Document of
The World Bank

FOR OFFICIAL USE ONLY

Report No: PGD51

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A

PROPOSED LOAN

IN THE AMOUNT OF US$ 500 MILLION TO THE

UNITED MEXICAN STATES
FOR THE

Mexico Financial Inclusion Development Policy Financing
May 21, 2019

Finance, Competitiveness And Innovation Global Practice
Latin America And Caribbean Region

United Mexican States
GOVERNMENT FISCAL YEAR
January 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of May 13, 2019)
Currency Unit
MXN 19.26 = US$ 1

ABBREVIATIONS AND ACRONYMS

APIs	Application Programming Interfaces *(Interfaz de Programación de Aplicaciones)*	CPF	Country Partnership Framework *(Alianza Estratégica de País)*
ASA	Advisory Services and Analytics *(Servicios de Análisis y Asesoría)*	CPMI	Committee on Payments and Market Infrastructure (*Comité de Pagos e Infraestructuras de los Mercados Financieros)*
B2B	Business to Business *(Negocio a Negocio)*	DPF	Development Policy Financing *(Financiamiento para Políticas de Desarrollo)*
BANSEFI	National Savings and Financial Services Bank (*Banco del Ahorro Nacional y Servicios Financieros*)	ENIF	National Survey of Financial Inclusion (*Encuesta Nacional de Inclusión Financeria*)
Banxico	Central Bank of Mexico *(Banco de México)*	EM	Emerging Markets *(Mercados Emergentes)*
BANOBRAS	National Bank of Works and Public Services *(Banco Nacional de Obras y Servicios Públicos)*	FCL	Flexible Credit Line *(Línea de Crédito Flexible)*
CAR	Capital Adequacy Ratio *(Coeficiente de Solvencia)*	FDI	Foreign Direct Investment *(Inversión Extranjera Directa)*
CCT	Conditional Cash Transfer *(Transferencia Condicionada de Efectivo)*	FIGI	Financial Inclusion Global Initiative Program *(Programa de Iniciativa Global para la Inclusión Financiera)*
CNBV	National Banking and Securities Commission *(Comisión Nacional Bancaria y de Valores)*	GDP	Gross Domestic Product *(Producto Interno Bruto)*
CNSF	National Insurance and Guarantees Commission *(Comisión Nacional de Seguros y Fianzas)*	GoM	Government of Mexico *(Gobierno de México)*
CONAMER	National Commission for Regulatory Improvement (*Comisión Nacional para Mejora Regulatoria*)	GRS	Grievance Redress Service *(Servicio de Atención de Reclamos)*
CONDUSEF	National Commission for the Protection and Defense of Users of Financial Services *(Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros)*	IBRD	International Bank for Reconstruction and Development *(Banco Internacional de Reconstrucción y Fomento)*
		IDA	International Development Association *(Asociación Internacional de Fomento)*
CONSAR	National Commission for Retirement Savings System *(Comisión Nacional de Sistema de Ahorro para el Retiro)*	IDB	Inter-American Development Bank *(Banco Interamericano de Desarrollo)*

IFC	International Finance Corporation *(Corporación Financiera Internacional*
IFCs	Crowdfunding Institutions *(Instituciones de Financimiento Colectivo)*
IFPEs	Electronic Payments Institutions *(Instituciones de Fondos de Pago Electrónico)*
IMF	International Monetary Fund *(Fondo Monetario Internacional)*
INEGI	National Institute of Statistics and Geography *(Instituto Nacional de Estadística y Geografía)*
IPF	Investment Project Financing *(Financiamiento para Proyectos de Inversión)*
ITFs	Fintech Institutions *(Instituciones Fintech)*
LAC	Latin America and Caribbean *(América Latina y el Caribe)*
LDP	Letter of Development Policy *(Carta de Desarrollo de Políticas)*
MSMEs	Micro, Small and Medium Enterprises *(Micro, Pequeñas y Medianas Empresas)*
NAFTA	North American Free Trade Agreement *(Tratado de Libre Comercio de América del Norte)*
NPLs	Non-Performing Loans *(Préstamos No Rentables)*
OECD	Organisation for Economic Co-operation and Development *(Organización para la Cooperación y el Desarrollo Económicos)*
P2P	*(De Igual a Igual)*
P2B	Person to Business *(De Particular a Empresa)*
PA	Programmatic Approach *(Enfoque Programático)*
PAFI	Payments Aspects of Financial Inclusion *(Aspectos de Pago para la Inclusión Financiera)*
PDO	Program Development Objective *(Objetivo de Desarrollo del Programa)*
PFM	Public Financial Management *(Gestión de las Finanzas Públicas)*
PPP	Purchasing Power Parity *(Paridad de Poder de Compra)*
PSBR	Public Sector Borrowing Requirement *(Requerimientos de Préstamo del Sector Públicos)*
PSIA	Poverty and Social Impact Analysis *(Análisis de Pobreza e Impacto Social)*
ROE	Return on Equity *(Rentabilidad sobre Fondos Propios)*
RTGS	Real Time Gross Settlement System *(Sistema Nacional de Liquidación Bruta en Tiempo Real)*
SCD	Systematic Country Diagnostic *(Diagnóstico Sistemático de País)*
SDR	Special Drawing Rights *(Derechos Especiales de Giro)*
SHCP	Ministry of Finance and Public Credit *(Secretaria de Hacienda y Crédito Público)*
SMEs	Small and Medium Enterprises *(Pequeñas y Medianas Empresas)*
SPEI	Interbanking Electronic Payment System *(Sistema de Pagos Electrónicos Interbancarios)*
TESOFE	Federal Treasury *(Tesorería de la Federación)*
TFP	Total Factor Productivity *(Productividad Total de los Factores)*
TIIE	Interbank Interest Rate *(Tasa de Interés Interbancaria de Equilibrio)*
UMICs	Upper Middle Income Countries *(Países de Ingreso Medio Alto)*
USMCA	United States – Mexico – Canada Trade Agreement *(Acuerdo Estados Unidos, México y Canadá)*
WB	World Bank *(Banco Mundial)*
WBG	World Bank Group *(Grupo Banco Mundial)*

Regional Vice President:	Axel van Trotsenburg
Country Director:	Pablo Saavedra
Practice Director:	Alfonso Garcia Mora
Practice Manager:	Zafer Mustafaoglu
Task Team Leader:	Patricia Caraballo, Jasmin Chakeri

UNITED MEXICAN STATES
MEXICO FINANCIAL INCLUSION DPF

TABLE OF CONTENTS

This operation was prepared by an IBRD team co-led by Patricia Caraballo (GFCLC) and Jasmin Chakeri (LCC4C), and consisting of: Alexandra Lelouch Loebl (LEGLE), Antonio Leonardo Blasco (GGOLF), Anita Tarce (GFCLC), Anna Gueorguieva (GSU09), Daniel Ortiz del Salto (GFCLC), Diacono Raul Vera Hernandez (GENLC), Diana Martinez Ramirez (LCC1C), Erik H.B. Feyen (GFCMF), Fabio Sola Bittar (GFCLC), Fabiola Altimari Montiel (LEGLE), Gabriela Inchauste (GPC04), José Antonio Garcia Garcia Luna (GFCPN), Jozef Draaisma (GMTLC), Kiyomi E. Cadena (GPV04), Maria Virginia Hormazabal (WFACS), Sharmista Appaya (GFCFI), and Victor Fitzpatrick Duggan (GMTLC). Harish Natarajan (GFCFI) and Julian Casal (GFCAS) provided peer reviewer comments. The operation was prepared under the overall guidance of Pablo Saavedra (Country Director, LCC1C), Alfonso Garcia Mora (Global Director, GFCD5) and Zafer Mustafaoglu (Practice Manager, GFCLC).

SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic
P167674	No

Proposed Development Objective(s)

Support the government's efforts to increase financial inclusion.

Organizations

Borrower: UNITED MEXICAN STATES

Implementing Agency: SECRETARÍA DE HACIENDA Y CRÉDITO PÚBLICO

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**500.00**

DETAILS

International Bank for Reconstruction and Development (IBRD)	500.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

Moderate

Results

Indicator Name	Baseline	Target
Results Indicator #1: Number of payments done using CoDI platform	Zero (March 2019)	200,000 (December 2020)
Results Indicator #2: Interest rate spread of consumer loans that have payroll accounts as the designated source of repayment,[1] using the 28-day "interbank equilibrium interest rate" (TIIE) as the relevant interest rate benchmark	1,625 basis points (February 2019)[2]	1,175 to 1,325 basis points (December 2020)
Results Indicator #3: Number of ITFs (crowdfunding institutions and IFPEs) that have formally submitted an authorization application to the CNBV and number of such applications that were approved	Zero (March 2019)	32 applications submitted 8 applications approved (December 2020)
Results Indicator #4: Number of applications for the establishment of regulatory sandboxes	Zero (March 2019)	5 (December 2020)
Results Indicator #5: Share of beneficiaries receiving social transfers via *Banco del Bienestar* through open loop accounts, and share of women among those beneficiaries	21% (March 2019)	80%, of which 50% women (December 2020)

[1] The specific measure of this interest rate is the average weighted (by loan amount) interest rate of payroll loans.
[2] As of February 2019, the average weighted interest rate of payroll loans (by loan amount) was 24.77 percent, and the average for the 28-day TIIE for that same month was 8.52 percent.

IBRD PROGRAM DOCUMENT FOR A PROPOSED LOAN TO THE UNITED MEXICAN STATES

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Development Policy Financing (DPF) supports Mexico's efforts to deepen financial inclusion, which has been a critical bottleneck for growth and poverty reduction.** Despite some progress over the last years, Mexico has significant space to improve access to finance, particularly for Micro, Small and Medium Enterprises (MSME) that generate considerable employment, for middle-and-lower income segments of the population, and for poorer regions of the country. This stand-alone DPF for US$500 million supports the authorities' reform program aimed at deepening access to the financial sector for individuals and firms, reducing inequality in access, and enabling innovation in the industry. It supports an integrated package of policy and institutional reform measures including core legislation, regulation, and implementation of regulations.

2. **The new authorities and the recent Systematic Country Diagnostic (SCD)[3] have highlighted the need for further financial inclusion as a way to foster inclusive growth.** Mexico's economic growth averaged only 2.4 percent between 1980 and 2017, limiting progress in convergence relative to the high-income economies. On a per capita basis, average growth was close to 1 percent. The country's per capita GDP today stands at 34 percent of U.S. per capita GDP, compared with 49 percent in 1980. The SCD points to a number of issues that have affected aggregate growth dynamics: (i) growth has been affected by a series of frequent and severe negative shocks to the economy (1994, 2001, 2002, 2008-9, 2014); (ii) limited capital accumulation, particularly in infrastructure, over the last four decades; (iii) average growth rates that mask significant regional income and growth disparities; and (iv) productivity growth that has been negative over the last 25 years, with a substantial dispersion across firms and states. One of the underlying structural impediments for higher inclusive growth identified by the SCD (as a key priority) is the limited financial access in the country. Credit to the private non-financial sector is just 42 percent of GDP, well-below the 72 percent average for the large 5 Latin American countries and far below the 143.2 percent average for emerging markets worldwide. A large share of the population still lacks access to financial services—only 37 percent of adults had an account in a formal financial institution in 2017.[4] As stated in the SCD, these gaps in access, among other factors, have a significant impact on economic inequality of individuals and on productivity, growth, and employment of MSMEs in Mexico.

3. **The new authorities and the SCD have also highlighted the need to reduce the significant household and regional disparities in access to finance.** Among households in the bottom 40 percent of the income distribution, only one in four adults has a bank account (Findex 2017). The gender gap in account ownership is 8 percentage points in Mexico, compared to 5 percentage points in Brazil, zero in Korea, -1 in Russia, -2 in South Africa and -4 in Argentina.[5] Out of the 47 percent of the population that,

[3] World Bank. 2018. Mexico - Systematic Country Diagnostic (English). Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/588351544812277321/Mexico-Systematic-Country-Diagnostic

[4] Global Findex data shows that while LAC, East Asia Pacific and Europe and Central Asia regions have seen account ownership grow to 54.4, 70.6 and 65.3 percent of the population, respectively, Mexico has exhibited a 2-percentage points contraction to 37 percent between 2014 and 2017. This places Mexico as the country with the lowest account ownership ratio among OECD countries, where median account ownership reached 94.7 percent of the population.

[5] ENIF is conducted by the National Banking and Securities Commission (CNBV) and the National Institute of Statistics and Geography (INEGI) for 2012, 2015 and 2018.

according to the ENIF survey, has access to transaction accounts, there was a proportional 20 percentage points difference in access between the Northwest of the country (60 percent) and the poorer Center South and East (40 percent). Only 29 percent of the rural population has an account at a formal financial institution, far below the LAC average of 41 percent. According to the 2017 Findex statistics, only 7 percent of adults in rural areas borrowed from a financial institution last year, the same level as in 2014 and below the 10 percent LAC average and 19 percent for OECD countries. Increased access to financial services can lead to a significant increase in income, particularly among low-income individuals and those located in areas with lower preexisting bank penetration. Financial inclusion promotes economic well-being by assisting vulnerable households to build up productive assets, manage risks, and respond to financial shocks, including those resulting from climate change. This operation supports measures that will enable better payment systems to reach all areas of the country, including the most marginalized. And it supports reforms that will facilitate the distribution of social benefits and private remittances to economic agents, including in the event of climate-related disasters among the most vulnerable populations and areas.

4. The authorities are also aiming to enable more financial access to micro, small, and medium enterprises (MSMEs). Mexican MSMEs provide 71 percent of employment and earn 51 percent of business income. Yet only 11 percent have access to finance, a significant share of which is backed by guarantees provided by State Financial Institutions. As discussed in the Mexico SCD, MSMEs with relatively few employees and low debt levels, and those in the initial stages of development, reported facing significantly less favorable conditions, even though they are the ones with the highest growth potential. This operation supports measures that further build the existing core payments system of the country. The main objective of this reform is to provide safe and efficient person-to-business (P2B) payments to better reach MSMEs, helping these firms to have more liquidity and to establish a track record to better access credit.[6] It also supports the establishment of interbank mechanisms that facilitate individuals to use their payroll account as the designated source of repayment for loans with any bank in the system, fostering competition and lower costs of borrowing.

5. Mexico's legal and institutional framework for Fintech, the first of its kind worldwide, will provide an opportunity to rapidly expand financial services access through innovation. While access to regular bank accounts is limited due to a number of factors, people have almost universal access to digital devices, which in turn can become a vehicle for financial development and inclusion. This operation supports a comprehensive legal and regulatory framework for Fintech in Mexico, which enables the authorization, operation and supervision of Fintech institutions (*Instituciones de Tecnología Financiera*, ITFs) focusing on two particular types: crowdfunding institutions and electronic payment funds institutions. The framework also introduces the legal underpinnings for a regulatory sandbox environment for innovative companies, and the concept of open data for non-confidential aggregate data and for transactional data with consumers' consent through the Application Programming Interfaces (APIs). These digital platforms can conveniently and transparently connect entrepreneurs and individuals with financial sector providers, suppliers and markets. These measures are essential for a more dynamic and inclusive financial system needed to support growth, while maintaining financial stability. The experience of Mexico though this pioneering work, is a global public good in terms of knowledge that can be transferred to other regions and countries.

[6] In addition, the CoDI will also enable person-to-person (P2P) transactions.

6. **The financial inclusion reforms undertaken by the government are expected to support adaptation climate co-benefits.** Mexico is highly vulnerable to natural disasters, including those related to climate change. According to Mexico's SCD, 41 percent of its territory and 31 percent of its population are exposed to hurricanes, storms, floods, earthquakes, and volcanic eruptions. In the period from 2000 to 2005 natural disasters increased poverty between 1.5 and 3.7 percent, depending on the poverty measure.[7] Forecasts indicate that the consequences of climate change are likely to increase, with more frequent and severe extreme weather events, with further impacts on poverty. The financial sector plays a key role in managing these risks. Using the typology introduced by the 2014 World Development Report on Managing Risk for Development, the measures supported by this operation provide access to (i) innovative, technology-based products such as *market insurance* (through Fintech); (ii) an expanded menu of products for the unbanked population provided by State Development Banks, including *self-insurance* (deposits); and (iii) electronic payments systems that offer a safe and efficient alternative to cash (*self-protection*). These measures therefore strengthen the resilience of vulnerable populations and contribute to adaptation co-benefits.

7. **The macroeconomic policy framework is adequate**. The Mexican economy expanded at a modest pace during 2018 (2 percent), still below its potential, despite the impetus of strong external demand from the U.S. The current account deficit (CAD) widened slightly to 1.8 percent of GDP in 2018 but remained comfortably financed by foreign direct investment (FDI). Over the last years, the Central Bank has been through a strong tightening cycle and the latest increase in December 2018 moved the policy rate to 8.25 percent. Mexico has a flexible exchange rate regime and an independent Central Bank. The financial sector is sound and well-capitalized, but it remains limited in terms of access. By 2018, the former authorities had achieved the fiscal consolidation required by the Fiscal Responsibility Law, including having, for the second year running, a primary surplus and the target of the Public-Sector Borrowing Requirement (PSBR) of 2.5 percent of GDP. The 2019 budget maintains a strong primary surplus and the same PSBR level, continuing the gradual decline of net public debt in GDP.

8. **Progress towards poverty reduction has been moderate**. The official poverty rate fell from 46.1 to 43.6 percent of the population between 2010 and 2016[8] due to increased labor income and a reduction in social deprivations. Monetary poverty using the upper middle-income poverty line (US$5.5 a day, 2011 Purchasing Power Parity (PPP)) amounted to 25.7 percent in 2016, while the population with one or more social deprivations decreased from 74.2 to 70.4 percent between 2010 and 2016. Although economic growth has been relatively pro-poor, growth rates have been low and the impact on poverty has thus been much slower than in peer countries that have cut poverty by half over the last 10 years. While the majority of the poor live in urban areas (69 percent), there is a higher incidence of poverty and extreme poverty in rural areas and among indigenous people. Poverty rates are also higher among women. There is a significant heterogeneity among regions and states of the country, with 68 percent of the extreme poor living in only six of Mexico's thirty-two states, located in the southern part of the country. Poverty is not only higher in southern states, but it has also been rising, while northern states have experienced reductions in their relatively low poverty rates. Poverty also overlaps with climate risks, both slow onset and sudden shocks. Financial inclusion presents a critical avenue to help accelerate the pace of growth

[7] Rodríguez-Oreggia, E., De La Fuente, A., De La Torre, R. and Moreno, H.A. 2013. "Natural Disasters, Human Development and Poverty at the Municipal Level in Mexico". The Journal of Development Studies, 49:3, 442-455
[8] https://www.coneval.org.mx/Medicion/MP/Paginas/Pobreza_2016.aspx

and poverty reduction through inclusion of citizen in the economic activity of the country and support the adaptation and recovery in case of disasters.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

9. Economic growth has remained below potential. The Mexican economy expanded at a modest pace during 2018 (2 percent), despite the impetus of strong external demand from the U.S. On the demand side, private consumption has been the main growth driver. Fiscal retrenchment forced public investment cuts over 2015-18, and private investment continued to be tamed in 2018 by the uncertainty surrounding the renegotiation of NAFTA and the presidential elections (that took place in July 2018), but showed a marginal recovery compared to 2017. On the supply side, the continued decline in oil production and reduction in prices in the last quarter of 2018 weighed on growth, partially offsetting the strong growth contribution of services and the recovery in manufacturing. Annual GDP growth has averaged 2.4 percent over the past six years (2013-2018), close to the country's long-term average since 1993.

10. Despite a strong export performance, the current account deficit deteriorated slightly. Exports were boosted by strong demand for Mexican manufactures, especially from the U.S., and the lower peso. But imports grew even faster, reflecting the fact that Mexico is a net importer of petroleum products, especially of refined gasoline and diesel. Remittance inflows, already strong in recent years, accelerated further through mid-2018, to US$33.6bn, while tourist visits reached a record high of 41m in 2018. As a result, the current account deficit (CAD) widened slightly to an estimated 1.8 percent of GDP in 2018, from 1.7 percent in 2017. At 2 percent of GDP, net foreign direct investment decreased slightly in 2018 (from 2.3 percent in 2017) due to investor uncertainty. International reserves remain robust and stable, at US$176.4bn in December 2018, enough to cover 4.2 months of imports and 320.7 percent of short-term external debt.

11. Inflation pressures subsided as the Central Bank tightened monetary policy. Headline inflation moderated through the first half of 2018 (from a 17-year peak of 6.77 percent in December 2017), as the base effect of the spike in energy prices from early 2017 faded from the annualized data, ending the year at 4.83 percent in December 2018. Since end-2015, the Central Bank has been through a strong tightening cycle, which was accelerated after the U.S presidential elections in late 2016. The latest increase in December 2018 moved the policy rate to 8.25 percent. Mexico's spreads are somewhat higher than comparable peers and have increased over the last months over a perceived higher policy uncertainty, particularly in the energy sector.

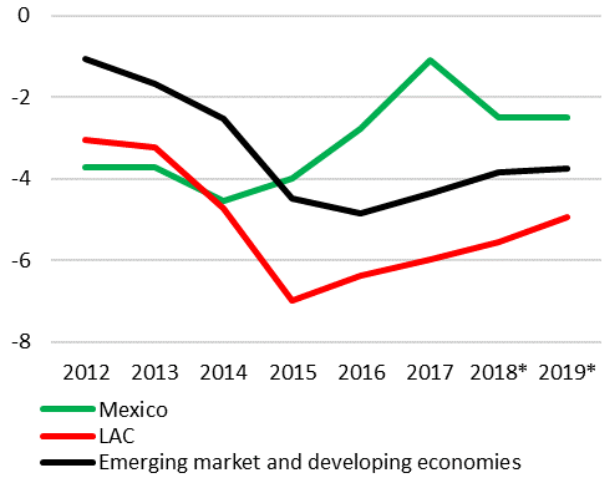
12. The financial sector is sound and well-capitalized, but it remains limited in terms of access. Credit (outstanding) to the private non-financial sector is just 42 percent of GDP, well below the 72 percent average for the other LAC-5 countries and far below the 143.2 percent average for Emerging Markets (EM) worldwide, with a large share of the population and firms lacking access to financial services. Credit growth slowed during 2018, however, to an annual rate of 5.6 percent by November, down from 8.9 percent a year earlier.[9] This credit expansion is being driven by lending to the corporate sector, which remains the largest and most dynamic lending segment. In contrast, consumer lending growth contracted

[9] Bank of International Settlements.

in real terms. The banking system is profitable, with a return on equity (ROE) of 15.68 percent in November 2018, up from 14.95 percent in November 2017, and well-capitalized, with a capital adequacy ratio (CAR) of 15.7 percent.[10] At 2.2 percent, non-performing loans (NPLs) are low and have been stable around that level since 2016, having declined from more elevated levels in previous years. The sector is characterized by significant concentration, the seven largest banks accounting for 78.4 percent of assets.

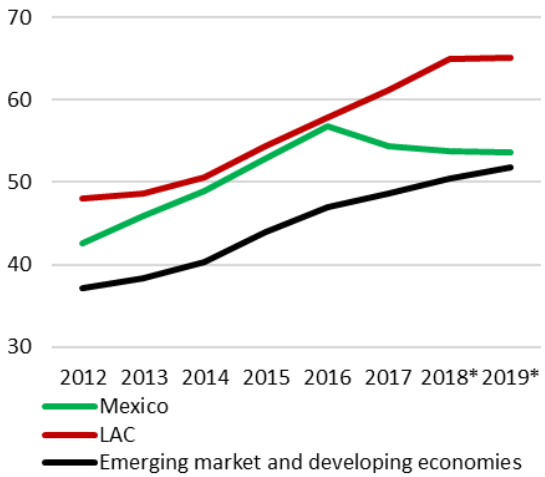
13. Fiscal consolidation enabled the achievement of public debt stabilization. By 2018, the former authorities achieved the fiscal consolidation required by the Fiscal Responsibility Law, including for the second year running a primary surplus and the target of the Public-Sector Borrowing Requirement (PSBR) of 2.4 percent of GDP (down from its 2014 high of 4.5 percent) (Figure 1). Mexico led EMs in stabilizing and then reducing public debt as a percentage of GDP, which stood at 53.1 percent in 2018 for gross public-sector debt (Figure 2) and at 44.8 percent on net basis as reported by the government. The needed adjustment between 2015-18, following the fall of commodity prices (in 2014) took a toll on public investment, but also on several recurrent spending categories. Markets seem increasingly concerned about the financial situation in Pemex, the state oil company, which was downgraded by one of the major credit rating agencies in early 2019.

Figure 1: General Government Fiscal Balances, % of GDP



Source: IMF, World Bank Staff (* estimates)

Figure 2: Gross Public-Sector Debt, % of GDP



Source: IMF, World Bank Staff (* estimates)

14. Public and private sector gross external debt stood at 37.8 percent of GDP by end-2018. The stock of foreign currency-denominated public debt has increased at a faster rate than the peso-denominated public debt over the past few years, among others due to the impact of changes in the exchange rate. In addition, a significant proportion of peso-denominated public debt is held by non-residents. The value of the latter peaked at about US$ 140 billion in 2014 and has hovered at about US$ 100 billion over the past few years. In terms of currency denomination, the net federal public debt stock remains predominately denominated in domestic currency at 63.4 percent of total debt. In contrast, 87

[10] Banxico and National Banking and Securities Commission (CNBV).

percent PEMEX's debt amounting to US$ 105.8 bn or 8.7 percent of GDP is denominated in foreign currency. Plans to refocus PEMEX's business model on less profitable fuel production for the domestic market in the context of substantial external debt service obligations and a high tax burden have not been received well by the markets and already led to a downgrade by one of the major credit rating agencies early 2019. Private external debt also increased substantially over the past decade to some US$ 139.3 billion or 11.7 percent of GDP by 2018.

Table 1: Mexico Key Macroeconomic Indicators, 2016-2022

				Proj.			
	2016	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Real Sector	Annual percentage change, unless otherwise indicated						
Real GDP	2.9	2.1	2.0	1.7	2.0	2.4	2.6
Contributions:							
Consumption	2.8	2.2	1.7	1.6	1.9	2.0	2.0
Investment	0.2	-0.3	0.3	0.0	0.4	0.6	0.8
Net exports	0.3	-0.3	-0.4	0.1	-0.2	-0.2	-0.1
Unemployment rate	3.9	3.4	3.6	..	..	..	..
GDP deflator	5.4	6.8	5.2	3.4	4.2	4.3	3.7
CPI (end-of-period)	3.4	6.8	4.8	4.0	3.8	3.5	3.5
Fiscal accounts	Percent of GDP, unless otherwise indicated						
Revenues	24.1	22.6	21.6	21.1	20.7	20.5	20.7
Expenditures	26.9	23.6	24.0	23.6	23.1	23.0	23.2
Fiscal balance	-2.8	-1.1	-2.4	-2.5	-2.5	-2.5	-2.5
Net public debt	48.7	45.8	44.8	44.8	44.6	44.2	44.2
Gross public debt	56.8	54.3	53.1	53.2	53.4	53.4	53.4
Monetary accounts	Annual percentage change, unless otherwise indicated						
Base money	14.4	8.8	16.2	12.6	8.7	7.6	7.6
Policy interest rate	5.75	7.25	8.25	..	..	..	..
External sector	Percent of GDP, unless otherwise indicated						
Current account balance	-2.2	-1.7	-1.8	-2.0	-2.2	-2.3	-2.5
Imports (% change, real)	2.9	4.4	7.7	3.9	4.1	4.1	3.8
Exports (% change, real)	3.7	3.6	6.7	4.2	3.7	3.6	3.5
Foreign direct investment	2.7	2.3	2.0	1.9	2.2	2.3	2.4
Gross reserves (US$ billion)	178.0	175.5	176.4	174.3	175.4	181.3	187.4
In months of imports	5.1	4.6	4.2	4.0	3.8	3.7	3.6
% of short-term ext. debt	330.9	329.7	320.7	306.9	294.7	288.9	285.4
Terms of trade (% change)	-0.2	1.3	1.0	-1.1	0.7	0.5	0.1
Exchange rate (MXN/US$)	18.66	18.9	19.24	..	..	..	..

Table 2: Mexico: Key Fiscal Indicators for the Public Sector, 2016-2022
(% of GDP)

				Proj.			
	2016	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Revenue	**24.1**	**22.6**	**21.6**	**21.1**	**20.7**	**20.5**	**20.7**
Federal Government	17.7	17.5	16.3	15.8	15.6	15.4	15.4
Tax revenue	13.5	13.0	12.9	13.2	13.2	13.2	13.2
Nontax revenue	4.2	4.5	3.4	2.6	2.4	2.2	2.4
Public enterprises	6.3	5.1	5.4	5.3	5.2	5.1	5.2
PEMEX	2.4	1.8	1.9	2.0	1.9	1.8	1.9
Other	3.9	3.3	3.5	3.3	3.3	3.3	3.3
Expenditure	**26.9**	**23.6**	**24.0**	**23.6**	**23.1**	**23.0**	**23.2**
Programmable	20.7	17.6	17.1	16.5	16.0	15.8	16.1
Current	14.8	13.8	14.0	13.7	13.7	13.7	13.8
Wages	5.5	5.2	5.2	5.0	5.0	5.0	4.9
Pensions	3.2	3.2	3.4	3.5	3.7	3.8	4.0
Subsidies	2.2	1.8	1.7	1.6	1.6	1.6	1.6
Other operating expenses	3.9	3.8	4.0	3.5	3.4	3.3	3.2
Capital	5.9	3.8	3.1	2.9	2.3	2.0	2.3
Physical capital	3.7	2.7	2.7	2.7	2.3	2.0	2.3
Financial capital	2.3	1.2	0.4	0.2	0.0	0.0	0.0
Nonprogrammable	5.9	6.0	6.5	6.8	6.7	6.6	6.5
Revenue sharing	3.4	3.5	3.6	3.7	3.6	3.6	3.6
Interest payments	2.4	2.4	2.7	3.0	3.0	2.8	2.8
Other	0.1	0.1	0.3	0.1	0.1	0.1	0.1
Adjustments to the budgetary balance	0.3	0.0	0.4	0.5	0.5	0.5	0.5
Overall Fiscal Balance (PSBR)	**-2.8**	**-1.1**	**-2.4**	**-2.5**	**-2.5**	**-2.5**	**-2.5**
Primary Budgetary Balance	-0.1	1.3	0.7	1.0	1.0	0.8	0.8
Financing needs	**13.6**	**7.5**	**9.2**	**10.1**	**10.3**	**10.0**	**10.4**
Overall fiscal balance (PSBR)	2.8	1.1	2.5	2.5	2.5	2.5	2.5
Amortizations	10.8	6.4	6.7	7.6	7.8	7.5	7.9
Net public debt	48.7	45.8	44.8	44.8	44.6	44.2	44.2
Gross public debt	56.8	54.3	53.1	53.2	53.4	53.4	53.4

Table 3: Balance of Payments Financing Requirements and Sources, 2016-2022 (US$ million)

	2016	2017	2018	2019	2020	2021	2022
Financing requirements	**152,569**	**103,528**	**116,080**	**119,713**	**130,665**	**142,643**	**152,236**
Current account deficit	23,321	19,352	22,159	25,246	29,315	31,875	35,886
External debt amortization	129,384	88,941	93,010	96,615	100,214	104,883	110,199
Medium and long term	59,129	35,143	39,776	41,605	43,438	45,375	47,460
Short term	70,255	53,798	53,234	55,009	56,776	59,508	62,739
Gross reserve accumulation	-136	-4,765	911	-2,148	1,136	5,885	6,150
Financing sources	**152,569**	**103,528**	**116,080**	**119,713**	**130,665**	**142,643**	**152,236**
FDI (net)	29,312	26,947	24,746	24,554	29,147	32,749	35,275
External debt disbursements	114,735	112,527	113,075	116,076	122,321	128,964	135,006
Medium and long term	60,937	59,293	58,066	59,930	62,814	66,225	69,327
Short term	53,798	53,234	55,009	56,776	59,508	62,739	65,678
Other capital flows (net)	8,522	-35,946	-21,741	-21,537	-20,803	-19,070	-18,045

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

15. Growth is expected to remain modest in 2019, held back by slightly slower export demand from the U.S. and some remaining domestic policy uncertainty. GDP growth is expected to fall to around 1.7 percent in 2019, before picking up to 2 percent in 2020 and to its long-term average of 2.4 percent in 2021. This baseline case assumes the successful ratification of the United States-Mexico Canada Agreement (USMCA) (successor to NAFTA) during 2019, with the removal of trade policy uncertainty expected to spur private sector investment thereafter. For the most part, USMCA represents a modernization and upgrade on NAFTA, largely following the logic of aspects of the Transpacific Partnership, with some important changes to rules of origin, notably affecting the automotive sector. The changes will be phased in over several years, allowing producers in Mexico to make any necessary adjustments to their supply chains. However, the downside risks to the investment component of GDP growth remain significant.

16. External demand is expected to moderate over the coming years as the U.S. economy returns to trend growth. In this context, the current account deficit is expected to widen modestly, but to remain financed by FDI. The ratification during 2019 of the USMCA should ease uncertainties surrounding trade policy, and thereby remove one roadblock to inward FDI. Downside risks come from a worse than expected deterioration in appetite for emerging market investment and Mexico's own risk perception, triggering capital markets reallocations.

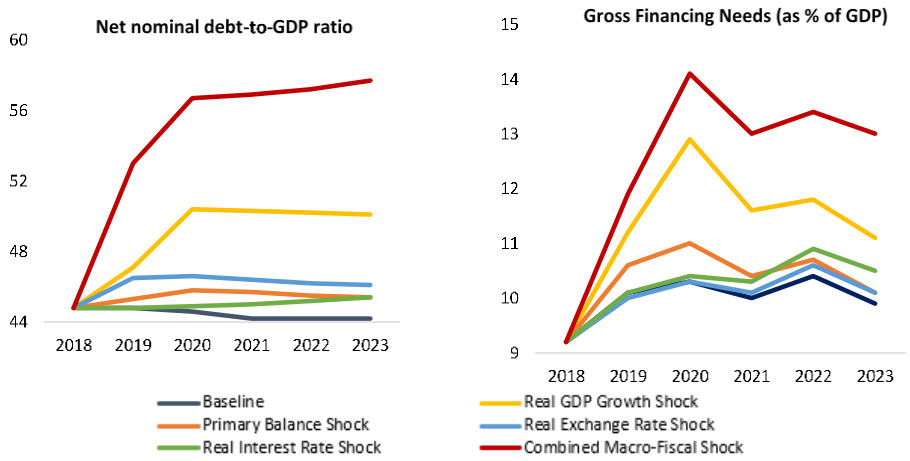
17. Inflationary pressures are expected to subside. Continued vigilance by the Central Bank underpins the institution's long-established credibility in maintaining price stability. Inflation is expected to converge towards Banco de Mexico's 4 percent upper tolerance band by end-2019, and towards the 3 percent target during 2020. Although inflation pressures are subsiding domestically, the pace of policy

rates hikes in the U.S (and Europe) and the level of risk aversion to EMs, including Mexico, in 2019 will determine whether there is space for momentary policy easing in 2019.

18. Adherence to fiscal prudence is expected to continue, but there will be little room to maneuver. The new administration presented its 2019 budget, foreseeing an increase in the primary surplus (from 0.7 percent to 1 percent of GDP) and again maintaining the 2.5 percent of GDP overall fiscal deficit. For 2019, the budget places emphasis on new categorical social programs (minimum pension and transfers for youth programs) and a moderate public investment increase, which in line with the approved budget would be financed by program consolidation and austerity measures in wages, goods and services, and reductions in discretionary transfers to states. Federal government oil revenues continue to be protected through a contracted hedge instrument. The 2019 budget has been well received by the markets, but it leaves limited room in case a shock would materialize. In line with some potential revenue shortfalls, the authorities have prudently taken actions on additional spending compression measures for 2019. Markets will look closely at the measures that the authorities are working on to remedy the short and medium-term weak financial position of Pemex, as it has important fiscal implications.

19. Net public debt (as a percentage of GDP) reached a peak in 2016, declined in 2017 and 2018, and is expected to continue to decrease marginally thereafter in the baseline scenario. The net public debt-to-GDP ratio is projected to decline marginally from 44.8 percent of GDP in 2018 to 44.2 percent of GDP by 2021, having fallen from a high of 48.7 percent at end-2016, due largely to the primary surplus observed in 2017 and 2018. Gross financing needs over the medium-term are projected to average around 10 percent of GDP. Since around two thirds of public debt is denominated in local currency, and the sovereign benefits from a long maturity structure[11], rollover and foreign exchange rate risks to the debt trajectory are reduced. Several stress test scenarios are presented in Figure 3. These results suggest that public debt sustainability is relatively resilient to a range of different shocks (Figure 3).

Figure 3: Debt Sustainability Analysis (2018-2023)



Source: Bank staff estimates.

[11] The federal government debt denominated in pesos has an average maturity of about 8 years. The average maturity of FX bonds is 20.7 years.

20. Mexico continues to face external and domestic risks. A slower growth in 2019 in the U.S compared to that of 2018 would weigh on economic activity in Mexico. Moreover, although the Federal Reserve has slowed the speed of rate hikes, there remains a risk of a continued normalization in response to the levels of inflation and employment. This may trigger further reallocations of portfolio and limited monetary policy space for policy rate reductions. The completion of the negotiations of the USMCA removed a great deal of the uncertainty surrounding trade policy, although some uncertainty remains regarding its ratification. Nonetheless, trade tariffs imposed during the first half of 2018, affecting bilateral trade flows of nearly US$7 billion, remain in place while increased global trade policy uncertainty represents a risk to global growth, with potentially negative knock-on effects on Mexico. Downside risks may also come from a worse than expected appetite for EMs and Mexico's own risk perception in the markets. Domestic risks include a delayed or incomplete plan to deal with Pemex's strategic and financial position and increased domestic policy uncertainty in the energy sector. With slower growth, the authorities will also face a sharper trade-off between spending commitments, Pemex's financial position, a stable public debt-to-GDP ratio, and the timing of a needed tax policy reform (currently envisaged to take place in the second half of the current administration, i.e. by 2021). At the same time, the government faces challenges in calibrating sectoral policies to ensure a conducive environment for private sector investment.

21. There are also important mitigation factors. The flexible exchange rate is likely to continue to be the first line of defense as a macroeconomic buffer. Moreover, the independent Central Bank of Mexico will continue to foster prudent monetary and financial policies. At the same time, Mexico has a strong track record of responsible fiscal policy management, leaving Mexico in a strong position to mitigate economic shocks. Mexico's macroeconomic policy framework is adequate.

2.3. IMF RELATIONS

22. On November 26, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the review under the Flexible Credit Line (FCL) arrangement with Mexico. The IMF Board's review concluded that Mexico has very strong policies and institutional policy frameworks, and that the authorities have a successful record of sound policy management and are firmly committed to maintaining prudent policies going forward. This view echoed the report which commended the authorities' adherence to their fiscal consolidation plan, their cautious monetary policy stance, and their strong financial supervision and regulation, while also recognizing the substantial external risks to the outlook. Mexico has a two-year precautionary FCL arrangement with the IMF (approved in November 2017). This is a successor arrangement to the 2015 FCL, which was cancelled ahead of its expiration. The current FCL is a two-year arrangement in an amount equivalent to SDR 62.3889 billion (about US$88 billion) and is treated by the authorities as precautionary. In November 2018, access under the FCL was reduced to SDR 53.4762 billion (about US$74bn) at the request of the Mexican authorities. Since assuming office in December 2018, the new government has signaled its intention to continue with this arrangement. The IMF and World Bank maintain close collaboration.

3. GOVERNMENT PROGRAM

23. The National Development Plan 2019-2025 will establish financial inclusion as one of its main objectives. Financial inclusion is a top priority for the new government, as part of a broader agenda of

social inclusion and broad-based economic growth. The new president committed to reverse the long-running trend of limited growth and moderate reduction of poverty and inequality. While the new National Development Plan is currently under preparation, a reorientation of spending towards new and expanded social programs, as well as a greater focus of government programs on the less-developed regions of the country, have already begun. Enhanced access to financial services, including through new technologies, is not only critical to reduce economic inequalities, but also to foster productivity and broad-based growth (Systematic Country Diagnostic 2018). On January 8, 2019, the Ministry of Finance and Public Credit (SHCP) and the Central Bank (Banxico) announced a package of measures to boost financial inclusion, which complement measures taken in the preceding months in this area.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

24. The Program Development Objective (PDO) is to support the government's efforts to increase financial inclusion. This stand-alone operation supports greater financial inclusion through a single integrated package of reform actions including core legislation, regulation, and implementation of regulations. The policy and institutional reforms in the proposed operation focus on: (i) facilitating electronic payments, which will improve access to payment systems for businesses (especially small merchants) and individuals (including those who do not own a credit card); (ii) reducing the cost of consumer loans, through greater competition in the provision of payroll-backed loans; (iii) incentivizing the development of the Fintech sector to provide flexible, transparent and innovative financial sector solutions and facilitate resource allocation to job-creating productive investments, particularly for small and medium size businesses as well as for individuals; and (iv) reconfiguring some of the State Financial Institutions to better attend their development mandate and the population that is underserved by commercial banking. Reforms in these areas represent an important first stage in a reform agenda to expand access to financial services, which has historically been limited in Mexico. They are a critical component of the country's overall financial sector reform program. The reforms also support the agenda of the Universal Financial Access (UFA) 2020 initiative, for which Mexico is a priority country.[12] While the achievement of the reforms over the last 12 months spans two administrations, all the reforms included in the proposed operation are fully supported by the new government and are aligned with its priorities.

[12] The UFA goal envisions that, by 2020, adults globally will have access to a transaction account or electronic instrument to store money, send and receive payments.

Box 1. Mexico's Financial Sector Reform Program

Reforms over the last 4 years in the sector have been positive in deepening the financial sector. Credit (as a share of GDP) to the private sector increased moderately and people with bank account increased by more than 10 percentage points. Yet, as signaled by the new Mexican government there is significant room for improvement. Credit to the private non-financial sector is just 42 percent of GDP, well below the 72 percent average for the other LAC-5 countries and far below the 143.2 percent average for emerging markets worldwide. Moreover, a large share of the population still lacks access to financial services, perpetuating economic inequality (37 percent of adults had an account in a formal financial institution in 2017). MSMEs provide 71 percent of the employment, but only 11 percent use bank credit due to affordability and access issues. The country's financial sector remains highly concentrated (the largest 5 banks have 70 percent of total assets)), and stronger competition may lead to more efficient intermediation.

On January 8, 2019, the Ministry of Finance and Public Credit and the Central Bank of Mexico presented a first package of reforms for the financial sector. This first package had a strong emphasis on financial inclusion (some of the measures supported by this DPF are part of it), but also included some initial measures to spur capital markets.

The new National Development Plan currently being discussed among stakeholders prior to approval, highlights the importance of the financial sector to support inclusive growth. It also highlights the shortcomings of the financial system in Mexico in terms of financial access for firms and individuals (particularly those of disadvantaged groups and in lagged regions of the country), limited competition, and limited levels of savings (including for retirement). The Plan highlights key areas of the sector for future reforms, including in: (i) capital markets access (particularly for medium size firms); (ii) pensions; (iii) insurance; (iv) consolidation of development banks and reorientation of their objectives; and (v) reducing access barriers in the banking system (particularly for disadvantaged groups of the population). The aim is to address those issues identified as shortcomings in the sector through various policy reforms and instruments on the supply side (including the development and use of digital technologies), and through financial education and other demand-side interventions.

25. Financial inclusion is a top priority highlighted in the most recent Mexico SCD. A focused approach to advancing financial inclusion in Mexico should aim to ensure that the necessary precondition - i.e., that all adults are able to access a transaction account or an electronic instrument to store money, send and receive payments - is met in the first place. With the legal and payments infrastructure foundations well in place and supported by institutional arrangements that underpin strong public and private sector commitment, it is critical that strategic efforts focus on the "catalytic pillars" that address the bottlenecks of existing, traditional delivery models. In this context, innovation and new players will play an important role in re-defining the supply side of transaction account and payment service provision, and in bridging underserved and hard-to-reach communities. The facilitation of electronic payments and increased supply of financial solutions through both traditional and innovative channels will improve access for both SMEs and individuals. Pricing and cost of intermediation is also expected to improve as reforms boost competition in the credit and payments market. More competition, innovative solutions (Fintech) and better targeted efforts by BANSEFI will also help reduce regional disparities.

26. The design of this DPF considers lessons learned from prior engagements through DPFs in Mexico. A key lesson from previous experience is that DPFs should be a targeted and strategic tool of

engagement for policy dialogue with a sophisticated client. They should also be accompanied by a broader program of technical and analytical support that responds to the country's needs and demands. This lesson was thoroughly applied in the context of this operation. This operation is focused and targeted on a single key development challenge (i.e., financial inclusion). Moreover, in the context of the policy engagement in the area of financial inclusion, the Bank has been working with the authorities on technical assistance through the Financial Inclusion Global Initiative. Consultations between the government agencies and the Bank, and the private sector, during preparation and implementation of the program have helped expand the dialogue in the area of financial inclusion and create opportunities to build on ongoing engagement and develop new areas for technical support.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Prior action #1: The Borrower has developed a new electronic payment platform ("CoDi") and issued its supporting regulations, to provide safe and efficient person-to-business payments to better reach micro, small and e-commerce merchants, as evidenced by Banco de Mexico's Circular No. 8/2019, duly published in the Official Gazette dated May 20, 2019.

27. ***Rationale*****.** Cash remains the predominant option for payment transactions in Mexico. 2018 ENIF data indicates that 95 percent of transactions under 500 pesos are cash-based. The figure improves only modestly for transactions equal to or above 501 pesos, with 87 percent of these transactions being cash-based. In 2016, payments with debit and credit cards in Mexico were equivalent to only 8.9 percent of GDP, compared to 17.6 percent for Brazil, 20.1 percent for India, 31.7 percent for the US, and 75.7 percent for China (Table 4).[13] Some of the key reasons for not having an account and not using electronic payments include the following: (i) they are perceived as costly, or in some cases are indeed costly: the cost of accepting payment cards in Mexico is, on average, between 2 to 2.5 percent of the sales amount, although with peaks of 4 percent or more for some types of merchants, mainly smaller ones; (ii) they do not meet the needs of the payer, the payee or both, in terms of aspects such as convenience, accessibility and ease of use, immediate availability of funds, etc.; and (iii) there is limited acceptance of electronic payments by those types of merchants with which most Mexicans interact regularly, such as micro and small businesses in nonaffluent urban and rural neighborhoods.[14] Moreover, low levels of trust in the financial sector contribute to the limited usage of bank accounts and electronic payment methods. In 2017, 26.7 percent of the unbanked population (aged 15+) declared that the lack of trust in financial institutions was a barrier for owning an account in Mexico. In this context, having system that reduces costs, improves efficiency, and provides trust to small business and individuals is critical.

[13] Source: presentation made by the Deputy Secretary of the SCHP of the Programa de Impulso al Sector Financiero, which in turn uses FINDEX and the IMF as sources.

[14] PAFI report (Committee on Payments and Market Infrastructure - CPMI-World Bank 2016, "Payments Aspects of Financial Inclusion", Basel) and FINDEX reports.

Table 4: Share of adults using different payment options

	Payment option			
	Cash	**Debit Card**	**Credit Card**	**Others**
Purchases lower than 500 pesos	95%	4%	1%	<1%
Purchases higher or equal to 501 pesos	87%	9%	3%	<1%
Rent	90%	3%	<1%	7%
Utility	95%	2%	<1%	2%
Private Services (internet, cable TV, etc)	91%	4%	2%	3%
Public Transportation	98%	<1%	<1%	2%

Source: ENIF 2018

28. ***Substance of the prior action*.** By introducing the digital payment platform *Cobro Digital* (CoDi), which has been developed jointly by the central bank and the payments industry, payees (mainly small, and micro merchants, e-commerce merchants, and individuals) will have a viable alternative for accepting and receiving electronic payments safely and in a cost-effective and transparent manner. Individuals will have at their disposal a new payment method that they can operate easily and safely with their mobile devices. Ease of use and wider acceptance may lead more individuals, especially small entrepreneurs, to open an account in order to receive CoDi payments. When a purchase is made, the amount will be transferred via the interbank electronic payment system (*Sistema de Pagos Electronicos Interbancarios*, SPEI), thereby making this core infrastructure available to any payer. CoDi will compete with other payment methods that are suitable for P2B-type payments such as payment cards, and in particular with debit cards. In this regard, advantages of CoDi include the real-time availability of funds for the merchant (compared to next-day availability or more for payment cards), reduction of fraud, a low and fixed cost per payment received, and much lower initial investment and maintenance costs.

29. The underlying regulation from Banxico ensures enhanced security, adoption of the same messaging and other relevant standards by all SPEI participants, and wide participation in CoDi. The CoDi relies on QR codes, a software generated two-dimensional barcode, which enable efficient and almost limitless data storage. The use of QR codes as a mean of payment was envisaged in 2012 for the Single European Payment Area. A payment can be performed by scanning a QR code displayed by the individual or merchant. Scanning QR codes enables a Peer-to-Peer money transfer, thereby avoiding the associated traditional payment infrastructure, such as payment cards, payment networks, payment terminal and merchant accounts. Payers and payees need only to have a smartphone[15] and a transaction account with a financial institution participating in SPEI (banks, non-bank financial institutions, and in the future also non-bank e-money issuers or "IFPEs"). The only additional requirement is for payees to download on their phones the CoDi applications developed by their financial institution. The use of technology to disburse payments rather than cash has been proven to increase transparency and reduce corruption.[16] In addition, in situations of natural disasters, where physical infrastructure may not be available, and cash may be in short supply, CoDI could help ensure that victims can receive funds and pay for vital goods and serviced, thereby contributing to greater resilience and adaptation co-benefits.

30. ***Expected results*.** Ease of use and wider acceptance can also lead more individuals to open an account, and to greater competition in the P2B payments market. CoDi will be fully operational in the

[15] In 2017, over 50 percent of the population had access to smartphones.
[16] Muralidharan, et al., 2016.

production stage by September/October 2019. The number of payments made using CoDI from the launch of the new platform is expected to increase from a baseline of zero in March 2019 to 200,000 by December 2020. Beyond the timeframe for the evaluation of the results of this DPF, over the medium term, this new electronic platform is expected to contribute to greater financial inclusion, especially among SMEs.

Prior action #2: The Borrower has issued regulations to create interbank mechanisms that facilitate individuals to use their payroll account as the designated source of repayment for loans with any bank in the system, to foster a broader access to credit under better terms and conditions, as evidenced by Banco de Mexico's Circular 15/2018, duly published in the Official Gazette dated October 29, 2018.

31. ***Rationale*.** Payroll accounts are the most common product among adults with banking accounts, with as much as 52 percent of the financially included population owning one such account (ENIF 2018). Payroll-backed loans represent nearly 25 percent of all formal consumer credit in Mexico. However, only 15.7 percent of payroll account holders currently have a payroll-backed loan, owing mainly to some limitations to competition in the regulation and the system. Only the commercial bank that manages the payroll account of the worker can grant these loans by regulation. Moreover, due to system shortcomings, only the commercial bank that manages the payroll account has the automatic collection mechanism. Commercial banks that are the largest providers of payroll services are in most cases the banks with a large network of branches and agents and have the largest share of the credit market, which is highly concentrated in Mexico (the largest 5 banks have 70 percent of total assets). Consequently, the largest banks are also the largest providers of payroll loans, limiting opportunities for competition and access in the system. Banks with smaller retail networks may offer better terms and conditions for payroll loans, including lower interest rates and fees, but they are practically excluded from this market as they only operate few payroll services for employers.[17] Moreover, only 26.7 percent of women with payroll accounts have solely formal loans, while 32.9 percent of male account holders do.

32. ***Substance of the prior action*.** First, the new regulation creates enforceable interbank mechanisms to facilitate the collection of payroll loans made by one bank from a payroll account at another bank under conditions of certainty, agility and efficiency. Second, it enables freedom of choice for the worker to find the best loan for her/his needs across the banking system with the backing of her/his payroll. Workers will be able to negotiate a loan with any bank (or a consumer credit subsidiary of a bank)[18] and authorize that bank to charge the installments to the workers' payroll account, with seniority over all other charges to that account[19] and before the funds of each salary payment become available to the worker. And third, it permits the effective participation of any bank and its consumer credit affiliates in this market segment. Moreover, the regulation minimizes any transaction costs of accessing a loan from an institution that does not hold ones' payroll account: an individual with a payroll account at "Bank A" simply needs to inform her/his bank that she/he wants to use this account as the source of repayment for payroll loans granted by "Bank B"; Bank A is required to accept debit orders from Bank B (up to a certain limit, to avoid over-indebtedness) and may charge the individual for processing the corresponding debit

[17] According to Banxico reports, the interest rates for consumer loans granted by banks are (average interest rate weighted on the basis of loan balance for the Sept 17-Aug 18 period): Payroll loans 24.6%; Credit cards 34.5%; Personal loans 37.5%. Other reports show that, with few exceptions, consumer loans granted by other types of financial institutions (e.g. *Sociedad Financiera Populares*) or by real sector retailers have higher interest rates.

[18] Other non-banks that offer consumer credit may be included in the future in the scheme.

[19] Except for any charges ordered by a court of law.

orders. The new regulation will therefore enable smaller banks to offer payroll loans even if they do not hold the payroll accounts. Additionally, the regulation preserves the incentives and mechanisms for avoiding over-indebtedness and adequate loan repayment.[20] Through these features, the reform paves the way to make progress on bank competition for payroll workers, potentially lowering costs and fostering access.

33. ***Expected results*****.** A key expected result is a reduction in interest rates of payroll-backed loans.[21] The regulation is expected to be fully implemented in the last quarter of 2019. On this basis, it is expected that the interest rate spread (over the 28-day interbank equilibrium interest rate) of consumer loans that have payroll accounts as the designated source of repayment is expected to fall to 1,175 to 1,325 basis points basis points by December 2020, from 1,625 basis points in February 2019. Beyond the timeframe for the evaluation of the results of this DPF, over the medium term, this reform is expected to increase competition in the financial sector.

Prior action #3: The Borrower has enacted the Law to Regulate Financial Technology Institutions, to mandate the establishment and regulate the operation of ITFs and technology-driven business models, products, and services to promote innovation, competition, and inclusion in the financial sector, as duly published in Official Gazette dated March 9, 2018.

34. ***Rationale*****.** The Fintech sector has the potential to contribute to closing the gap in access to financial services in Mexico and enhance competition in the financial sector. But the sector and its growth need to be well regulated to safeguard financial stability, enable more inclusiveness, and protect individuals and firms' rights. Financial technology companies leverage online, mobile and information technologies to deliver financial services. According to Finnovista's Radar, Mexico ranked the second largest Fintech market in Latin America in 2018. Startups in Mexico are concentrated in lending (23 percent of startups), payments and remittances (22 percent), enterprise and personal financial management (15 and 10 percent, respectively), crowdfunding (9 percent), and insurance (6 percent). Most companies are young—69 percent were created over the last three years. Some features of the Mexican market that make it a fertile environment for Fintech include: (i) a high internet and smart mobile devices penetration (in 2017 there were 64.7 million inhabitants with access to smartphones[22] and 71.3 million with internet access); (ii) a strong ecosystem of entrepreneurship and ecommerce; (iii) a low traditional banking penetration; and (iv) an undeveloped consumer lending offer, according to the Finnovista report. Moreover, an estimated 540,000 people are already served by existing Fintech companies. Fintech solutions also hold substantial potential benefits for MSMEs. Fintech can provide efficient and effective solutions at lower scale, which will benefit small businesses and provide them with increased access to more diverse and tailored funding options. Such solutions may include peer-to-peer lending, merchant and e-commerce finance, invoice finance, online supply chain finance and online trade

[20] As per the previous example, "Bank A" can only accept debit orders from other banks as long as the sum of all debit orders does not exceed 40 percent of the amount that is credit to the payroll account each month (based on a 12-month average). Before a payroll loan is actually granted, the bank making the loan consults with "Bank A" whether the debtor has repayment capacity. In addition, the regulation: (i) limits workers opening a new payroll account if they have another payroll account to which loans are still being charged; and (ii) inhibits the potential practice of workers cancelling the mandate they have given to the bank that granted the loan to charge the underlying installments to their payroll account.
[21] The specific measure of the interest rate is the average weighted (by loan amount) interest rate of the payroll loans.
[22] Instituto Nacional de Estadística y Geografía (INEGI)

finance. Innovative finance solutions can also provide with better cash flow, improved working capital management and more stable or secure funding, thereby strengthening the financial resilience of SMEs.

35. Given the sustained and accelerated growth of the Fintech sector and the inherent risks associated with new firms, products and activities that lie outside of the regulatory perimeter, there was a need to regulate Fintech in Mexico. While Fintech offers substantial benefits, it also comes with potential risks related to consumer and investor protection; the potential for regulatory arbitrage and contagion; and possible threats to financial integrity. This is particularly important as Fintech firms tend to cover segments that are normally excluded through traditional business models due to high costs and operational limitations.

36. ***Substance of the prior action*.** The new law provides a regulatory framework for the authorization, operation and supervision of Fintech institutions (*Instituciones de Tecnología Financiera*, ITFs). The new legislative and regulatory framework for the Fintech industry supported by this operation is the first one of its kind worldwide. In particular, the law aims at regulating the main Fintech companies that created disruption in the Mexican market and have an impact on consumers' and private investors. The Law comprises: A legal framework for the authorization, operation and supervision of Fintech institutions (ITFs) focusing on two types: crowdfunding institutions (IFCs) and electronic payment funds institutions (IFPEs)[23]. It also contains: (i) the legal underpinnings for a regulatory sandbox environment for innovative companies, (ii) the introduction of the concept of open data for non-confidential aggregate data and for transactional data with consumers' consent through the Application Programming Interfaces (APIs); and (iii) a provision to recognize virtual assets and regulate their usage and operations in Mexico.

37. The design of the Law is based and guided by five public policy objectives. The first is financial inclusion and innovation. By stablishing the basis for regulation and development of the Fintech industry, Mexico is providing legal certainty to industry participants and facilitating financial innovation and inclusion by covering segments which are typically excluded by traditional business models due to high costs and operational limitations. Financial inclusion and innovation in products and services helps strengthen resilience of previously unbanked, vulnerable populations. Second, consumer protection, particularly in the context of business models, systems and platforms that are new to individuals and firms. Third, financial stability, particularly by providing prudential rules in financial risk, operational, technological, marketing, corporate governance and accounting rules, as well as establishing limitations and maximum amounts for transactions. Forth, fostering competition and access. Encouraging healthy competition is key in order to have greater diversity and reduced costs in the provision of services and new distribution channels for financial services consumers, which also encourages inclusion. And fifth, avoiding anti-money laundering and combating the financing of terrorism**.** This initiative intends to provide the basis for preventing the use of FinTech activities for purposes of money laundering and terrorism financing, as well as protecting the users of financial services. A basic principle of "same activities, same regulatory approach" was followed in order to ensure that growth of Fintech operations does not originate from lack of regulatory oversight. Some provisions of the law are not only directed to Fintech firms but to the banking system in general in order to open the informational architecture and

[23] There are other types of Fintech companies operating in Mexico that are not captured by the law although they have significant presence in the country (e.g. scoring, identity and fraud identification, lending, insurance, personal financial management, enterprise financial management).

prevent them from not collaborating with Fintech firms. Moreover, a careful balance was considered in order for innovation to prevail while legal certainty is provided to the operational environment. [24]

Prior action #4: The Borrower has issued regulations regarding the licensing and operation of ITFs, as evidenced by CNBV's General Rules for ITFs and Banco de Mexico's Circular No. 12/2018, duly published in the Official Gazette dated September 10, 2018 and March 25, 2019, respectively.

38. ***Rationale*.** The Fintech law is the broad legal framework and thus it requires detailed regulation for its implementation. The Fintech Law empowers the CNBV and Banxico to issue general provisions that define the requirements for the operation of ITFs, including authorization to act as financial technology institution, minimum capital, risk management, among others.

39. ***Substance of the prior action*.** CNBV's General Rules for ITFs and Banco de Mexico's Circular 12/2018:[25]

- *Licensing requirements*: To safeguard the health of the institution, protect its investors, and promote market confidence, ITFs should meet well-defined ownership, internal control, governance and other criteria in order to safely and professionally conduct their business. The secondary regulation defines operational risk control functions, data confidentiality, organizational structure, fitness and propriety of board members and senior management and internal controls.

- *Minimum capital requirements:* minimum capital should be commensurate with the expected size of operations. This will help protect consumers and investors and instill confidence in markets.

- *Information sharing guidelines on prospective applicants:* To protect investors and ensure the legitimate use of their investments, IFCs should provide the investors with the necessary information regarding its operations and the information it requests, analyzes, and verifies to screen, select, and monitor prospective applicants and their projects.

- *Limits:* Limits on funding that can be raised through IFCs are required to ensure a level playing field with public or private securities issuance and protect consumers. Similarly, limits on funds that are held or transferred by IFPEs on behalf of their clients are required to ensure a level playing field with deposit taking institutions.

- *Risk management, information security, and business continuity*: ITFs should have comprehensive and adequate risk management, internal control, and reporting processes in place. These processes should address business continuity and information security issues related to the central role of data

[24] In line with Mexico's institutional arrangements for financial sector supervision, a number of authorities play a relevant role in the supervision and enforcement of the Fintech law, including the Ministry of Finance (*Secretaría de Hacienda y Crédito Público*, SHCP), the banking and securities supervisor (*Comisión Nacional Bancaria y de Valores*, CNBV); the Central Bank of Mexico (*Banco de Mexico*); the consumer protection agency for users of financial services (*Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros*, CONDUSEF); the insurance supervisor (*Comisión Nacional de Seguros y Finanzas*, CNSF) and the pensions supervisor (*Comisión Nacional de Sistema de Ahorro para el Retiro*, CONSAR).

[25] The authorities have outlined a roadmap for comprehensive Fintech regulations to follow the implementation of the Law, within 6, 12 and 24 months. This prior action comprise the first set of 6 months regulations issued.

and information technologies as well as ensure that ITFs have adequate reporting and external auditing policies.

- *Operational requirements for IFPEs:* IFPE's accept funds from customers and enable them to transact against them. This raises the need to ensure the safety of customer funds and operational reliability. Further, the way these products are sold, structured and transacted are different from traditional banking accounts. This raises the need for ensuring adequate consumer protection measures, mitigating money laundering and terrorist financing risks and protect against cyber security risks. The operational requirements for IFPEs cover: protection of customer funds, cybersecurity, business continuity and disaster recovery, IT and communication systems design, internal operational procedures related to accessing payment systems, authentication requirements for customer transaction requests and minimum standards for customer service and consumer protection.

- Moreover, on March 25, 2019, the authorities issued modifications to CNBV's General Rules for ITFs regarding regulatory reports; and for crowdfunding institutions, the regulations regarding the use of electronic means and security of information (cybersecurity) were also issued.

40. ***Expected results***. The Fintech law and its implementing regulations, such as this one for ITFs, are expected to result in an increase in the number of Fintech companies operating in Mexico. Specifically, it is expected that the number of ITFs (crowdfunding institutions and IFPEs) that have formally submitted an authorization application to the CNBV will increase from a baseline of zero in March 2019 to 32 by December 2020, and that the number of applications that are approved would reach 8. Beyond the timeframe for the evaluation of the results of this DPF, this comprehensive reform is expected to contribute to a reduction in the gap in access to financial services in Mexico, especially for under-banked and unbanked sectors and enhance competition in the financial sector.

Prior action #5: The Borrower has issued regulations for the operation of Regulatory Sandboxes, including eligibility criteria, oversight, and interinstitutional coordination, as evidenced by: (i) Banco de Mexico's Circular No. 5/2019; and (ii) General Rules for Regulatory Sandboxes issued by SHCP, CNBV, CNSF and CONSAR, published in the Official Gazette dated March 8, 2019, March 11, 2019, March 19, 2019, March 26, 2019 and March 8, 2019, respectively.

41. ***Rationale*****.** In an environment of rapid technological innovation in financial markets as that enabled by the Fintech framework, firms need the space to test innovative products, services or business models in a live and time-bound market environment, ensuring that appropriate safeguards are in place. Such a test environment enables innovation and can support competition and financial inclusion by increasing access and choice available to consumers, while ensuring that that key risks are effectively monitored by the authorities and that it operates effectively within the context and resources of a particular jurisdiction. This makes it imperative that the key objective of the test environment be clearly defined, including the eligibility criteria and boundaries within which eligible firms need to operate and the related supervisory capabilities needed to administer it appropriately. A sandbox also has the potential to change the nature of the relationship between regulators and financial service providers by creating an open and active dialogue between them. However, there are associated risks and implications for other entities, such as the supervisory capability, that should be carefully mitigated.

42. ***Substance of the prior action*.** The regulation supported establishes the requirements and criteria for obtaining a temporary license for admission in the regulatory test environments (called "sandboxes"). Applicants should present a statement of fact that they intend to carry out their activities in accordance with the temporary license as allowed under the law, a clear indication of the shareholders as well as an organizational structure chart, and clearly defined contingency plans. In addition, firms applying for a temporary sandbox license should also provide to the authorities: (i) reasoning behind why and how the model is different to currently existing models in the ecosystem; (ii) detailed specifications on the business model including the products, activities, technology as well as the target audience and regions in which the firm wishes to operate; (iii) distinct timeframes for the operation of the product as well as clear articulation of the specific tests that will be carried out during the period of temporary licensing to measure the validity of the product; (iv) a clear risk management framework to ensure adequate customer protection controls have been considered; (v) proof of the availability of adequate resources, both capital and otherwise, to ensure the proper working of the firm during the period of temporary authorization; and (vi) exit procedures including the procedures in place to return assets to customers or provide compensation if required.

43. The prior actions establishing the legal and regulatory framework for Fintech in Mexico are expected to have positive adaptation co-benefits. This framework will enable the growth of innovative financial technologies with the objective to strengthen financial inclusion among the unbanked population, the majority of which are in the rural and poorest parts of the country. By enabling the growth of non-traditional financial products and services – including crowdfunding, digital payments, remittances and insurance – the new legal and regulatory framework contributes to greater financial resilience of individuals and economic agents (especially MSMEs) affected by climate-related disasters. There is evidence on increase in flow of remittances from diaspora following major natural disasters and household-specific economic shocks. Further, the usage of mobile money and other faster payment services for mobilizing contributions to relief funds in the aftermath of natural disasters is well-documented. Electronic payment mechanisms have been found to be effective by enabling efficient transfers, improving transparency, and mitigating fraud in humanitarian response.[26] The adoption of the Fintech Law (Prior Action #4), the regulation on the licensing and operation of ITFs (Prior Action #5), and the establishment of regulatory sandboxes (Prior Action #6) create the prerequisites for these products and services to spread, while protecting consumers.

44. ***Expected results*.** The regulatory sandboxes will contribute to greater innovation in products, services and business models. Specifically, the number of applications for the establishment of regulatory sandboxes is expected to reach 5 by December 2020.[27] Beyond the timeframe for the evaluation of the results of this DPF, over the medium term, an effectively working sandbox will, on the one hand, open competition and lower the costs for innovators to test their products, encourage partnerships between Fintechs and incumbents and enable firms to successfully scale. On the other hand, it will help regulators to understand new innovations as they are being launched, as well as provide clarity on the regulations that might need to be adapted while ensuring that the appropriate safeguards are in place.

[26] International Rescue Committee, "Making Electronic Payments Work for Humanitarian Response". October 2016. https://www.rescue.org/sites/default/files/document/469/makinge-paymentsworkforhumanitarianresponse-final1.pdf
[27] Applications are received by the four financial sector regulators: CNBV, CONSAR, CNSF and SHCP.

Prior action #6: The Borrower has submitted to its Legislature, for approval thereof, a bill of law to improve BANSEFI's mandate in supporting financial inclusion and its role in the distribution of social benefits to the poorest population, as evidenced by the Senate Gazette No. 114, Volume I, dated April 2, 2019.

45. ***Rationale*.** The Mexican government created BANSEFI (National Savings and Financial Services Bank) in its 2001 Community Savings and Loan Act in order to improve access to banking facilities, especially among low-income families in remote regions. Although BANSEFI's contribution has been important over the years, significant areas of opportunity remain to better achieve its mandate of financial inclusion. BANSEFI is small compared to other development banks in the Mexican financial system, however it plays a critical role as the financial intermediary for government transfers and social protection programs. The coverage of the institution, particularly in rural areas, is restricted. Moreover, BANSEFI clients are particularly vulnerable to climate shocks as conditional government payment recipients are estimated to face higher climate risks due to poverty, remoteness and climactic exposure. The Findex 2017 report states that in Mexico only 47 percent of recipients of "government transfers" receive those transfers in bank accounts. The equivalent figure for other upper middle-income countries like Malaysia or South Africa is 70 percent, and close to 90 percent for Brazil. BANSEFI could in principle support this agenda of expanding bank services to underserved populations and areas of the country, while also becoming a more efficient agent of the government in terms of transfers of social benefits. Moreover, evidence shows that the partial digitalization of transfers of the social benefit programs in Mexico resulted in a large increase in financial inclusion for rural women, by 23 percentage points between 2012 and 2018. Furthermore, after two years of the introduction of the debit card, beneficiaries saved an additional 3 to 4 percent of their income.[28] However, most debit cards issued under PROSPERA continue to be "closed loop" (*canal cerrado*), which means they only serve to cash out benefits at special payment points in one transaction, rather than serving as true payment cards ("open loop") that can be used at Point of Sales terminals.

46. ***Substance of the prior action*.** The proposed reform of the Organic Law of BANSEFI provides a clearer and stronger mandate for this institution to better align it with the government's priorities of poverty reduction, supporting the economic and social wellbeing of Mexicans throughout the country, especially vulnerable and excluded populations, through services and financial instruments that respond to their needs, thereby reducing unemployment, violence and social instability. It also enables this institution under its new name *Banco del Bienestar* to support the authorities' strategy to make the delivery of social benefits more efficient. The proposed reform would expand the Banks' potential and scope for the distribution of government social programs to beneficiaries. It explicitly introduces the following key changes: (i) it mandates the development and adoption of financial technologies to facilitate the transfer of benefits and provide improved financial products to the Bank's clients;[29] and (ii) it introduces a specific mandate to design and execute programs that promote savings, investment and the adoption of modern payment options in indigenous communities.

[28] Bachas et al., 2018.

[29] BANSEFI has been the sole payment service provider (PSP) for the Prospera CCT program, operating nearly 7 million accounts for the beneficiaries of this program. BANSEFI is also one of the payment service providers of another major program, the "*Programa Pensión para Adultos Mayores*".

47. The proposed reform will further strengthen the institution's ability to deliver social payments to the neediest in case of natural disasters, thereby contributing to adaptation co-benefits. Following natural disasters in the past, BANSEFI was charged with delivering resources from Mexico's Natural Disaster Fund to low-income families whose homes were damaged or destroyed, through pre-charged debit cards. With the use of new technologies and greater reach to vulnerable populations and rural areas, the institution would be able to deliver financial benefits more effectively, faster and with greater transparency in case of natural disasters. As such, the substance of this prior action is directly linked to improving disaster response for the most vulnerable, both economically and climatically, populations. Greater use of new technologies also reduces household's dependence on cash and gives them more options for receiving and sending payments quickly, thus making them better prepared for disaster events. Finally, BANSEFI's new focus on offering a full suite of financial products (including savings options and loans) to vulnerable and poor populations will strengthen their ability to financially prepare for shocks, including those from climate-related disasters.

48. *Expected results*. It is expected that the share of beneficiaries receiving social transfers via *Banco del Bienestar* through open loop accounts will reach 80 percent by December 2020, of which 50 percent would be women. Beyond the timeframe for the evaluation of the results of this DPF, over the medium term, this reform is expected to contribute to greater financial inclusion of unserved populations, particularly in rural and marginalized regions.

Table 5: DPF Prior Actions and Analytical Underpinnings

Prior Actions	Analytical Underpinnings
Prior action #1	Financial Sector Assessment – Mexico (March 2017); Achieving Effective Financial Inclusion in Mexico: The Payments Perspective (Jan 2019); Financial Sector Assessment Program – Sistema de Pagos Electrónicos Interbancarios (SPEI) (July 2016); The Global Findex Database 2017 – Measuring Financial Inclusion and the Fintech Revolution *Mobile transaction accounts and transaction volumes are still low in Mexico. Authorities should foster the adoption of new technologies, including innovative card acceptance devices/methods that are less onerous for merchants.*
Prior action #2	Financial Sector Assessment – Mexico (March 2017) *Mexico should strengthen mechanisms to foster financial inclusion and increase competition.*
Prior action #3	Policy Notes (2018); Systematic Country Diagnostic (2018); The Global Findex Database 2017 – Measuring Financial Inclusion and the Fintech Revolution *Access to finance is one of the priorities set by the SCD. Mexico is one of the seven economies that are home to nearly half of the world's unbanked population. Authorities should strengthen mechanisms to foster financial inclusion, including through new technologies. The Fintech Law provides an opportunity to expand access to financial services while enabling innovation in the industry.*
Prior action #4	
Prior action #5	
Prior action #6	Financial Sector Assessment – Mexico (March 2017) – Development Banks Technical Note; Policy Notes (2018); Systematic Country Diagnostic (2018); Payment Delivery Mechanisms of Federal Social Assistance Programs in Mexico (Jan 2019) *Mexico should reform state banks to s ensure that they provide services to those not served by commercial banks. Particularly, BANSEFI's role in improving access of households to financial services needs to be rethought.*

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

49. The proposed operation is fully aligned with the Country Partnership Strategy (CPS) 2014-19 and the upcoming Country Partnership Framework 2020–25 (expected to reach the Board in Q2 FY20). The operation is also based on the findings of the 2016 Financial Sector Assessment Program (FSAP), tackling some of the key recommendations to develop a more inclusive and competitive financial sector in Mexico. This DPF is also supported by the technical work developed under the thematic Programmatic Approach (PA) for Mexico and the Financial Inclusion Global Initiative Program (FIGI) funded by the Bill and Melinda Gates Foundation, as well as other analytical work as described in Table 5. Moreover, this operation, which supports policies that affect the whole country, complements the Rural Finance Project (P153338), which is aimed at enhancing small and micro enterprises and entrepreneurs' access to finance in rural areas, particularly in the poorer south of the country and with special focus on women. These targeted and complimentary efforts to increase financial inclusion aim to tackle a long-standing bottleneck to reduce income inequality and boost inclusive growth in Mexico.

50. Moreover, the program is fully aligned with the WBG Maximizing Finance for Development (MFD) approach in that it addresses constraints to access to finance for individuals through the private sector and helps make sustainable private sector financing for productive activities. The program encourages private financing to address access to finance and improved financial inclusion, including via new technologies (i.e. Fintech). In addition, the public-sector investment in improving the payments system will help spur private sector investment in new payments products and services, which will promote financial sector inclusion and deepening.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

51. The government's reform program included an extensive process of consultations. The Fintech law was approved following months of consultation with public and private sector stakeholders. The process comprised focus groups and other meetings with key stakeholders including Fintech associations, banking association, and academic institutions. The consultation process included a workshop attended by public officials and representatives of international organizations, and a public consultation process to gather comments from 7 different banks, non-bank intermediaries, Fintech associations and international organizations. The draft law was discussed as well during the second financial inclusion forum organized by federal authorities which was attended by around 800 citizens, including researchers and members of financial institutions.

52. Another set of consultations took place through the National Commission for Regulatory Improvement (CONAMER) and via Banxico's website. CONAMER is the agency responsible for the promotion of the transparent development and implementation of regulatory reform policies. Prior to that, the government undertook specific consultations with stakeholders, including banking association, pension associations and other relevant stakeholders. In the case of Banxico regulations, a consultation process was launched for prior actions 1 and 2 on their website where the public submitted online comments for consideration.

53. The Bank has collaborated closely with the IMF. Collaboration and communication focused on macroeconomic and structural developments. Within the World Bank Group, the DPF team has

coordinated with the International Finance Corporation (IFC) on areas related to access to finance and Fintech development.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

54. The prior actions supported by this operation are not likely to have any negative poverty, social or distributional effects in the short term, but rather contribute to positive effects in these areas over the short and medium terms. The policy measures supported under this DPF series are expected to increase the provision of financial services to traditionally unserved populations to unlock their economic potential. The share of adults with a bank account increased between 2012 and 2018, however it is still very low, particularly among the poor and those in rural areas, which already had significantly lower account ownership compared to regional peers and upper middle-income countries. In 2017, only 7 percent of the rural population and less than 4 percent of those in the bottom 40 percent of the distribution saved at a formal financial institution. Similarly, only 12 percent of microenterprises received finance, while 32 percent of SMEs needed to invest but could not do so due to financial constraints. The expected poverty and social impact of each prior action are summarized below, and a detailed analysis is presented in Annex 4.

55. Actions under this DPF can help close gender gaps in financial inclusion, helping women smooth consumption, provide security, increase savings and investment rates, and manage economic risk. Between 2012 and 2018, the gender gap in bank account ownership decreased by 10 percentage points. This was largely driven by an increase in rural areas, where the percentage of women with a bank account increased by 23 percentage points. The evidence shows that having access to and use of a range of financial services enhances not only the contribution of female-owned business to growth, but also contributes to women's empowerment, allows for better use of resources, and reduces the vulnerability of their households and businesses.

56. Greater flexibility and security in the national payments system through an innovative electronic payment platform (CoDi) has the potential to increase financial inclusion and unlock the potential of e-commerce and small and micro enterprises. Nearly 88 percent of all transactions in Mexico are currently done in cash. The new electronic payments platform is expected to expand access to alternative payment options, reducing the cost of doing business for e-commerce, micro and small merchants and providing a path for them to establish a track record that could eventually enable them to obtain a loan. Technologies, such as debit cards and mobile accounts, lower indirect transaction costs by facilitating access to money and reducing the cost of checking balances. Although the expansion of electronic payments also presents risks, enabling a transparent and secure environment through CoDi is an opportunity to create the much-needed trust in the financial sector.

57. Access to credit through payroll accounts is expected to lower the borrowing costs for consumers and reduce highly costly informal lending. Only 15.7 percent of payroll account holders had a payroll loan in 2018. These low rates of payroll lending contrast with the fact that nearly 40 percent of the population with a payroll account uses some type of informal loans, either from family, friends, money lenders, and/or pawn shops. Such informal sources of credit, especially pawn shops and money lenders,

charge very high interest rates, affecting negatively household incomes. Efforts to facilitate using payroll accounts as the designated source of repayment for loans therefore has the potential to expand access to finance at lower costs, including for women.

58. The Fintech law and the associated regulations have the potential to increase the provision of financial services to unserved and underserved populations and unlock their economic potential. The use of technology to better deliver financial services holds great potential to reach populations that have been underserved by traditional banks and enable the poor to save. Moreover, the empirical evidence has shown that households work more when savings options improve, suggesting that the labor allocation channel is an important mechanism linking savings opportunities to income. Moreover, new technologies generate data on borrowers that can replace heavy collateral requirements. This could be particularly important for the financially excluded women, who are less likely to than men to own high-value assets that can served as collateral to obtain loans. ITFs also have the potential of improving competition in the sector, which remains concentrated in Mexico. There is evidence that more credit is being allocated to less productive sectors, limiting the growth of the less concentrated sectors; while more concentrated sectors could be producing less than the socially optimal.

59. Coupled with improved supervision, a regulatory sandbox is expected to ensure that the poor and vulnerable benefit from improved financial services, while being protected from mismanagement and abuse. New technologies simplify operational processes, allow more detailed and less costly analytics that enhance transparency while maintaining personal privacy and security of the financial activity. However, to the extent that firms become more visible through technology, this could pose a disincentive for microentrepreneurs to enter the financial sector, as there is a strong bias towards informality to avoid taxes.

60. The reform of BANSEFI has the potential to extend its reach to a larger share of the population. Evidence has shown that the digitalization of transfers of government programs in Mexico resulted in a large increase in the access to finance of rural women. However, it is crucial to go beyond access to foster usage in order to have an impact on welfare. The development of an electronic public transfer infrastructure represents an important step to further promote financial inclusion of the poor. In addition, it can reduce administrative costs for the government as well as fraud and corruption.

5.2. ENVIRONMENTAL ASPECTS

61. Prior actions supported by this operation are not expected to have significant direct effects on the environment, forests and other natural resources, although indirect effects are expected to be positive. Measures to promote the use of electronic payment systems and Fintech solutions will bring indirect positive environmental effects associated with reductions in the use of cash, more efficient connectivity and reduced travel times. Measures to promote the use of electronic payment systems, the regulatory framework for Fintech and the strengthening of BANSEFI will also contribute to greater resilience of the poor population, especially in areas vulnerable to natural disasters associated with climate change.

62. Mexico has a solid and comprehensive national environmental legislation. The legislation was formally developed around the publication of the General Law of Ecological Equilibrium and Environmental Protection (LGEEPA) in 1988. Since then, Mexico has developed laws, regulations and rules

for the protection of wildlife, forestry development, waste management, pollution control, climate change, environmental impact, etc., which establish the environmental requirements regarding investments. Moreover, the Government of Mexico has committed to supporting adaptation to climate change as reflected in its ambitious Nationally Determined Contribution (NDC) under the United Nations Framework Convention on Climate Change (UNFCCC). Mexico's NDCs recognize the important role of rural development in enhancing resilience.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

Fiduciary Aspects

63. The Mexican Government has introduced a number of reforms in public finances in line with international good practices. More recent reforms were related to public sector accountability, integrity and transparency with the creation of the National Anti-Corruption System, the National Transparency System and the National Auditing System (*Sistema Nacional de Fiscalización*). Additionally, Mexico established accrual accounting, harmonized accounting and budgeting norms across all levels of government and created the National Council of Accounting Harmonization (*Consejo Nacional de Armonización Contable*). The Bank is supporting the Government in reforms related to transparency and accountability efforts to improve the design, effectiveness, and implementation of open government initiatives, public integrity and anticorruption policies and tools.

64. The analytical underpinnings confirm that the foundations of PFM systems in Mexico are in place. They are supported by an adequate legal framework, human resources and technical skills. Reforms include the introduction of internationally recognized good practices, such as the publication of financial statements four months after the end of the fiscal year. There is therefore reasonable assurance that the country's PFM system manages the country's resources in a manner that is adequate to support this operation. In some areas, however, PFM practices could be improved, such as for example the inclusion of missing assets/liabilities, the creation of a comprehensive framework for the financial governance and oversight of non-financial public corporations, and over PFM system integration.

65. As for external oversight, the Federal Supreme Audit Institution conducts, on a regular basis, a number of performance, financial and compliance audits on federal programs. The annual public accounts are prepared and sent to Congress within four months after the end of each fiscal year. The external audit of the annual public accounts is undertaken by the Auditor General's office and submitted to the legislature fourteen months after the end of each fiscal year. Audit reports are comprehensive and there is a system in place to follow up on audit findings and recommendations. The results of audits by the Auditor General's office are reviewed and assessed by designated Committees appointed by Congress (*Comision de Vigilancia de la Auditoria Superior de la Camara de Diputados* and *Comision de Presupuesto y Cuenta Publica de la Camara de Diputados*) and made public in the Annual Audit Report on the Federal Public Accounts.

Disbursement and Audit

66. Disbursement arrangements. Once the DPF becomes effective and the Borrower complies with any withdrawal tranche release conditions, following the Borrower's request, the Bank will deposit the funds into an account denominated in U.S. dollars owned by the Central Bank (*Banco de México*) for

subsequent credit into the account of the National Treasury (*Tesorería de la Federación*). The Bank will notify the Borrower three days before making the deposit. The SHCP will provide the Bank with a written confirmation of the transaction and accreditation in the budget within thirty days after the funds are disbursed by the Bank.

67. Financial Agent. SHCP will use a financial agent for specific purposes, as described in the contract (*Contrato de Mandato*) with BANSEFI, satisfactory to the Bank.

68. The banking control environment into which the DPF proceeds would flow is deemed adequate. The FM assessment was based on the experience of Mexico managing World Bank DPFs, the Bank's analysis of project flow of funds and the review of the audited annual report of *Banco de México* from 2016 and 2017 with clean opinions under standards aligned with International Financial Reporting Standards (IFRS). The FM assessment concluded that from a fiduciary point of view, the control environment, procedures and regulations governing this Bank operation are adequate. Therefore, and based on the flow of funds described above, no additional FM-related arrangements are needed for this operation.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

69. The SHCP, through the Development Banking Unit, will be responsible for collecting the data necessary and for monitoring the indicators. The SHCP, in close coordination with Banxico, CNBV and other supervisory authorities, will take the lead in monitoring progress and implementation of this operation, with ongoing support from the World Bank. The results indicators selected to monitor and evaluate implementation progress and the achievement of program outcomes will be monitored by the institution that takes the coordination lead for the respective prior actions. While most of the indicators are new and will be collected for the monitoring of this operation, some of the indicators selected (particularly those in charge of Banxico) are already collected and monitored by the associated institution. The results matrix for the proposed operation can be found below in Annex 1.

70. Grievance Redress. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

6. SUMMARY OF RISKS AND MITIGATION

71. The overall level of risk for the proposed operation is assessed as Moderate. The key risk ratings are included in the table below. All ratings are assessed as either Moderate or Low. The reforms that underpin this operation involve various public stakeholders, and while their institutional capacity is relatively strong, there are risks related to the coordination required amongst these various governmental authorities due to the innovative nature of the measures. These risks can be mitigated by the ongoing World Bank engagement with key program counterparts on the issues supported, and the strong technical analysis at the preparation stage that underpins the implementation of the reforms supported.

72. Risks associated with the institutional capacity for implementation, including that related to the application of new regulations, is assessed as moderate. The Fintech Law contains provisions that typify criminal penalties related to the operation of ITFs. Pursuant to the Staff Guidance Note on World Bank Support for Criminal Justice Activities, a risk assessment was carried out. The assessment concluded that the risk of partiality in the implementation of the Fintech Law is moderate. The Fintech Law defines criminal penalties for individuals that misuse resources of Fintech clients, however, it does not transfer responsibilities of other stakeholders of the criminal justice system to SHCP, nor does it weaken the criminal process. Its implementation will occur in the context of existing institutional arrangements with SHCP as the main responsible actor for administrative penalties. In addition, Regulatory Impact Assessments and public consultations on draft regulations have been mandatory in Mexico for all regulatory proposals coming from the executive branch since 2000. Finally, the establishment of the National System of Better Regulation, and the creation of *Comisión Nacional de Mejora Regulatoria* (CONAMER), was aimed at promoting transparency in the development and enforcement of regulations and simplification of procedures, ensuring that they generate benefits that outweigh their costs.

73. Mexico continues to face external and domestic risks. Slower growth in 2019 in the U.S compared to 2018 as well as any hike in the U.S Federal Reserve policy rate, are likely to weigh on economic activity in Mexico. Although some uncertainty remains regarding its ratification, completion of the negotiations of the USMCA removed some of the uncertainty surrounding bilateral trade policy during 2017-2018. Downside risks may also come from a worse than expected appetite for EMs and Mexico's own risk perception in the markets. Domestic risks include a delayed or incomplete plan to deal with Pemex strategic and financial position; and an increase in the perceived policy uncertainty in the sector and overall investment climate. The flexible exchange rate is likely to continue to be the first line of defense as a macroeconomic buffer, while a strong track record of responsible monetary and fiscal policy management leave Mexico in a strong position to mitigate any future economic shocks.

Risk Categories	Rating
1. Political and Governance	Moderate
2. Macroeconomic	Moderate
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Moderate
6. Fiduciary	Low
7. Environment and Social	Low
8. Stakeholders	Moderate
9. Other	Moderate
Overall	Moderate

ANNEX 1: POLICY AND RESULTS MATRIX

Prior actions	Results		
Prior Actions under the DPF	**Indicator Name**	**Baseline**	**Target**
	Improving Financial Inclusion		
Prior Action #1: The Borrower has developed a new electronic payment platform ("CoDi") and issued its supporting regulations, to provide safe and efficient person-to-business payments to better reach micro, small and e-commerce merchants, as evidenced by Banco de Mexico's Circular No. 8/2019, duly published in the Official Gazette dated May 20, 2019.	**Results Indicator #1:** Number of payments done using CoDi platform	0 (March 2019)	200,000 (December 2020)
Prior Action #2: The Borrower has issued regulations to create interbank mechanisms that facilitate individuals to use their payroll account as the designated source of repayment for loans with any bank in the system, to foster a broader access to credit under better terms and conditions, as evidenced by Banco de Mexico's Circular 15/2018, duly published in the Official Gazette dated October 29, 2018.	**Results Indicator #2:** Interest rate spread of consumer loans that have payroll accounts as the designated source of repayment,[30] using the 28-day "interbank equilibrium interest rate" (TIIE) as the relevant interest rate benchmark.	1,625 basis points (February 2019)[31]	1,175 to 1,325basis points (December 2020)
Prior Action #3: The Borrower has enacted the Law to Regulate Financial Technology Institutions, to mandate the establishment and regulate the operation of ITFs and technology-driven business models, products, and services to promote innovation, competition, and inclusion in the financial sector, as duly published in Official Gazette dated March 9, 2018	**Results Indicator #3:** Number of ITFs (crowdfunding institutions and IFPEs) that have formally submitted an authorization application to the CNBV and number of such applications that were approved	0 (March 2019)	32 applications submitted 8 applications approved (December 2020)

[30] The specific measure of this interest rate is the average weighted (by loan amount) interest rate of payroll loans.
[31] As of February 2019, the average weighted interest rate of payroll loans (by loan amount) was 24.77 percent, and Banco de Mexico's and the average for the 28-day TIIE for that same month was 8.52%.

Prior actions	Results		
Prior Action #4: The Borrower has issued regulations regarding the licensing and operation of ITFs, as evidenced by CNBV's General Rules for ITFs and Banco de Mexico's Circular No. 12/2018, duly published in the Official Gazette dated September 10, 2018 and March 25, 2019, respectively.			
Prior action #5: The Borrower has issued regulations for the operation of Regulatory Sandboxes, including eligibility criteria, oversight, and interinstitutional coordination, as evidenced by: (i) Banco de Mexico's Circular No. 5/2019; and (ii) General Rules for Regulatory Sandboxes issued by SHCP, CNBV, CNSF and CONSAR, published in the Official Gazette dated March 8, 2019, March 11, 2019, March 19, 2019, March 26, 2019 and March 8, 2019, respectively.	**Results Indicator #4:** Number of applications for the establishment of regulatory sandboxes	0 (March 2019)	5 (December 2020)
Prior action #6: The Borrower has submitted to its Legislature, for approval thereof, a bill of law to improve BANSEFI's mandate in supporting financial inclusion and its role in the distribution of social benefits to the poorest population, as evidenced by the Senate Gazette No. 114, Volume I, dated April 2, 2019.	**Results Indicator #5:** Share of beneficiaries receiving social transfers via *Banco del Bienestar* through open loop accounts, and share of women among those beneficiaries	21% (March 2019)	80%, of which 50% women (December 2020)

ANNEX 2: LETTER OF DEVELOPMENT POLICY

SHCP
SECRETARÍA DE HACIENDA Y CRÉDITO PÚBLICO

2019
AÑO DEL CAUDILLO DEL SUR
EMILIANO ZAPATA

Subsecretaría de Hacienda y Crédito Público

Oficio No. 102-B-042
Ciudad de México, a 30 de abril de 2019

David Malpass
Presidente del Banco Mundial
P R E S E N T E

Estimado Señor Malpass,

La principal prioridad de la Administración encabezada por el Presidente de México, Andrés Manuel López Obrador, es mejorar el bienestar de la población de escasos recursos. Por ello, el Gobierno de México trabaja en acciones para enfrentar tres grandes retos: el bajo crecimiento económico, la pobreza y la desigualdad.

Reconocemos que en las últimas tres décadas el crecimiento anual de la economía en México ha sido bajo, en promedio de 2 por ciento desde 1982 a la fecha, y la desigualdad entre las distintas regiones del país se ha mantenido considerablemente alta, ejemplo de ello es que la Ciudad de México tiene un PIB per cápita 6.6 veces mayor al de Chiapas.

En los últimos años, México ha emprendido numerosas reformas para establecer un sistema financiero moderno, sólido, rentable y competitivo. No obstante estos esfuerzos, México aún enfrenta muchos retos. Por ejemplo, el crédito al sector privado sólo representa el 34.1% por ciento del PIB, muy por debajo del promedio de otros países similares. Además, una gran parte de la población todavía carece de acceso a los servicios financieros, lo que prolonga la desigualdad económica. Por ejemplo, solamente 37% de la población adulta tiene una cuenta bancaria. Si bien el valor de los pagos con tarjeta –débito o crédito- ha aumentado entre 2000 y 2016, todavía es bajo como proporción del PIB, pues el valor de los pagos solo alcanza el 8.9%. Asimismo, en México el 93% de las transacciones para compras o pagos de servicios se lleva a cabo en dinero en efectivo. Un sector financiero que funcione adecuadamente transforma el ahorro en inversión productiva, gestiona los distintos riesgos económicos y proporciona la infraestructura necesaria para las transacciones financieras.

Con el fin de impulsar un crecimiento económico más dinámico, incluyente y equitativo y abatir la desigualdad económica, la Secretaría de Hacienda y Crédito Público (SHCP) y el Banco de México (Banxico) presentaron a principios de enero de 2019 ocho acciones para impulsar el sector financiero. Lo anterior incluye medidas para profundizar tanto el sector bancario como el mercado de valores, contar con medios de pago más eficientes para la población y, en general, hacer más eficiente la labor de captar y promover el ahorro así como canalizarlo a la inversión productiva.

El Gobierno de México ha mantenido una estrecha colaboración con el Banco Mundial, gracias a la cual, México ha podido modernizar la regulación bancaria conforme a estándares internacionales.

Palacio Nacional S/N, Primer Patio Mariano, Piso 4, Colonia Centro, Cuauhtémoc, Ciudad de México, C.P. 06000.
T: +52 (55) 3688 1293 www.gob.mx/shcp

SHCP SECRETARÍA DE HACIENDA Y CRÉDITO PÚBLICO | 2019 EMILIANO ZAPATA

Subsecretaría de Hacienda y Crédito Público

Agradecemos el apoyo de esa institución a las acciones que hemos emprendido para promover la inclusión financiera de todos los mexicanos. En virtud de lo anterior, solicitamos amablemente su apoyo para obtener un préstamo de desarrollo de políticas que reconozca las medidas descritas, con el firme compromiso del Gobierno de México de continuar con los esfuerzos en el desarrollo del sector financiero que promuevan inclusión, crecimiento y competitividad en un marco de aprovechamiento de las tecnologías digitales.

La primer área de reforma se enfoca en una plataforma electrónica que permitirá a los consumidores contar con un medio de pago electrónico adicional inmediato, seguro y eficiente, y a los comercios con una mayor seguridad en sus transacciones de liquidación instantánea y sin costo. Con la plataforma de pago digital "Cobro Digital" (CoDi), que ha sido desarrollada conjuntamente por el Banco de México y la industria de pagos, los beneficiarios (principalmente pequeños y micro comerciantes, comerciantes de comercio electrónico e individuos) tendrán una alternativa viable para aceptar y recibir pagos electrónicos de manera segura, rentable y transparente.

Las personas tendrán a su disposición un nuevo método de pago que podrán operar de forma fácil y segura con sus dispositivos móviles. La facilidad de uso y una mayor aceptación pueden llevar a más personas, especialmente a pequeños empresarios, a abrir una cuenta para recibir pagos de CoDi. Cuando se realice una compra, el monto se transferirá a través del sistema de pago electrónico interbancario (Sistema de Pagos Electrónicos Interbancarios, SPEI), lo que hace que esta infraestructura central esté disponible para cualquier pagador. CoDi competirá con otros métodos de pago que sean adecuados para pagos de tipo P2B, como las tarjetas de pago y, en particular, con las tarjetas de débito. Con esto se busca reducir el uso de efectivo, e incentivar a que un mayor número de establecimientos utilicen esta herramienta, dándoles acceso a otros servicios financieros formales adecuados a sus necesidades.

Asimismo, las autoridades en su afán de promover un sector financiero más competitivo y con menores costos, han fomentado la apertura de créditos asociados a la nómina con cualquier banco, la cual permitirá que todos los trabajadores puedan usar sus cuentas bancarias de nómina como fuente de pago para todo tipo de créditos y con cualquier institución financiera, bajo una arquitectura abierta. Esta medida hará efectiva la libertad de elección del trabajador, aumentando su poder de negociación y contribuyendo así a la baja de costos en este tipo de créditos. Adicionalmente, se promoverá la efectividad de la referida fuente de pago al hacer portable el derecho de cobro de los créditos independientemente del banco que administre la cuenta de nómina. Así, los trabajadores cuentahabientes tendrán acceso a una mayor oferta de créditos en mejores condiciones.

Otra de las principales líneas de acción del Gobierno es permitir que los jóvenes entre los 15 y 17 años de edad puedan abrir su primera cuenta de débito y fungir como titulares de la misma. Esto se traducirá en beneficios para alrededor de 7 millones de jóvenes. Cabe destacar que, conforme a la Encuesta Nacional de Ingreso y Gastos de los Hogares 2016

Palacio Nacional S/N, Primer Patio Mariano, Piso 4, Colonia Centro, Cuauhtémoc, Ciudad de México, C.P. 06000.
T: +52 (55) 3688 1293 www.gob.mx/shcp

destacar que, conforme a la Encuesta Nacional de Ingreso y Gastos de los Hogares 2016 realizada por el INEGI, México cuenta con 2.4 millones de personas de entre 16 y 18 años de edad que, respecto de un universo de 6.8 millones, forman parte de la población económicamente activa que se encuentra trabajando, los cuales requieren contar con una cuenta bancaria de la que sean titulares por sí mismos y en la que puedan depositar sus ingresos, los cuales conforme a la legislación civil nacional pueden ser administrados y dispuestos libremente por ellos, sin requerir del consentimiento de sus padres o tutores, por provenir de su propio trabajo.

Además, como parte de las diversas acciones de apoyo social que el Gobierno de México ha decidido implementar para combatir la pobreza y disminuir la desigualdad social, se encuentran el otorgamiento de apoyos económicos a estudiantes que estén cursando el bachillerato en escuelas públicas para abatir la deserción escolar y promover la participación de sus beneficiarios en actividades para el mejoramiento de su comunidad. Para poder instrumentar lo anterior, era necesario que los jóvenes estudiantes contaran con herramientas que los incorporen al sistema financiero formal desde una edad temprana y que puedan ser usuarios activos de los servicios que ofrecen las instituciones bancarias.

El Gobierno Federal ha logrado importantes avances para fomentar la industria Fintech en Mexico con la adopción de la Ley Fintech (Ley para Regular las Instituciones de Tecnología Financiera) en Marzo 2018 y sus consecuentes regulaciones secundarias. Mexico es el segundo país con mayor número de empresas Fintech en América Latina. La nueva ley es la primera de su tipo en el mundo y proporciona un marco regulatorio para la autorización, operación y supervisión de las instituciones de Fintech (instituciones de tecnología financiera, ITF), y está dirigida a dos tipos particulares: las instituciones de financiamiento colectivo y las instituciones de fondos de pago electrónico.

La ley se basa en cinco principios de política pública, entre ellos: (i) inclusión e innovación financiera, (ii) protección al consumidor, (iii) estabilidad financiera, (iv) fomento de la competencia y (v) lucha contra el lavado de dinero y lucha contra la financiación del terrorismo. Al establecer las bases para la regulación y el desarrollo de la industria de FinTech, México está brindando seguridad jurídica a los participantes de la industria y facilitando la innovación e inclusión financiera al cubrir segmentos que normalmente están excluidos a través de modelos de negocios tradicionales debido a los altos costos y las limitaciones operativas. La Ley Fintech ofrece la oportunidad de ampliar el acceso a los servicios financieros, al tiempo que no restringe la innovación en la industria. Algunos de los puntos que la Ley estableció son los siguientes:

- **Requisitos de entrada:**
  - Solicitar autorización ante la Comisión Nacional Bancaria y de Valores (CNBV) para comenzar a operar.

JLM

- Presentar a sus accionistas y administradores el aviso de operaciones.
- Contar con capital mínimo para operar y por activos sujetos a riesgo.
- Deben constituirse legalmente como sociedades anónimas (S.A.).

- **Requisitos para operar:**
  - Controles internos y administración de riesgos.
  - Seguridad de la información y continuidad de la operación.
  - Límites de operación por cada cliente.
- **Para protección al consumidor:**
  - Divulgación de riesgos y responsabilidades.
  - Confidencialidad de la información.
  - Separar los recursos propios de los ingresados por sus clientes.
- **De supervisión:**
  - Las instancias encargadas de su supervisión serán la CNBV, Banxico y la CONDUSEF.
  - Deberán de cumplir con un marco de prevención de lavado de dinero.
  - Se establecen sanciones, delitos, multas, suspensiones y revocaciones.
  - Se deberá contar con auditores externos independientes.

Asimismo, como parte de las herramientas para fomentar la innovación en el sistema financiero, la Ley FinTech prevé la posibilidad de que se autorice la operación de modelos novedosos (conocido internacionalmente como regulatory sandbox). Conforme a la Ley FinTech, un modelo novedoso es "aquel que para la prestación de servicios financieros utilice herramientas o medios tecnológicos con modalidades distintas a las existentes en el mercado al momento en que se otorgue autorización temporal en términos de esta Ley" (art 4, fracción XVII). La autorización para operar con dichos modelos novedosos podrá ser de dos formas distintas:

a. Autorización otorgada a sociedades mercantiles (distintas a entidades financieras e ITF) para llevar a cabo una actividad que conforme a la legislación financiera requiere de autorización, registro o concesión por parte de las autoridades financieras.
b. Autorización otorgada a entidades financieras e ITF para llevar a cabo temporalmente operaciones o actividades de su objeto social, cuando en su realización se requiera de excepciones o condicionantes a lo contenido en las disposiciones de carácter general aplicables emitidas por las autoridades financieras.

La reforma de la Ley Orgánica de BANSEFI cambia el nombre a la institución por Banco de Bienestar y proporciona un mandato más claro y sólido para que esta institución se alinee mejor con las prioridades gubernamentales de reducción de la pobreza, apoyando el bienestar económico y social de los mexicanos en todo el país, especialmente las poblaciones vulnerables y excluidas, a través de servicios e instrumentos financieros que responden a sus necesidades, reduciendo así el desempleo, la violencia y la inestabilidad social. También amplía el potencial y el alcance del banco para la distribución de

JLM

SHCP
SECRETARÍA DE HACIENDA Y CRÉDITO PÚBLICO
2019
AÑO DEL CAUDILLO DEL SUR
EMILIANO ZAPATA

Subsecretaría de Hacienda y Crédito Público

programas sociales gubernamentales a los beneficiarios. Esta reforma, en conjunto con otras reformas que el Gobierno planea realizar para el fortalecimiento de la banca de desarrollo podría beneficiar a 15 millones de nuevos clientes en zonas rurales, municipios marginados y áreas semi-urbanas en donde no llega la banca múltiple.

Finalmente, cabe resaltar la importancia de este programa para el país, en la medida en que contribuirá significativamente al cumplimiento de las estrategias del Plan Nacional de Desarrollo (PND) 2019-2024. El PND establecerá la inclusión financiera como uno de sus principales objetivos. Si bien el nuevo PND está actualmente en preparación, ya se ha iniciado una reorientación del gasto hacia programas sociales nuevos y ampliados, así como un mayor enfoque de los programas gubernamentales en las regiones menos desarrolladas del país. El acceso mejorado a los servicios financieros, incluso a través de nuevas tecnologías, no solo es crítico para reducir las desigualdades económicas, sino también para fomentar la productividad y el crecimiento.

Agradeciendo de antemano su atención a la presente, aprovecho la oportunidad para enviarle un cordial saludo y reiterar el interés del Gobierno mexicano para continuar la fructuosa relación de trabajo con el Banco Mundial.

ATENTAMENTE,
EL SUBSECRETARIO

ARTURO HERRERA GUTIÉRREZ

JLM

Palacio Nacional S/N, Primer Patio Mariano, Piso 4, Colonia Centro, Cuauhtémoc, Ciudad de México, C.P. 06000.
T: +52 (55) 3688 1293 www.gob.mx/shcp

Unofficial translation of the Letter of Development Policy

Secretariat of Finance and Public Credit **Deputy Secretary of Finance and Public Credit**

Oficio No. 102-B-042
April 30, 2019
Mexico City

David Malpass
President of the World Bank Group

Dear Mr. Malpass,

The main priority for the Administration led by the President of Mexico, Andrés Manuel López Obrador, is to improve the wellbeing of those with scarce resources. Thus, the Government of Mexico is working on action plans to address three great challenges: low economic growth, poverty and inequality.

We recognize that in the last three decades annual economic growth in Mexico has been low – growing an average of 2% since 1982 to date – and inequality amongst the different regions of the country has remained considerably high, an example is Mexico City having a per capita GDP 6.6 times higher than that of Chiapas.

In recent years, Mexico has launched numerous reforms aimed to establish a modern, solid, profitable and competitive financial system. Regardless of these efforts, Mexico still faces many challenges. For example, credit to the private sector only represents 34.1% of the GDP, well below the average of that of its peers. Moreover, a large part of the population still lacks access to financial services, exacerbating financial inequality. For example, only 37% of the adult population has a bank account. Although the total value of card payments – debit or credit – has increased between 2000 and 2016, it is still low as a share of the GDP, as it only represents 8.9%. Additionally, 93% of purchase or service payment transactions in Mexico are made in cash. An adequately functioning financial sector turns savings into productive investment, manages economic risks and provides the necessary infrastructure for financial transactions.

To foster a more dynamic, inclusive and equitable economic growth and curb economic inequality, in early January 2019, the Secretariat of Finance and Public Credit (SHCP) and the Central Bank of Mexico (Banxico) presented eight actions aimed at pushing the financial sector forward. This included measures to further the banking sector as well as the capital market, provide people with more efficient payment method options and increase overall efficiency in capturing and promoting savings, as well as channeling it into productive investment.

The Mexican Government has maintained a close relationship with the World Bank, thanks to which Mexico has been able to modernize its banking regulations in accordance to international standards. We thank the institution for supporting the actions that we have undertaken to promote financial inclusion for all Mexicans. In view of this, we kindly request your support to obtain a development policy loan that recognizes the described measures, with the firm commitment of the Mexican Government to continue its efforts within the financial sector to promote inclusion, growth and competitiveness, taking advantage of digital technologies.

The first area of reform focuses on an electronic platform which will provide consumers with an additional immediate, secure and efficient electronic payment method; and businesses with higher security in their transactions for instant settlement that is free of charge. With the digital payment platform (CoDi), co-developed by the Mexican Central Bank and the payment industry, beneficiaries (mainly micro and small businesses, eCommerce businesses and individuals) will have a viable alternative to accept and receive electronic payments in a safe, profitable and transparent way.

People will have at their disposal a new payment method that they can use through mobile devices in an easy and secure manner. The ease of use and a higher acceptance could make more people, especially small business owners, open an account that would allow them to receive payments through CoDi. When a purchase is done, the amount will be transferred through the inter-bank electronic payment system (Sistema de Pagos Electrónicos Bancarios, SPEI), which will make this central infrastructure available to any payer. CoDi will compete with other P2B payment methods, such as purchase cards and, particularly, debit cards. This aims to reduce the use of cash and to incentivize a higher number of establishments to use this tool, offering them access to alternative formal financial services better tailored to their needs.

Moreover, in their pursuit to promote a more competitive and less costly financial sector, the authorities have facilitated the opening of credits associated to payroll accounts with any bank, which will allow all workers to use their payroll bank accounts as a source of payment for all types of credits and with any financial institution, within an open infrastructure. This measure will give workers freedom of choice, increasing their negotiation power and contributing to cost reduction for these types of credits. Additionally, effectiveness of the mentioned source of payment will be promoted by making the right to payment for these credits portable regardless of the bank managing the payroll account. Hence, account-holding workers will have access to a greater credit offer under better conditions.

Another main line of action for the Government is to allow young people, between 15 and 17 years old, to open their first debit account and act as the account holders. This would translate into benefits for approximately 7 million young people. It should be mentioned that according to the 2016 National Household Income and Expense Survey conducted by the National Institute of Statistics and Geography (INEGI), Mexico has 2.4 million people between the ages of 16 and 18 who, with regard to a 6.8 million universe, are a part of the economically active population currently working and are in need of access to a bank account they can hold on their own and deposit their income to. Income which, according to national civil legislation, can be managed and used freely by them as owners, without requiring consent from their parents or tutors, as these are earnings from their own labor.

Furthermore, as part of the diverse social support actions that the Government of Mexico has decided to implement to fight poverty and decrease social inequality, economic support for students enrolled in public high schools is being provided to lower school desertion and promote the participation of beneficiaries in activities aimed to improve their communities. To implement this, it was necessary for young students to have access to the tools that would allow them to join the formal financial system from an early age, and to be active users of the services that banking institutions offer.

The Federal Government has achieved important advancements promoting the Fintech industry in Mexico through the adoption of the Fintech Law (Law to Regulate Financial Technology Institutions) in March

2018 and its subsequent secondary regulations. Mexico is the country with the second largest number of Fintech companies in Latin America. The new law is the first of its kind in the world, providing a regulatory framework for the authorization, operation and supervision of Fintech institutions (*Instituciones de Tecnología FInanciera*, ITF). It is directed at two types in particular: crowdfunding institutions and electronic wallets.

The law is based on five public policy principals, among them: (i) financial inclusion and innovation, (ii) consumer protection, (iii) financial stability, (iv) the promotion of competition, and (v) the fight against money laundering and against financing of terrorism. By establishing bases for the regulation and development of the Fintech industry, Mexico is offering the industry's participants legal security and facilitating financial innovation and inclusion by covering segments normally excluded from traditional business models due to their high costs and operational limitations. The Fintech Law offers the opportunity to widen access to financial services, while not restricting innovation within the industry. Some of the points established by the Law are as follows:

- **Entry requirements:**
  - Request authorization of the National Banking and Securities Commission (CNBV) to begin operations.
  - Present notice of operations to shareholders and administrators.
  - Possess the minimum capital needed to operate and to cover risky assets.
  - Legally register as a company (Sociedad Anónima, S.A.).
- **Operating requirements:**
  - Internal controls and risk management.
  - Information security and operational continuity.
  - Operational limits for each client.
- **Consumer protection:**
  - Disclosure of all risks and responsibilities.
  - Confidentiality of information.
  - Separate own resources from those paid in by clients.
- **Supervision**:
  - The institutions in charge of supervision will be the CNBV, Banxico and CONDUSEF.
  - Must comply with a framework for the prevention of money laundering.
  - Sanctions, crimes, fees, suspension and revocation measures are established.
  - Independent external auditors must be hired for supervision.

Furthermore, as part of the tools used to promote innovation in the financial system, the Fintech Law foresees the possibility of authorizing the operation of innovative models (internationally known as regulatory sandbox). According to the Fintech Law, an innovative model is "that which offers financial services making use of technological means or tools with approaches different from those existing in the market at the time the temporary authorization is granted under the terms of this Law" (article 4, fraction XVII). There are two different types of authorization granted to operate such innovative models:

a. Authorization granted to commercial companies (different from financial entities and ITFs) to carry out activities which, according to financial legislation, require authorization, registration or concession from financial authorities.

b. Authorization granted to financial entities and ITFs to temporarily carry out operations or activities, when these require exceptions or limits from what may be stated in the pertaining general conditions published by financial authorities.

The reform of BANSEFI's Organic Law changes the name of this institution to *Banco de Bienestar* and provides a clearer and more solid mandate for it to be better aligned to the poverty reduction priorities set by the Government, supporting the economic and social wellbeing of all Mexicans, especially of the vulnerable and excluded populations, through financial services and instruments that tend to their needs, thus reducing unemployment, violence and social instability. It also broadens the potential and scope of the bank in terms of distribution of social government programs to beneficiaries. This reform, along with other reforms the Government is planning to undertake to strengthen the state development banks, may benefit 15 million new clients in rural areas, marginalized municipalities and semi-urban areas, unreached by banking institutions.

Finally, it is important to highlight the importance of this program for the country, to the extent that it will significantly contribute in the accomplishment of the strategies of the National Development Plan (NDP) 2019-2024. The NDP will establish financial inclusion as one of its main objectives. Although the new NDP is currently under preparation, a reorientation of public spending to new and broader social programs is already underway, as well as a greater focus on government programs in the less developed regions of the country. Improved access to financial services, including through the use of new technologies, is not only critical to reduce economic inequality, but it also promotes productivity and growth.

I would like to thank you in advance for your attention and take this opportunity to extend my warm regards and reiterate the interest of the Mexican Government to continue its fruitful work relationship with the World Bank.

Sincerely,
Arturo Herrera Gutiérrez
Deputy-Secretary
Secretariat of Finance and Public Credit

ANNEX 3: FUND RELATIONS ANNEX

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 18/440
FOR IMMEDIATE RELEASE
November 27, 2018

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Completes Review of Mexico's Performance Under the Flexible Credit Line Arrangement

On November 26, 2018, the Executive Board of the International Monetary Fund (IMF) completed its review of Mexico's qualification for the arrangement under the Flexible Credit Line (FCL) and reaffirmed Mexico's continued qualification to access FCL resources. At the request of the Mexican authorities for a reduction of access under the FCL arrangement for Mexico consistent with their intention last year, the Executive Board approved the FCL access of SDR 53.4762 billion (about US$74 billion[1]). The Mexican authorities stated their intention to continue treating the arrangement as precautionary.

The current two-year FCL arrangement for Mexico was approved by the IMF's Executive Board on November 29, 2017 for an original access amount equivalent to SDR 62.3889 billion (about US$86 billion) (see Press Release No. 17/459). Mexico's first FCL arrangement was approved on April 17, 2009 (see Press Release No. 09/130), and was renewed on March 25, 2010 (see Press Release No. 10/114), January 10, 2011 (see Press Release No. 11/4), November 30, 2012 (see Press Release No. 12/465), November 26, 2014 (see Press Release No. 14/543), and May 27, 2016 (see Press Release No. 16/250).

Following the Executive Board's discussion on Mexico, Ms. Christine Lagarde, Managing Director and Chair, made the following statement:

Very strong policies and policy frameworks have helped Mexico navigate a complex external environment. Growth has remained resilient while inflation declined. Fiscal policy has stemmed the rise in the public debt-to-GDP ratio, monetary policy has maintained a prudent stance, and financial regulation and supervision remain strong. The flexible exchange rate has played a key role in helping the economy adjust to external shocks.

The current and the incoming administrations have stated their commitment to maintain very strong policies and policy frameworks, including the independence of economic-policy institutions. They are also committed to fostering a reform agenda to strengthen the rule of law and boost private investment. It will be important to adhere strictly to these commitments to preserve hard-won gains and instill policy predictability.

Given its openness to financial and trade flows, the Mexican economy remains exposed to external risks. These risks include renewed volatility and increased risk premia in global

[1] Amount based on the Special Drawing Right (SDR) quote of November 27, 2018 of I USD=SDR 0.724065.

financial markets, a sharp pull-back of capital from emerging market economies, as well as weakening global growth and intensified global trade tensions. The risk of an abrupt change in Mexico's trade relations, however, has receded.

The Flexible Credit Line arrangement plays an important role in supporting the authorities' macroeconomic strategy by providing insurance against tail risks and bolstering market confidence. In light of the dissipation of some of the risks facing Mexico and given Mexico's strong buffers, the authorities requested a reduction in access under the current arrangement, in line with the commitment they made at the time of its approval a year ago. The lower access is appropriate and consistent with the authorities' strategies that envisage a gradual phasing out of Mexico's use of the facility subject to a reduction in risks. Both current and incoming administrations intend to continue to treat the arrangement as precautionary.

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Operation Pillar 1: Financial Inclusion		
Prior action #1	There are no significant direct environmental effects, neither positive nor negative.	Not likely to have poverty, social or distributional effects in the short term.
Prior action #2	There are no significant direct environmental effects, neither positive nor negative	Positive
Prior action #3	There are no significant direct environmental effects, neither positive nor negative	Not likely to have poverty, social or distributional effects in the short term.
Prior action #4	There are no significant direct environmental effects, neither positive nor negative	Not likely to have poverty, social or distributional effects in the short term.
Prior action #5	There are no significant direct environmental effects, neither positive nor negative.	Not likely to have poverty, social or distributional effects in the short term.
Prior Action #6	There are no significant direct environmental effects, neither positive nor negative.	Positive

Detailed Poverty and Social Impact Analysis[32]

1. **The PSIA is developed according to World Bank guidelines and is designed to provide an analysis of the potential poverty and social impacts of the policy actions outlined in the DPF series**. The present PSIA outlines the expected impacts from a gender-informed, social and distributional perspective. The assessment is meant to provide analysis of the policy actions with outcomes contributing to the key objectives of this operation.

2. **The policy measures supported under this DPF series are not expected to have large short-term poverty or social impacts.** Over the medium term, the set of prior actions under the program are expected to enable increased access to finance for the population, including poor and vulnerable groups through lower cost options for saving, receiving remittances, and accessing credit. The expected individual impacts of prior actions under the specific pillars are summarized below. Information from several surveys on financial inclusion and the use of technology in Mexico was gathered to inform this analysis. In addition, a literature review of the empirical evidence on potential impacts of these prior actions has been gathered, including academic research papers and previous evaluations by the World Bank and other multilateral organizations.

3. **Financial inclusion is important for poverty reduction.** The literature has found that when people are part of the financial system, they are better able to start a business, invest in health and education or absorb unexpected financial shocks.[33] The empirical evidence for Mexico shows that the expansion in the supply of financial services has proven to have a positive effect on the economic opportunities for the poor. For instance, in 2002 a new bank (Banco Azteca) that targets low income households and least populated municipalities, led to a massive increase in banking services in Mexico, enabling the poorest to smooth consumption and accumulate more durable goods (Ruiz, 2013). The increase in financial services had positive effects on labor market activity and income levels with impacts more pronounced for individuals below median income levels (Bruhn and Love, 2009). A similar regulation introduced in 2007 –which authorized five more banks that targeted low-income households–also had effects on employment outcomes and entrepreneurial activities, particularly for informal business owners.

4. **Access to finance is key for women's access to economic opportunities.** Closing gender gaps in financial inclusion has positive effects in smoothing consumption, providing security, increasing saving and investment rates, and managing economic risk. The evidence shows that having access to and use of a range of financial services enhances not only the contribution of female-owned business to growth, but also contributes to women's empowerment, allows for better use of resources, and reduces the vulnerability of their households and businesses.[34] Therefore, closing the gender gap in access to finance can enable economic growth, inequality reduction, and social inclusion. In Mexico, the recent expansion of financial services has had positive impact on employment, but the effects are differentiated by gender. While, for women, it has increased the opportunities for salaried employment, it has encouraged the creation among men of new businesses, mostly of an informal nature (Bruhn and Love, 2009).

[32] Prepared by the Poverty and Equity Global Practice, with contributions from the Environment teams.
[33] See Burguess and Pande (2005), Karlan and Zinman (2010) Dupas and Robinson (2013), Kast and Pomenraz (2014), and Brune et. al (2016)
[34] See Delavallade et al, 2015; Aker et. al, 2015; Ashraf et. al, 2010; and Dupas and Robinson, 2013.

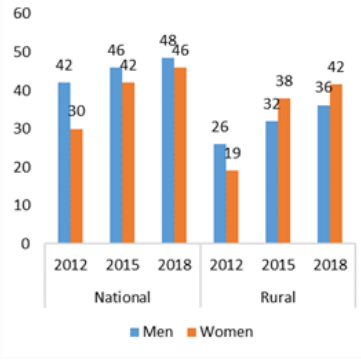
5. **Although access to finance has been increasing in Mexico, it continues to be low relative to peer countries, particularly among the bottom of the distribution.** A larger share of the population had a bank account in 2018 comparted to 2012. However, account ownership continues to be very low compared to other regional and upper middle-income countries, particularly in rural areas (29.3 vs 72.9 percent). Moreover, less than 4 percent of people at the bottom 40 and only 7 percent in rural areas saved at a formal financial institution in 2017.

Table A.1. Account ownership (% age 15+) by individual characteristics, Findex, 2017

	Mexico	LAC	UMC
Total	36.9	54.4	73.1
Male	41.1	57.8	77.0
Female	33.3	51.3	69.3
Older adults (ages 25+)	38.3	59.5	74.6
In labor force	42.9	59.5	78.4
Out of labor force	26.0	43.3	61.6
Primary education or less	24.5	43.9	65.6
Secondary education or more	43.8	60.1	80.2
Income, poorest 40%	25.8	41.9	62.4
Income, richest 60%	44.0	62.7	80.3
Rural	29.3	52.6	72.9

Source: Global Findex (Global Financial Inclusion Database), *https://globalfindex.worldbank.org/* .

Figure A.1. Percentage of adults with a bank account, ENIF, 2018



Source: ENIF, INEGI 2018

6. **Lending to micro, small and medium enterprises is scarce in Mexico.** Only 12 percent of microenterprises received finance, while 32 percent of SMEs needed to invest but could not do so due to financial constraints.[35] Moreover, only about 5 percent of the bottom 40 percent borrowed from a financial institution in 2017.[36] This is even though microentrepreneurs have high rates of return on capital and thus would benefit from increasing access to finance. In Mexico, McKenzie and Woodruff (2008) estimate a return to capital of at least 20-30 percent a month, concentrated among firms that were more financially constrained. This is impressively high, particularly when compared to other countries such as Sri Lanka, where the calculated return to capital is of 4.6 and 5.3 percent per month (Del Mel, McKenzie and Woodruff, 2008).

[35] According to *Encuesta Nacional sobre Productividad y Competitividad de las micro, pequeña y medianas empresas* (ENAPROCE)
[36] Global Findex (Global Financial Inclusion Database), World Bank, Washington, DC, *https://globalfindex.worldbank.org/* .

Table A.2. Formal credit at a financial institution (% age 15+) by individual characteristics, 2011-2017

	Mexico		**Latin America & the Carib.**		**Upper middle countries**	
Borrowed from a financial institution or used a credit card	2014	2017	2014	2017	2014	2017
Total	18.3	11.8	24.8	20.8	22.1	22.4
Male	21.5	13.6	28.2	23.9	24.2	25.1
Female	15.2	10.3	21.7	18.0	20.1	19.8
Young adults (% age 15-24)	11.9	11.2	14.7	13.3	19.1	16.1
Older adults (% age 25+)	20.6	12.0	28.3	23.3	22.8	23.7
In labor force	22.2	15.3	29.9	25.2	25.7	27.0
Out of labor force	12.2	5.4	16.5	11.3	13.7	12.2
Primary education or less	9.5	7.3	15.2	12.0	11.8	13.7
Secondary education or more	25.2	14.1	31.1	25.6	33.4	30.6
Poorest 40%	9.3	5.2	14.3	11.9	12.3	13.9
Richest 60%	24.3	16.1	31.9	26.7	28.5	28.2
Rural areas	13.8	9.8	21.9	19.2	16.9	20.0

Source: Global Findex (Global Financial Inclusion Database), World Bank, Washington, DC, *https://globalfindex.worldbank.org/*.

Prior action#1: Electronic payments platform

The Borrower has developed a new electronic payment platform ("CoDi") and issued its supporting regulations, to provide safe and efficient person-to-business payments to better reach micro, small and e-commerce merchants, as evidenced by Banco de Mexico's Circular No. 8/2019, duly published in the Official Gazette dated May 20, 2019.

7. **Greater flexibility and security through innovations like CoDi in the national payments system can lead to greater financial inclusion and positive social and poverty impacts.** Most transactions in Mexico are currently done in cash. This is true for large transactions as well as for regular payments including taxes, fees, public and private services. The new electronic payments platform is expected to expand access to alternative electronic payment options, reducing the cost of doing business for micro and small firms and providing a path for these firms to establish a record in the financial system, potentially enabling a future access to credit.

Table A.3. Mexico. Forms of Payment Used

	For payments of MX500+			Form of payment used by type of transaction				
	National	Urban	Rural	Rent	Taxes or fines	Utilities: electricity, water, other	Private services: phone, cable, internet, other	Public transport
Cash	87.5%	83.5%	95.0%	89.8%	92.3%	95.2%	91.5%	97.6%
Debit card	9.3%	12.4%	3.3%	3.3%	4.0%	2.4%	4.2%	0.4%
Credit card	2.6%	3.3%	1.3%	0.3%	1.3%	0.6%	1.5%	0.2%
Electronic transfer	0.4%	0.5%	0.1%	3.6%	1.7%	1.3%	1.5%	0.1%
Check	0.1%	0.1%	0.1%	0.1%	0.1%	0.0%	0.0%	0.0%
Prepaid card	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	1.6%
Automatic debit to account/card	0.0%	0.0%	0.0%	1.5%	0.3%	0.4%	1.1%	0.1%
Other	0.2%	0.1%	0.2%	1.3%	0.3%	0.1%	0.1%	0.1%

Source: ENIF, INEGI 2018

8. **New technologies, such as CoDi, can lower transaction costs.** Mobile banking is a growing market in Mexico. In 2017, 5.6 percent of adults (aged 15+) had mobile money account. This represents a larger shared compared to the LAC region and to the average for upper middle income countries. The share of the population that made digital payments among the bottom 40 increased by 3 percentage points, more than the increase among the top 60 percent of 1.6 percentage points, showing that electronic payments are being taken up by the poorest. This is because financial technologies, such as debit cards and mobile accounts, lower indirect transaction costs by facilitating access to money and reducing the cost of checking balances.

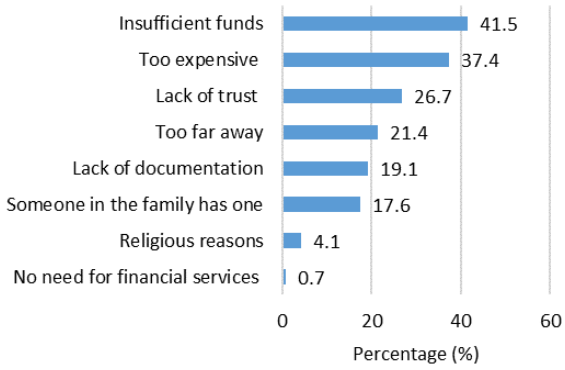
Table A.4. Mobile money account (% age 15+) by individual characteristics, 2014-2017

	Mexico		**Latin America & the Carib.**		**Upper middle countries**	
Mobile money account	2014	2017	2014	2017	2014	2017
Total	3.4	5.6	1.7	5.3	0.8	3.2
Male	4.1	7.1	1.1	3.0	0.4	1.8
Female	2.8	4.2	0.7	2.2	0.4	1.4
Young adults (% age 15-24)	6.0	11.6	0.6	1.7	0.2	1.0
Older adults (% age 25+)	2.5	3.5	1.1	3.6	0.6	2.2
In labor force	2.8	7.9	1.1	4.8	0.5	2.6
Out of labor force	4.4	1.3	0.6	0.4	0.2	0.6
Primary education or less	2.6	0.7	0.5	0.6	0.1	0.3
Secondary education or more	4.1	7.9	1.3	4.6	0.7	2.8
Poorest 40%	2.3	2.3	0.5	1.1	0.2	0.8
Richest 60%	4.1	7.7	1.2	4.1	0.6	2.4
Rural areas	3.6	4.0	0.9	2.2	0.4	1.4

Source: Global Findex (Global Financial Inclusion Database), World Bank, Washington, DC, *https://globalfindex.worldbank.org/* .
Note: people who report using mobile money service in the past 12 months

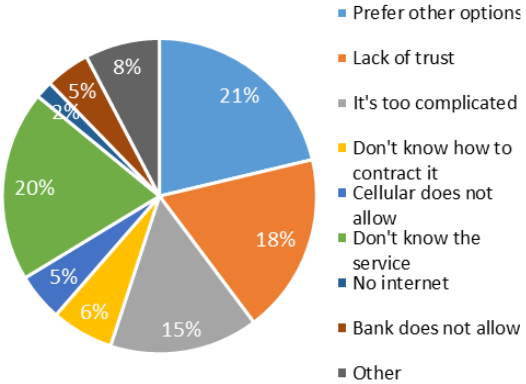
9. **Enabling a transparent environment through Codi is an opportunity to create trust in the financial sector, which is much needed.** In 2017, 26.7 percent of the unbanked population (aged 15+) declared the lack of trust in financial institutions as a barrier for owning an account in Mexico. Moreover, out of the 23.2 million of adults with a savings account that have not contracted mobile banking services, 18 percent declared it was because they lack trust, according to the ENIF 2018. The use of technology to disburse payments rather than cash has been proven to increase transparency and reduce corruption (Muralidharan, et. al, 2016). In fact, a secure payment infrastructure is an investment that could improve the implementation of social programs.

Figure A.3. Barriers for owning an account, Findex 2017



Source: Findex, World Bank, 2017

Figure A.4. Reasons for not using mobile banking services among account holders, ENIF 2018



Source: ENIF, INEGI 2018

Prior action #2: Access to credit using payroll accounts

The Borrower has issued regulations to create interbank mechanisms that facilitate individuals to use their payroll account as the designated source of repayment for loans with any bank in the system, to foster a broader access to credit under better terms and conditions, as evidenced by Banco de Mexico's Circular 15/2018, duly published in the Official Gazette dated October 29, 2018.

10. **Access to credit through payroll accounts would allow for financial inclusion of underserved populations and discourage informal lending.** Payroll accounts are the most common product among adults with banking account, with as much as 52 percent of the financially included population owning one such account (ENIF 2018). However, only 15.7 percent of payroll account holders had a payroll loan in 2018. Store credit and credit cards are the most common type of credit among payroll account holders, with 53.9 percent and 37.7 percent respectively. Moreover, about 7.5 percent have a personal loan instead of using their payroll account to acquire a credit and getting tied up to the conditions of the bank where their payroll is. These low rates of payroll lending contrast with the fact that nearly 40 percent of the population with a payroll account uses some type of informal loan, either from family, friends, money lenders, and pawn shops. Of these, as much as 16.3 percent of holders of payroll accounts resort to informal channels alone. This is problematic because using informal sources of credit, such as pawn shops and money lenders, imply a high cost of borrowing due to significantly higher rates. Pawn shops charge an annual percentage rate (APR) up to 5 times higher than traditional banks (Ruiz, 2010). In terms of gender gaps, a smaller share of female account holders has access to credit compared to male account

holders, and among those who do, fewer rely solely on formal loans compared to male account holders. Therefore, efforts to facilitate using payroll accounts as the designated source of repayment for loans has the potential to expand access to finance to unserved populations, including women.

Figure A.5. Type of credit across payroll account holders

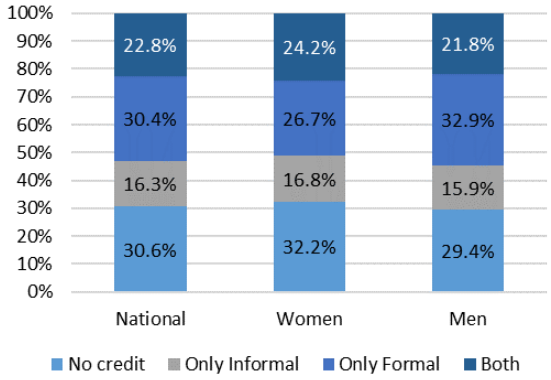
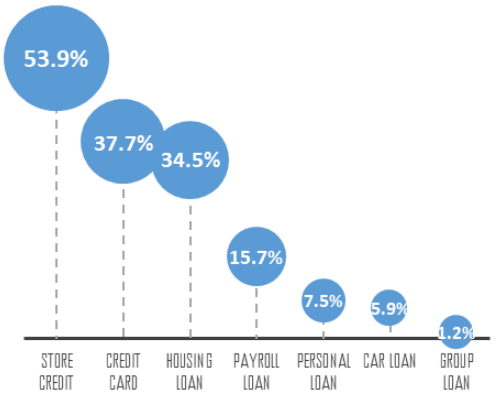


Figure A.6. Type of formal credit across payroll account holders



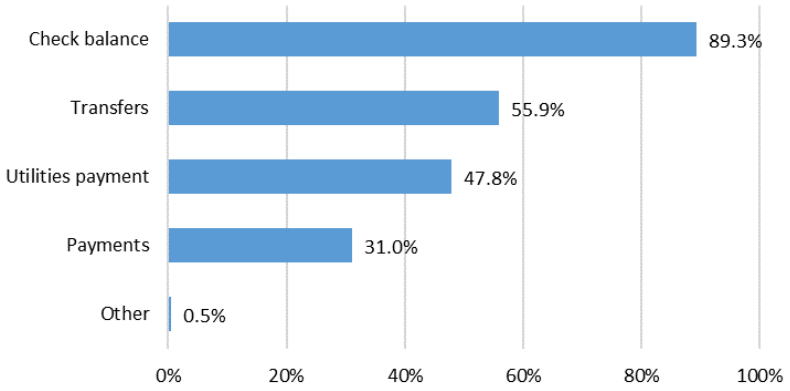
Source: ENIF, INEGI 2018

Prior action #3: Fintech legal basis
The Borrower has enacted the Law to Regulate Financial Technology Institutions, to mandate the establishment and regulate the operation of ITFs and technology-driven business models, products, and services to promote innovation, competition, and inclusion in the financial sector, as duly published in the Official Gazette dated March 9, 2018.

Prior action #4: Fintech Secondary Regulation
The Borrower has issued regulations regarding the licensing and operation of ITFs, as evidenced by CNBV's General Rules for ITFs and Banco de Mexico's Circular No. 12/2018, duly published in the Official Gazette dated September 10, 2018 and March 25, 2019, respectively.

11. **Financial Technology Institutions (ITFs) have the potential to increase the provision of financial services to traditionally unserved population and unlock their economic potential.** The use of technology to better deliver financial services holds great potential to reach populations that have been underserved by traditional banks and enable the poor to save. For instance, Bachas et al (2018) study a natural experiment in which debit cards are rolled out to beneficiaries of the CCT program in Mexico, who already received benefits in a savings account. The use of debit cards increases overall savings rate by 3-4 percent of the household income, as customers began trusting financial institutions. Debit cards are first used to check balances and gain trust that the money is safe. Over time, customers begin to take advantage of reduced transaction costs associated with debit cards and increase the amount of savings held in their bank accounts. In fact, the most common use of internet and mobile banking services in Mexico is as a monitoring mechanism to check balance (89 and 85 percent of mobile and internet banking customers use the service to check their balance). Moreover, the empirical evidence has shown that households work more when savings options improve, suggesting that the labor allocation channel is an important mechanism linking savings opportunities to income (Callen et. al., 2014, Suri and Jack, 2016).

Figure A.7. User-applications for internet and mobile banking, 2018



Source: ENIF, INEGI 2018

12. **Moreover, ITFs can reduce heavy collateral requirement and increase financial inclusion.** Alibhai et. al (2017) describe the potential that new technologies have for generating data on borrowers that can replace heavy collateral requirements. Financial institutions hold plenty of information on their customers that is barely used (business cash flow, assets, education, employment, etc.). However, this information can bridge the asymmetry between borrowers and lenders through a credit score that determines the probability of defaulting on a loan. Thus, an algorithm can be used to predict the credit worthiness of new borrowers instead of relying on high collaterals. This could be particularly important for financially excluded women, who are less likely to than men to own high-value assets that can served as collateral to obtain loans. In 2018, according to the ENIF, only 35 percent of women declared they own property or a high-value asset[37] compared to 58 percent of men.

13. **ITFs also have the potential of improving competition in the sector, which will have positive distributional impacts.** The banking sector remains concentrated in Mexico. The five largest banks account for about 70 percent of total bank assets.[38] Due to the lack of competition, overhead and administrative costs in commercial banks have not declined and intermediation margins have increased over recent years. Banks appear to allocate credit based on strong balance sheets and stable profits, common in firms with market power, and less on productivity growth, output, or wage growth rates. Ramos-Francia and Garcia-Verdu (2017) show that sectors with high levels of concentration in Mexico tend to obtain a high share of credit from banks, relative to firms in less concentrated sectors, with little regard to productivity growth. Thus, more credit is being allocated to less productive sectors, limiting the growth of the less concentrated sectors; while more concentrated sectors could be producing less than the socially optimal. Lopez (2017) estimates that the misallocation of resources due to credit constraints is estimated to lead to a loss in TFP of 10 percent, which represents 23 percent of the TFP gap between the US and Mexico.

[37] This includes land, vehicles, houses, offices, businesses, storages or any other kind of property.
[38] Estimated from CNBV data (2017)

Prior action #5: Regulatory Sandboxes
The Borrower has issued regulations for the operation of Regulatory Sandboxes, including eligibility criteria, oversight, and interinstitutional coordination, as evidenced by: (i) Banco de Mexico's Circular No. 5/2019; and (ii) General Rules for Regulatory Sandboxes issued by SHCP, CNBV, CNSF and CONSAR, published in the Official Gazette dated March 8, 2019, March 11, 2019, March 19, 2019, March 26, 2019 and March 8, 2019, respectively.

14. **Enabling a regulatory sandbox will allow for the development of regulation that keeps up with the fast pace of innovation and ensures that a broader segment of the population, including the poor and vulnerable benefit from improved financial services.** The purpose of the sandbox is to adapt compliance with strict financial regulations to the growth and pace of the most innovative companies in a way that does not smother the fintech sector with rules, but also does not diminish consumer protection. The regulatory sandbox will allow businesses to test new models and financial services. Coupled with improved supervision, a regulatory sandbox will ensure that a broader segment of the population benefit from improved financial services, while being protected from mismanagement and abuse**.**

15. **New technologies can simplify procedures and reduce costs to comply with regulations, ensuring financial services are expanded to unserved populations.** New technologies simplify operational processes, allow more detailed and less costly analytics that enhance transparency while maintaining personal privacy and security of the financial activity. For instance, in the case of cross-border payments and remittances, ITFs have been able to offer better and cheaper services, while lowering the cost of compliance with AML/CFT regulations. In the current system, cross-border payments and remittances move through multiple intermediaries, which adds opacity and an inherent operating cost. Automation of cross-border payments and remittances simplifies the process bypassing the current correspondent system and doing so reduces the opportunity for error or illegal activities in an inexpensive manner. By lowering the cost, an increase in remittances can help households to smooth consumption, ease capital constraints to invest in small business and increase household expenditure on education and health. Empirical evidence shows that the increase of income by remittances has positive effects on enrollment of children in school and increase in educational attainment (Alcazar, Chiquiar, and Salcedo, 2010; Antman, 2012; Hanson and Woodruff, 2003), reduces homicide rates (Brito et al, 2014) and alleviates poverty (Adams et. al, 2005).

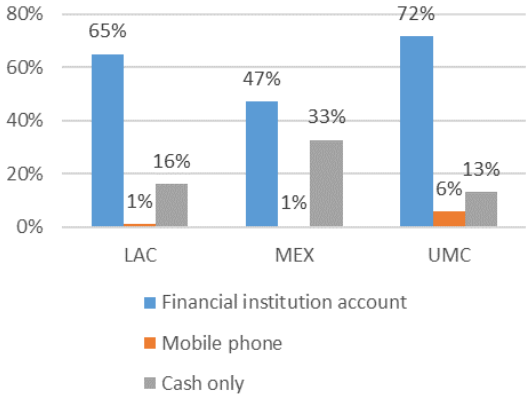
Prior action #6: Development Bank
The Borrower has submitted to its Legislature, for approval thereof, a bill of law to improve BANSEFI's mandate in supporting financial inclusion and its role in the distribution of social benefits to the poorest population, as evidenced by the Senate Gazette No. 114, Volume I, dated April 2, 2019.

16. **Evidence shows that the digitalization of transfers of the CCT program in Mexico resulted in a large increase in the access to finance of rural women.** Since 2009, the government began issuing debit cards to beneficiaries of the largest CCT program in Mexico who were previously receiving their benefits directly deposited into a BANSEFI savings account but had no associated debit card.[39] The card enabled

[39] With only 500 BANSEFI branches nationwide many beneficiaries incurred in large transaction costs. In 2016, 82 percent of BANSEFI clients were women and 63 percent were part of the CCT program.

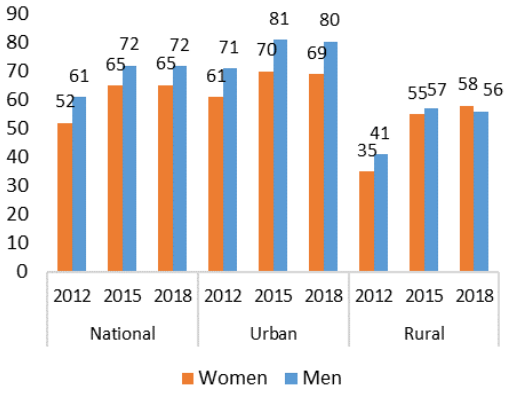
account holders to withdraw cash and check balances at any ATM and encouraged the use of other financial products. Because beneficiaries of the CCT program are all women and most of them live in rural areas, the distribution of debit cards had a large effect on reversing the gender gap in rural areas. In fact, financial inclusion for rural women increased by 23 percentage points between 2012 and 2018. Furthermore, after two years of the introduction of the debit card, beneficiaries saved an additional 3 to 4 percent of their income (Bachas et al, 2018).

Figure A.8. Received government transfers through…



Source: Global Findex 2017 (Global Financial Inclusion Database), *https://globalfindex.worldbank.org/*
Note: This includes payments for educational or medical expenses, unemployment benefits, subsidies, or any kind of social benefits. It does not include a pensions or public sector wages.

Figure A.9. Evolution of financial inclusion by gender and area of residence in Mexico



Source: ENIF, 2012, 2015 and 2018
Note: Financial inclusion is measured by the ownership of any financial product (savings account, credit, insurance and pension fund). Adult population aged 18-70.

17. **The reform of BANSEFI provides an important opportunity to strengthen financial inclusion through government transfers.** Despite recent progress, 1 out of every 3 government transfer recipients in Mexico continue to receive benefits through cash-based channels. While in other UMICs and in the LAC region 72 and 65 percent of beneficiaries received public transfers through financial institution accounts, only 47 percent did so in Mexico in 2017. Cash-based schemes require recipients to be physically present at a particular place and time to receive the payment, which is not only costly and inconvenient, but makes recipients vulnerable to robbery. Government-to-Person payments into banking accounts are often considered the first step in building the infrastructure to promote financial inclusion via branchless banking and debit cards.[40] The combination of technology with social transfer programs has the potential to reach and bank the poor because of the large number of beneficiaries that these programs serve. According to Findex, almost half of the population receiving public transfers into a financial account opened the account for that purpose in 2017. Overall, 11.4 percent of the population in Mexico has a banking account where they receive government transfers (ENIF, 2018).

18. **Fostering electronic public transfers can reduce fraud, corruption and government costs.** The lack of a secure payment infrastructure to make transfers to intended beneficiaries is one key constraint

[40] Government-to-person payments includes social transfers, pension payments, and wages.

in the effective implementation of social programs. When payments are made directly to instruments controlled by recipients, such as debit cards or mobile phones, the opportunities for corruption are reduced. Thus, building a secure payment infrastructure is an investment in state capacity that can lead to improved implementation of existing social programs. Evidence from countries such as Brazil, India, Mexico and South Africa, has shown that switching to an electronic payment infrastructure can substantially reduce administrative costs and "leakage" (Pickens, Porteous and Rotman, 2009; CGAP, 2012; Muralidharan et al, 2014).

19. **Despite the increase of account ownership in recent years to receive government transfers, it is crucial to go beyond access to foster usage in order to have an impact on welfare.** Notwithstanding the benefits of financial accounts and services, their active usage is low. Cash transfer recipients generally withdraw the entire transfer amount in one lump sum each pay period (Aker et al, 2016; Muralidharan et al, 2016). In 2018, barely 11.2 percent of the population who declared having a banking account to receive government transfers used it to save in the last year.[41] Moreover, only 37.7 percent declared to have a debit card associated with the account where they received the transfers, and of those, 67 percent do not use it to purchase goods (ENIF, 2018). It is critical to go beyond access to foster usage. The broadening of the menu of financial services offered by Banco del Bienestar, coupled with the effect of Fintech and improved payment platforms, could contribute to incentivizing greater usage of bank accounts.

[41] The percentage is consistent with findings from other countries such as Brazil, Colombia and South Africa (CGAP, 2012).

References

Adams, R.H., Lopez-Feldman, A., Mora, J., Taylor, J.E., DeWind, J. and Holdaway, J., 2008. Remittances, inequality and poverty: Evidence from rural Mexico. Migration and development within and across borders: Research and policy perspectives on internal and international migration, pp.101-130.

Aker, Jenny C., Rachid Boumnijel, Amanda McClelland, and Niall Tierney. 2016. "Payment Mechanisms and Antipoverty Programs: Evidence From a Mobile Money Cash Transfer Experiment in Niger." Economic Development and Cultural Change, 65: 1–37.

Alcaraz, C., Chiquiar, D. and Salcedo, A., 2012. "Remittances, schooling, and child labor in Mexico." *Journal of Development Economics*, 97(1), pp.156-165.

Alibhai, Salman; Achew, Mengistu Bessir; Coleman, Rachel; Khan, Anushe; Strobbe, Francesco. 2017. *Algorithms for Inclusion: Data Driven Lending for Women Owned SMEs.* World Bank, Washington D.C.

Antman, F.M., 2012. "Gender, educational attainment, and the impact of parental migration on children left behind". *Journal of Population Economics*, 25(4), pp.1187-1214.

Berg, G. and Zia, B., 2013. "Financial Literacy through Mainstream Media: Evaluating the Impact of Financial Messages in a South African Soap Opera." World Bank Working Paper, Washington, DC.

Brito, S., Corbacho, A. and Osorio, R., 2014. "Remittances and the Impact on Crime in Mexico" (No. IDB-WP-514). IDB Working Paper Series.

Bruhn, M., de Souza Leão, L., Legovini, A., Marchetti, R. and Zia, B., 2013. "Financial education and behavior formation: large-scale experimental evidence from Brazil". World Bank Working Paper, available at: http://siteresources. worldbank. org/NEWSLETTERS/Resources/442941-1360884692016/Financial_Education_IE_Feb_7_2013t. pdf.

Bruhn, M. and I. Love. 2014. "The Real Impact of Improved Access to Finance: Evidence from Mexico." *Journal of Finance*, 69:3, 1347-1376.

Brune, Lasse, Xavier Giné, Jessica Goldberg, and Dean Yang. 2016. "Facilitating savings for agriculture: Field experimental evidence from Malawi," Economic Development and Cultural Change, 64 (2016), 187–220.

Burgess, Robin, and Rohini Pande. 2005. "Can rural banks reduce poverty? Evidence from the Indian social banking experiment", *American Economic Review* 95, 780–795.

Cadena, Kiyomi. 2012. "The Impact of Retail-Owned Banks on Employment and Entrepreneurship: Evidence from Mexico", Master's Thesis, Faculty of the Graduate School of Arts and Sciences of Georgetown University.

Cai, J., De Janvry, A. and Sadoulet, E., 2015. "Social networks and the decision to insure". *American Economic Journal: Applied Economics*, 7(2), pp.81-108.

CGAP. 2012. "Social Cash Transfers and Financial Inclusion: Evidence From Four Countries." Consultative Group to Assist the Poor (CGAP) Focus Note 77.

Cole, S., Sampson, T. and Zia, B., 2011. "Prices or knowledge? What drives demand for financial services in emerging markets?", *The journal of finance*, 66(6), pp.1933-1967.

De Mel, Suresh, David McKenzie, and Christopher Woodruff. 2008. "Returns to capital: Results from a randomized experiment", *Quarterly Journal of Economics* 123, 1329–1372.

Dupas, Pascaline and Jonathan Robinson. 2013. "Why don't the poor save more? Evidence from health savings experiments", *American Economic Review*, 103 (2013), 1138–1171.

Fajnzylber P, Maloney WF, Montes-Rojas GV. 2009. "Releasing constraints to growth or pushing on a string? Policies and performance of Mexican micro-firms". *The Journal of Development Studies*. 2009 Aug 1;45(7):1027-47.

Gatti, R. and Honorati, M., 2008. *Informality among formal firms: firm-level, cross-country evidence on tax compliance and access to credit*. The World Bank.

Hanson, G.H. and Woodruff, C., 2003. "Emigration and educational attainment in Mexico". Mimeo., University of California at San Diego.

Kahn, Theodore A. 2017. "Elusive Alliances: Local Governments, Transnational Capital, and Regional Development in Post-reform Mexico". Doctoral Dissertation, SAIS, Johns Hopkins University.

Kast, Felipe, Stephan Meier, and Dina Pomeranz. 2016. "Saving more in groups: Field experimental evidence from Chile," Harvard Business School Working Paper 12-060, 2016.

Karlan, Dean, and Jonathan Zinman. 2010. "Expanding credit access: Using randomized supply decisions to estimate the impacts", *Review of Financial Studies* 23, 433–464.

Kochar, Anjini, 2005, "Social banking and poverty: A micro-empirical analysis of the Indian experience", Working paper, Stanford Center for International Development, Stanford University.

López, José Joaquín. 2017. "Financial frictions and productivity: Evidence from Mexico". *The Quarterly Review of Economics and Finance,* 66 (2017) 294–301

McKenzie, David, and Christopher Woodruff. 2008. "Experimental evidence on returns to capital and access to finance in Mexico", *World Bank Economic Review* 22, 457–482.

McKenzie, D. and Sakho, Y.S., 2008. "Does it pay firms to register for taxes? The impact of formality on firm profitability". The World Bank.

Muralidharan, Karthik, Paul Niehaus, and Sandip Sukhtankar. 2016. "Building state capacity: Evidence from biometric smartcards in India." *American Economic Review* 106.10 (2016): 2895-2929.

Panagariya, Arvind. 2006. "Bank branch expansion and poverty reduction: A comment". Working Paper, Columbia University.

Pickens, Mark, David Porteous, and Sarah Rotman. 2009. "Banking the Poor via G2P Payments." Focus Note 58. Washington, D.C.: CGAP and DFID.

Ramos-Francia, M. and García-Verdú, S. 2017. "Bank Credit Allocation and Sectorial Concentration in Mexico: Some Empirical Evidence". Working Papers 2017-14, Banco de México

Rodríguez-Oreggia, E., De La Fuente, A., De La Torre, R. and Moreno, H.A. 2013. "Natural Disasters, Human Development and Poverty at the Municipal Level in Mexico". The Journal of Development Studies, 49:3, 442-455

Rodriguez Zamora, Carolina. 2018. "Bank account ownership by microentrepreneurs in Mexico". Investigación Conjunta-Joint Research, in: María José Roa García & Diana Mejía (ed.), *Financial Decisions of Households and Financial Inclusion: Evidence for Latin America and the Caribbean,* edition 1, chapter 13, pages 429-461 Centro de Estudios Monetarios Latinoamericanos, CEMLA.

Ruiz, Claudia. 2010. "From pawn shops to banks: the impact of formal credit on informal households." Policy Research working paper; WPS 6634. Washington, DC: World Bank.

World Bank. 2018. Mexico - Systematic Country Diagnostic (English). Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/588351544812277321/Mexico-Systematic-Country-Diagnostic