

## Project Information Document

Project Name: Mexico-Bank Restructuring Facility Loan (BRFL)

Region: Latin America and the Caribbean

Sector: Finance

Project ID : MX-PE-P067491

Borrower: NAFIN

Guarantor: United Mexican States

Implementing Agencies: Bank Savings Protection Institute (IPAB)  
 Lic. Jose Antonio Meade  
 Secretario Ejecutivo Adjunto  
 Boulevard Manuel Avila Camacho No. 184 Piso 13  
 Col. Reforma Social. C.P. 11650 Mexico DF

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Project Board Date: December 14, 1999

## Country Sector and background

The Mexican economy has recovered from the Tequila episode of 1994-95. Previous bank resolution scheme under FOBAPROA, now under liquidation, was able to avert a systemic crisis and a run on the banks, but did not solve the problem of the insolvent and undercapitalized banks. The approval, in December 1998, of a law establishing the Banks Savings Protection Institute (IPAB), provides the framework and the incentives for a more effective resolution of the remaining problem banks, in a way that was not possible before. The new approach adopted by the Government to strengthen the banking sector and accelerate the resolution of the bank problems include:

Legal reforms to improve incentives in the banking sector by: (i) the gradual phase-out of the universal deposit insurance scheme, replacing it with one with limited coverage; (ii) the presentation to Congress of the Bankruptcy Law and the Secured Transactions Law; and (iii) the end to additional debtor relief programs ("Punto Final").

Regulatory reforms to improve Banks' capitalization and soundness: these include the change in the definition of bank capital, change in the loan classification norms according to risk; the phasing out of deferred taxes; the tightening of provisioning rules; changes in accounting standards (in the direction of USGAP) and higher provisioning rules.

IPAB's bank capitalization and resolution program. IPAB has under its purview the banks that had been assisted by the old FOBAPROA. There are four groups of banks in IPAB's program: (i) Two large banks recently intervened; (ii) three banks under the new restructuring program; (iii) intervened banks in the final stage of resolution/liquidation (12 banks); and (iv) banks under private capitalization programs.

IPAB's program for the disposition of bank assets. IPAB is in the process of outsourcing the sale of the mountain of loans purchased from banks to specialized asset management companies, in compliance with the timetable set in IPAB's law (5 years for banks under operation and 3 years for banks under liquidation).

#### Loan Objectives

The Bank loan would support the Government's bank restructuring program. Bank funds would help finance part of IPAB's debt-servicing needs arising from the implementation of its bank resolution program, complementing other sources of funds available to IPAB, such as: fiscal transfers, proceeds from asset disposal/recovery; and fees from deposit insurance premia. The proposed operation would be the first of a series of adjustment loans in support of Mexico's bank restructuring program, in particular the incremental cost of servicing the real component of IPAB's liabilities.

#### Loan Description

The Bank loan would support the first stage of the Government's program for bank restructuring, which is based on: (i) intervening, selling, merging or closing five banks and speeding the strengthening of the banking system through IPAB; (ii) improving market incentives in the financial sector through the introduction of a limited deposit insurance system to replace the universal deposit guarantee scheme; (iii) regulatory reforms to improve the quantity and quality of the banks' capital and enhancing transparency and disclosure; and (iv) speeding the sale of bank assets inherited or acquired by IPAB.

#### Loan financing

The proposed loan will be for US\$500 million, to be disbursed in three tranches. It is anticipated that all the tranches will be disbursed before the end of this administration.

#### Project Implementation

IPAB is the implementing agency for the operation. It will work with the Secretaría de Hacienda y Crédito Público (SHCP) and the National Banking and Securities Commission (CNBV) to ensure that the bank resolution transactions supported by this operation meet agreed eligibility criteria.

#### Program sustainability

The legal, institutional and regulatory changes that support the Government's bank restructuring program ensure the sustainability of the restructuring transactions supported by this operation. Congressional debates for the approval of the IPAB law have made clear to all stakeholders, including the public, of the urgency to tackle the financial resolution of the intervened and insolvent banks. The bank resolution transactions to be supported by this operation will be the restructuring, sale, merger, or liquidation of banks under IPAB's purview. These transactions will create stronger banks that will be able to operate and expand credit availability in the Mexican market.

#### Lessons learned from past operations in the country/sector

Lessons learned from past banking sector operations in Mexico and other countries have been taken into account in the design of this operation. These include: (i) a strong borrower ownership is indispensable in complicated, time-intensive banking sector operations; (ii) the operations should set limited objectives, because over ambitious objectives may be beyond a single operation; (iii) loan disbursements should be linked to the completion of specific bank transactions; and (iv) the main implementing agency should be the main recipient of the loan funds.

#### Poverty category

The proposed loan would have little social impact in the short-run. In the longer run, however, the measures supported by this operation would have important social implications as they would stimulate the resumption of prudent lending to the private sector, with the associated benefits in terms of output growth and employment generation. The ultimate objective of the bank restructuring/resolution process supported by the proposed operation is a better functioning banking sector, able to withstand external shocks and better able to lend to the private sector, opening access to groups and enterprises (SMEs) today largely excluded from bank financing. Greater access to credit by small and medium enterprises would create more job opportunities. A banking system less vulnerable to crises is a clear protection for the welfare of the poor, who tend to be the most severely affected by generalized banking system dislocations.

#### Environmental aspects

This operation would not have any direct effect on the environment. For that reason, it has been placed in Category "C", in accordance with the Bank's Operational Directive on Environmental Assessment (OD 4.00 Annex A).

Program Objective Category. The Program Objective Category is Economic Management (EA).

#### Contact Point

The World Bank InfoShop  
1818 H Street NW  
Washington , D.C. 20433  
Telephone: (202) 458-5454  
Fax: (202) 522-1500