insured Deposits:** checking accounts, saving accounts, time deposits, and balances on debit cards, among other operations.
- **Systemic risk coverage:** subject to the approval of financial authorities, coverage may be increased up to 100%, in exceptional cases.

\* When Mexico established a limited coverage of 400 thousand UDIs (January 1, 2005), this was equivalent to USD \$126,908, that is MXN \$1,414,020.

### III. Overview – DIS in Mexico

INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



## Insured Deposits

Concept	September 2011 <sup>1-/</sup>
<b>Insured Accounts</b>	<b>101,555,432</b>
Fully Insured Accounts	101,447,533
% of Insured Accounts	99.89%
Partially Insured Accounts	107,899
% of Insured Accounts	0.11%
<b>Balances of Insured Deposits (ID) <sup>2-/</sup></b>	<b>174.02</b>
<b>Balances of Fully Insured Deposits (FID) <sup>2-/</sup></b>	<b>95.11</b>
<b>Balances of Deposits not Covered <sup>2-/</sup></b>	<b>78.91</b>
FID as % of ID	54.65%
Nominal GDP <sup>2-/ 3-/</sup>	1,043.14
Current Coverage level <sup>4-/</sup>	136,812

- The Mexican banking system comprises 41 commercial banks, 36 of which hold deposits insured by IPAB.
- Balance of fully insured deposits: USD \$95.1 billion (which represent 25.22% of the commercial banking sector's total liabilities and 9.12% of the nominal GDP as of 2Q2011).

<sup>1-/</sup> Preliminary figures. Source: CNBV and Mexico's Central Bank.

<sup>2-/</sup> Figures in billions of USD.

<sup>3-/</sup> For the second quarter of 2011, is considered an estimated nominal GDP provided by SHCP.

<sup>4-/</sup> Considering UDI value as of October 25th, 2011.

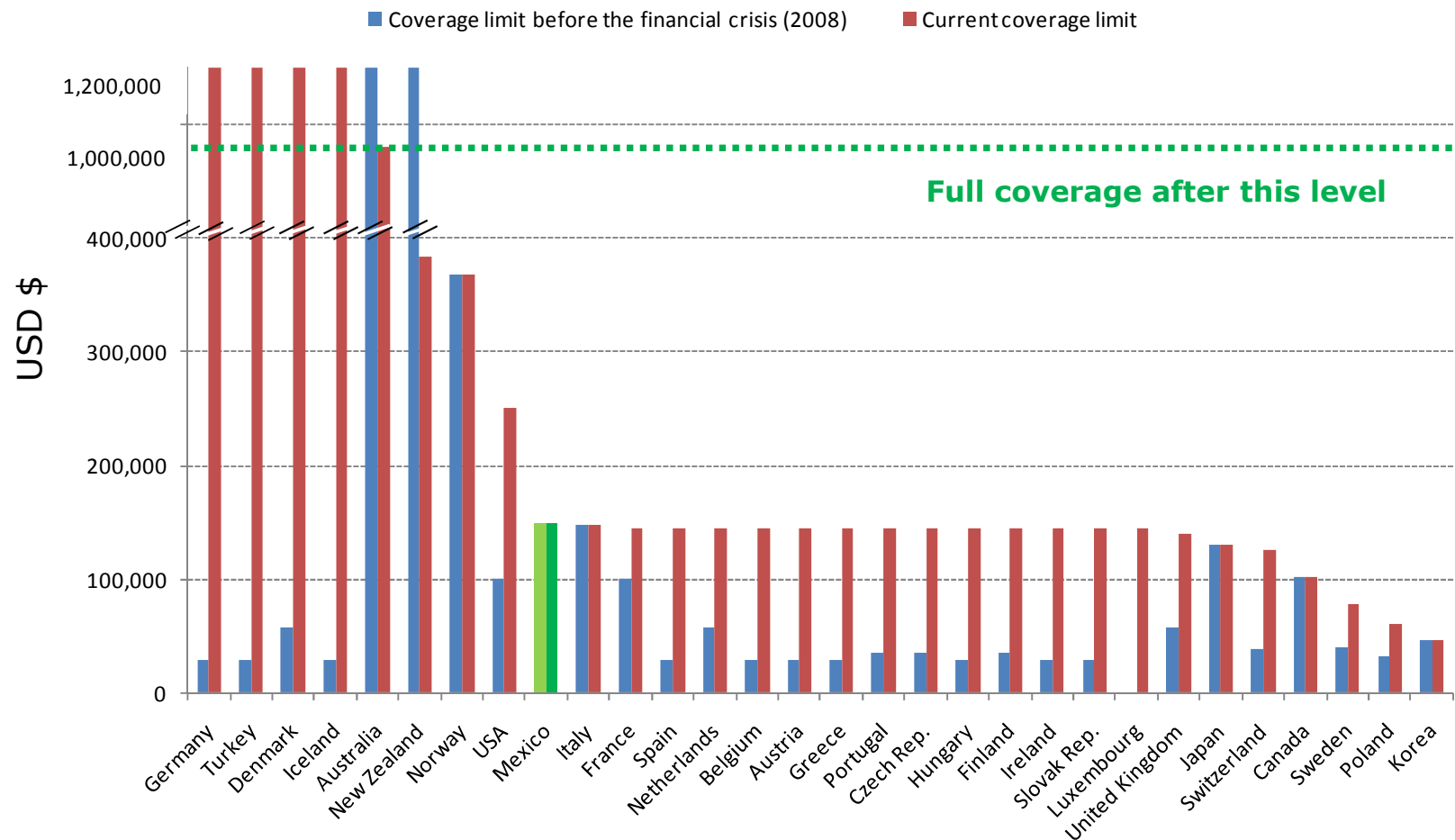
### III. Overview – DIS in Mexico

INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



## Coverage

Coverage limit of OECD member countries before and after the current financial crisis.



Source: Deposit Insurance Systems of the countries and IADI.

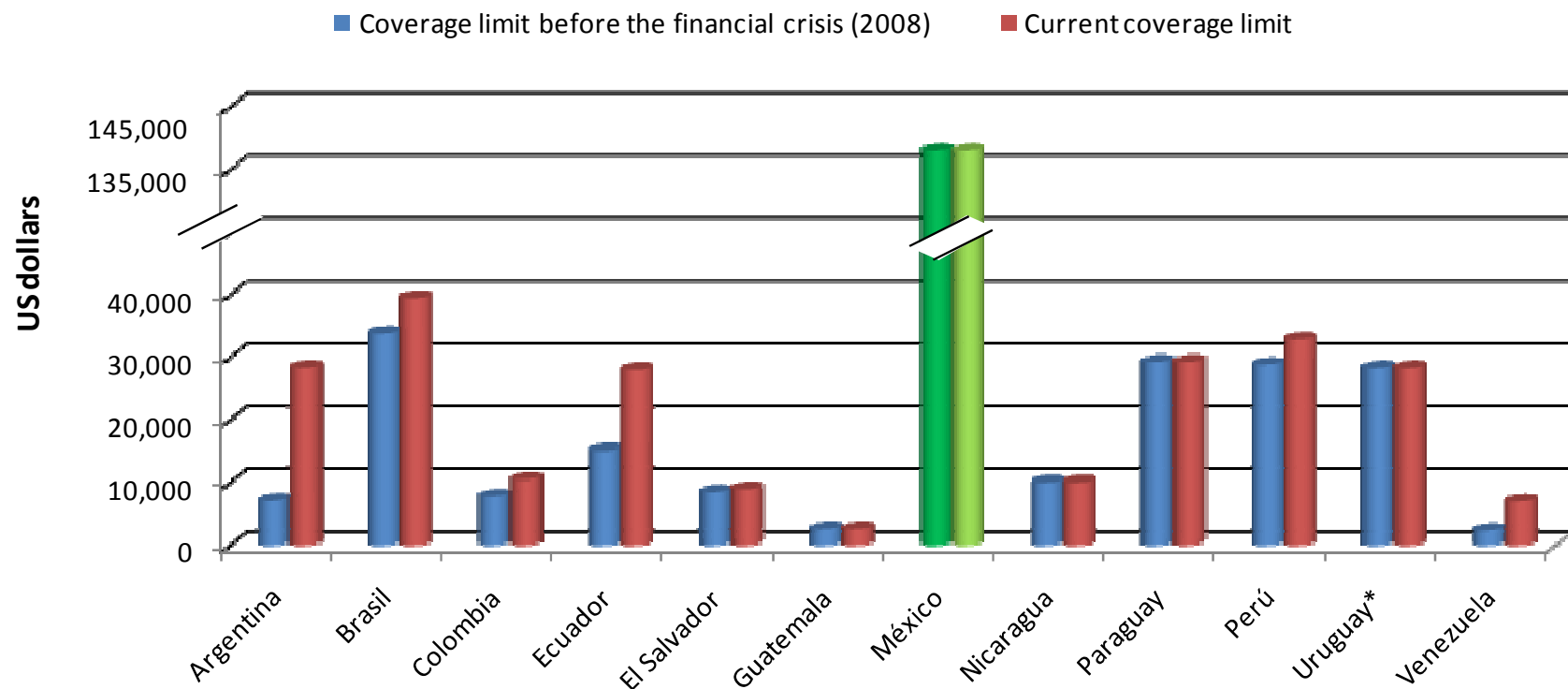
### III. Overview – DIS in Mexico

INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



## Coverage

Coverage limit of Latin America Regional Committee (LARC) member countries before and after the current financial crisis.



\* Uruguay's coverage limit is made up of 250,000 Indexed Units for domestic deposits and USD \$5,000 for foreign deposits.

Source: Deposit Insurance Systems of the countries and IADI. Coverage limits in US dollars as of October 25, 2011.

### III. Overview – DIS in Mexico

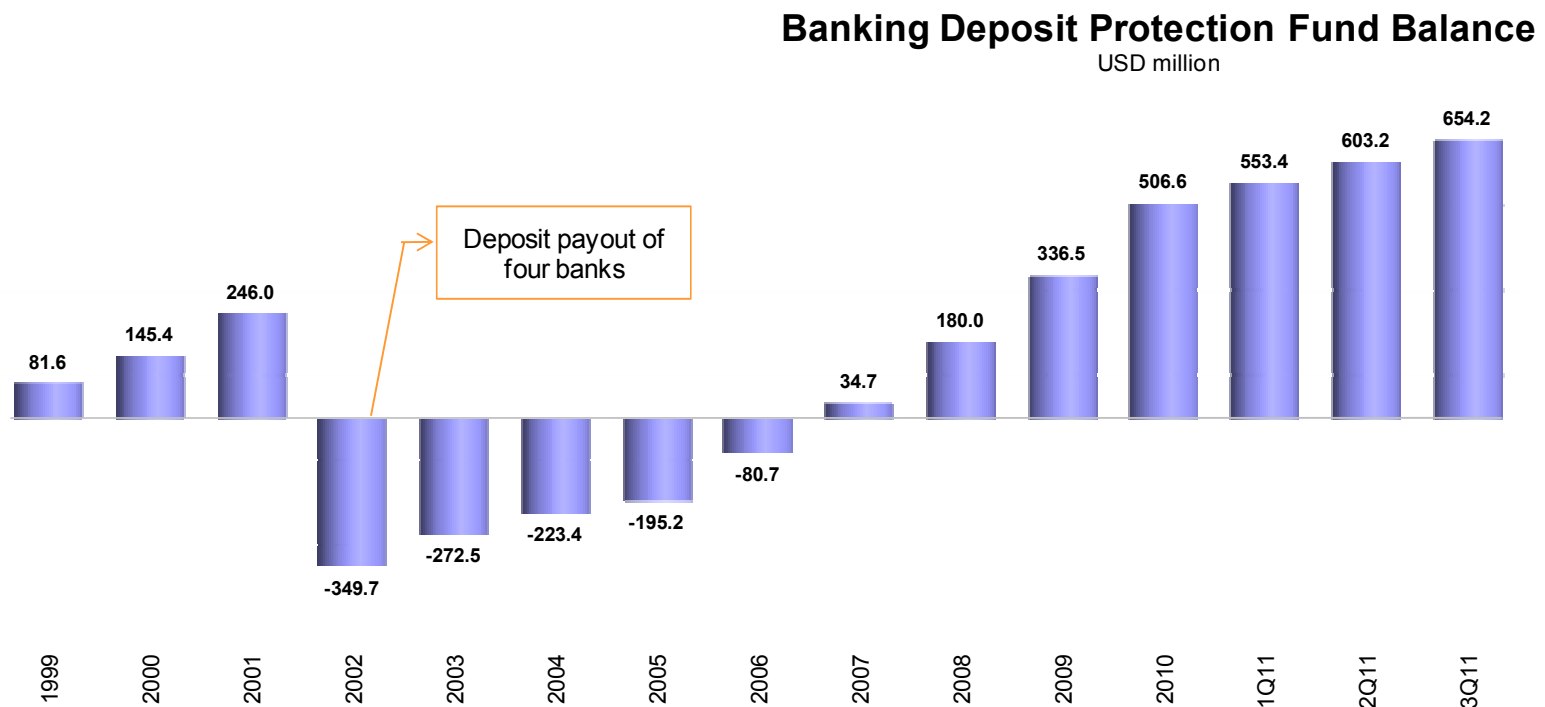
INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



#### Funding Mechanisms

- IPAB has in place the following **funding mechanisms** to guarantee the reimbursement of depositors:

1. **Banking Deposit Protection Fund**: USD \$654.2 million as of 3Q2011.



Source: IPAB.  
Balances in US dollars as of October 25, 2011.

### Funding Mechanisms

2. **Supplementary Funding**: IPAB may request funding, which may not exceed, in a 3 year period, 6% of the banking system's total liabilities (USD \$22.6 billion as of September 30, 2011<sup>a-/</sup>).
3. **Extraordinary Funding**: in the event that this funding is not sufficient, the Mexican Congress must establish the measures it deems necessary for this purpose.
4. **Bond issuance**: IPAB can refinance its financial obligations through bond issuance. This has been the leading strategy since 2000.

<sup>a-/</sup> US dollars as of October 25<sup>th</sup>, 2011.



## IV. Challenges of DIS in Latin America

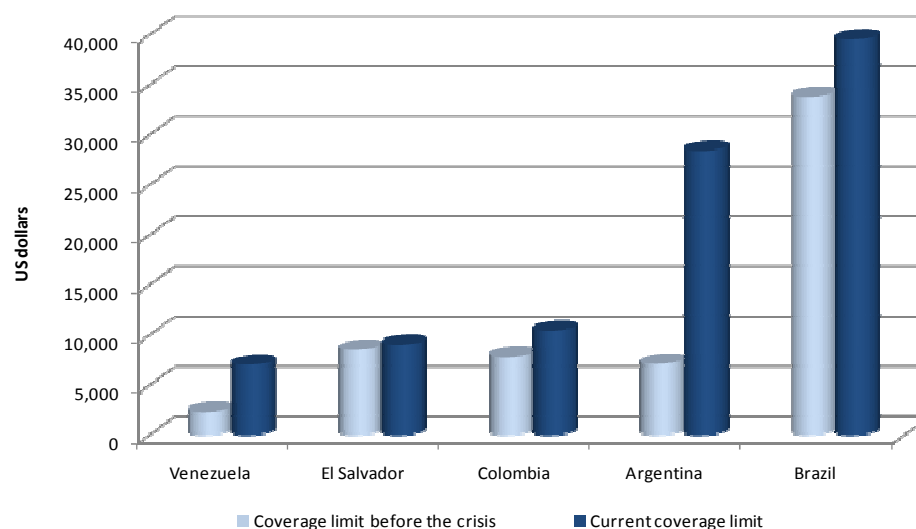
INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



### Changes in DIS coverage limits in Latin America

In response to the international crisis, some Latin American countries increased their DIS coverage limit in order to maintain confidence and certainty among depositors and other economic agents.

	Coverage prior to the crisis (A)	Changes in coverage as a result of the crisis	Coverage in effect from January 2011 (B)	$\Delta \%$ (B/A - 1)
Colombia	7,800	10,400	10,400	33%
El Salvador	8,500	8,500	9,000	6%
Venezuela	2,300	2,300	7,000	204%
Brasil	33,800	33,800	39,500	17%
Argentina	7,100	7,100	28,400	300%



Source: Deposit Insurance Systems of the countries. Coverage limits in US dollars as of October 25, 2011.

### Main challenges of DIS in Latin America based on the conclusions of the 8th Annual Meeting of the LARC (Colombia, March 2011)

- Implement **Basel III** regarding regulatory capital standards and its impact on the **early warnings system**.
- **Strengthen the regulation** based on international best practices.
- **Consolidation of the Financial Safety Net** and Stability Committees.
- Improve DIS resources.
- Develop **operational guidelines** regarding banking resolutions.
- Broaden **financial education efforts**.
- **Increase DIS public awareness** regarding its scope and benefits.
- **Perform banking resolution simulation exercises (drills)**.
- Establish performance management and quality systems.

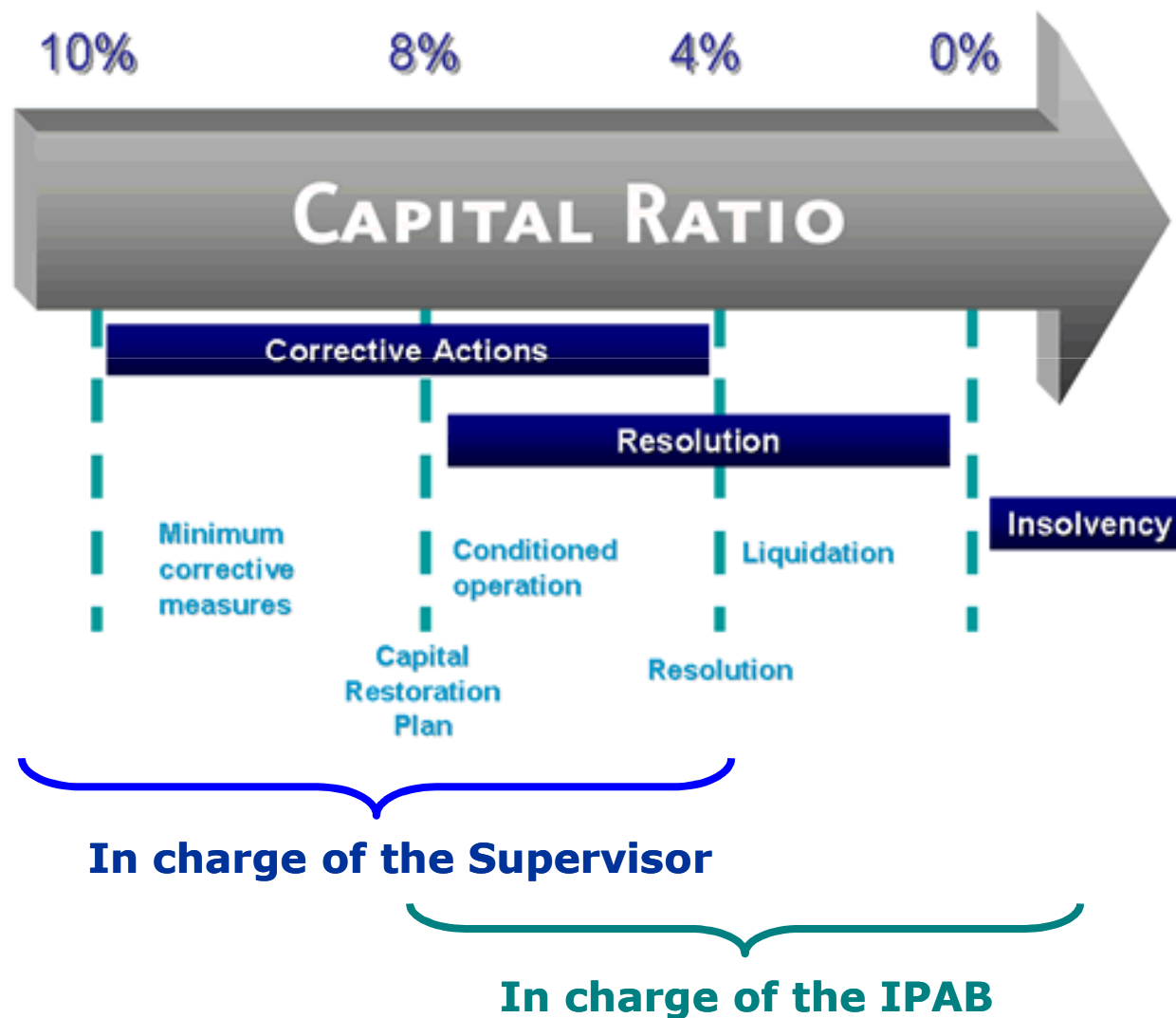
## V. Banking Resolution's Frameworks

INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



Mexico's banking resolution framework includes three stages:

**CR is the  
trigger**



### I. Prompt Corrective Actions (already established by law):

- If CR falls below 8%, the bank must submit a capital restoration plan to the supervisor and suspend dividend payments to shareholders and all mechanisms that imply the transfer of equity benefits.

### II. Banking Resolutions (already established by law):

- If CR falls below 4%, the supervisor revokes its operating license and IPAB's Governing Board determines one of the following resolution mechanisms according to the least-cost rule: (i) Deposit payout, (ii) P&A or (iii) Bridge bank.

### III. Judicial Banking Liquidation (law in design stage):

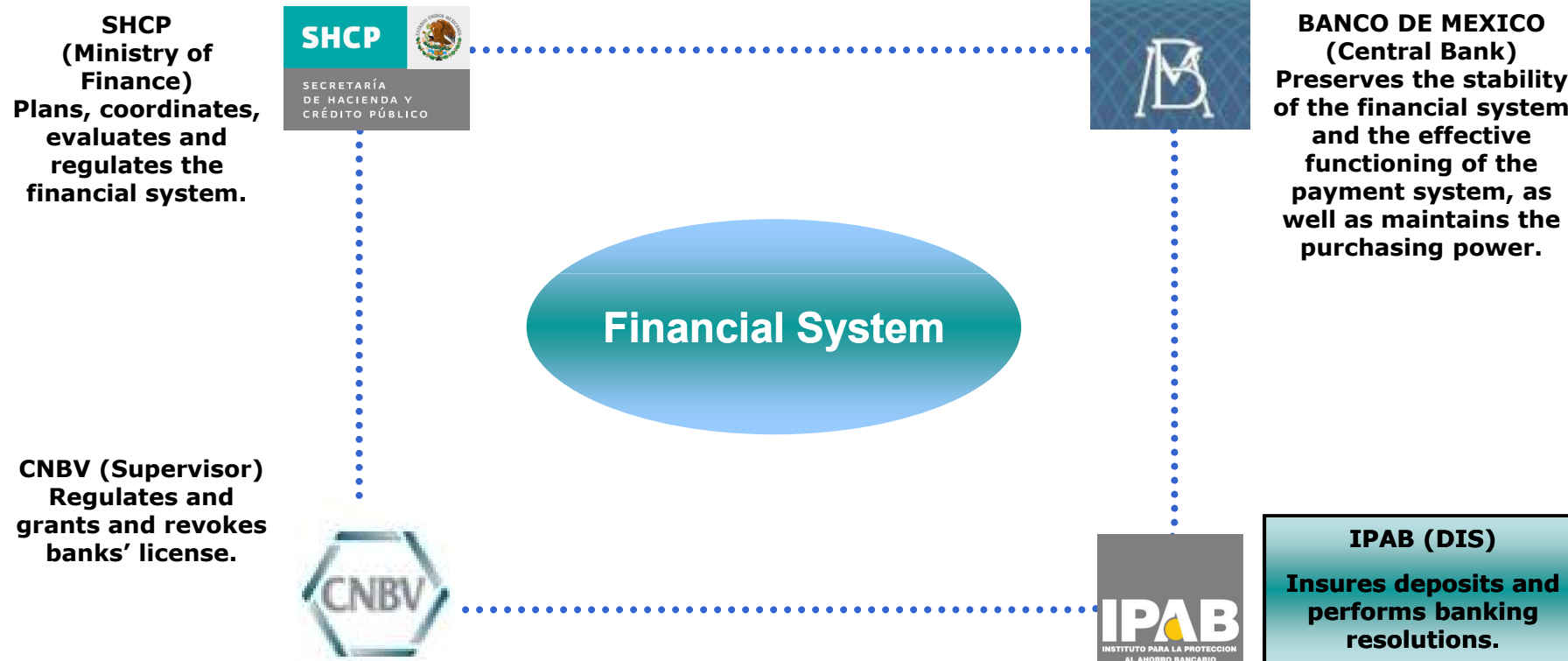
- If CR falls below 0%, the proposed reform will lay out: (i) A complete and prompt process, (ii) An orderly exit of banks under liquidation, (iii) Protection of depositors, creditors and the payment system, and (iv) Substitution of bank's special regime included in the current Commercial Insolvency Act.

## VI. Financial Safety Net

INSTITUTO PARA LA PROTECCIÓN  
AL AHORRO BANCARIO



### Financial Safety Net Members (FSN)



Mexico was one of the first countries around the world to establish a coordinated mechanism among its financial authorities through the **Financial Stability Committee (FSC)**



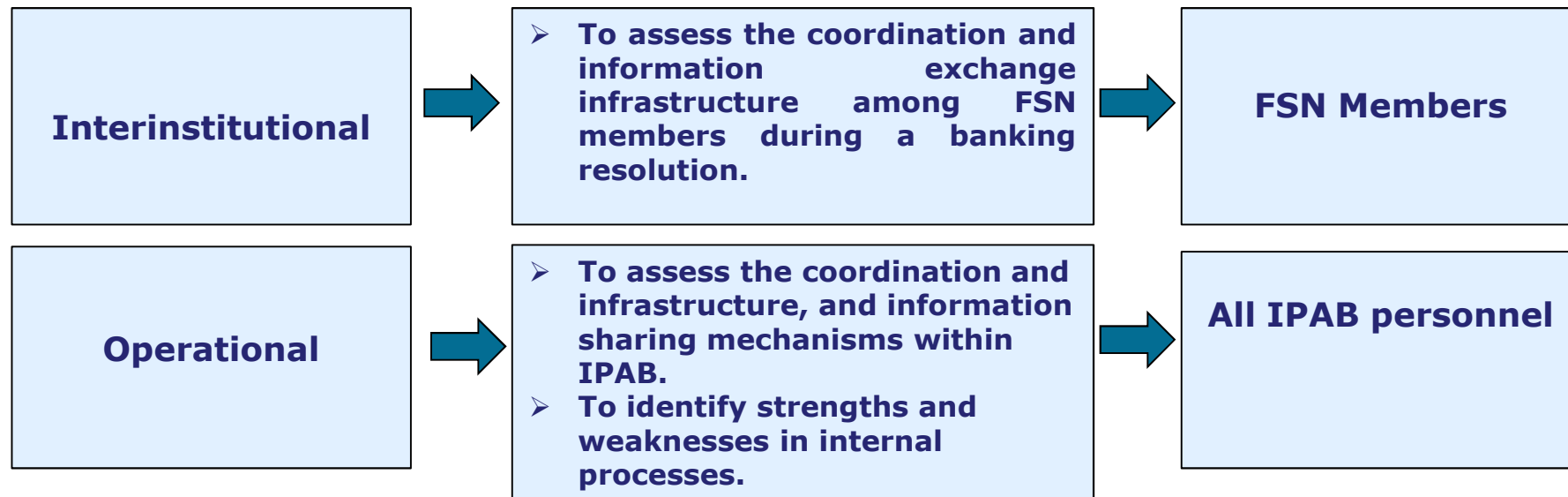
### Banking Resolution simulation exercises

In order to strengthen FSN coordination mechanisms, Mexican financial authorities are carrying out bank resolution simulation exercises along with the World Bank.

#### Simulation exercises

#### Objectives

#### Participants



**The following activities are being carried out in order to improve the DIS in Mexico:**

- Activities with IADI and the inclusion of the best international practices.
- Strategic Planning.
- Research.
- Inspection Visits.
- Financial Education and Public Awareness for depositors.
- Banking Resolution Simulation Exercises .

The international financial crisis highlighted the importance that financial authorities and, in particular, the DIS should strengthen:

- Legal and operative **tools -wide and flexible-**, in order to deal with financial problems and to reduce financial cost.
- **Clear communication, coordination and mandate** of the FSN to avoid overlapping of functions and loopholes.
- **Banking Resolution Simulation Exercises.**
- **Financial Stability Committee** to prevent emerging risks and to monitor systemic institutions.
- **Public awareness** about DIS benefits.
- Prudential **supervision and regulation.**
- **Mandates and legal instruments on a regular basis** to adapt to market innovation.



# Thank you



**For further information please contact our  
Office of International Affairs at:**

**[rvelazquez@ipab.org.mx](mailto:rvelazquez@ipab.org.mx)**

**or by phone at:**

**+52 (55) 52-09-55-00 ext. 1300**

**Or visit our website:**

**[www.ipab.org.mx](http://www.ipab.org.mx)**