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LADB Staff

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Independent Auditor Uncovers Corruption, Mismanagement in Bank Rescue Fund

by LADB Staff

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The auditor hired by the Mexican Congress to examine the failed savings-protection program (Fondo Bancario de Proteccion al Ahorro Bancario, FOBAPROA) uncovered ample evidence of corruption and mismanagement in the Mexican government's rescue of 13 financially troubled banks during a four-year period. The Chamber of Deputies hired Canadian auditor Michael Mackey in mid-1998 to conduct an audit of all transactions completed since FOBAPROA was created in 1995 (see SourceMex, 1998-09-30). Legislators demanded the audit as a condition for passing banking-reform legislation, which replaced FOBAPROA with the Instituto de Proteccion al Ahorro Bancario (IPAB) in December 1998 (see SourceMex, 1998-12-16).

Mackey's 300-page report, initially released only to the Chamber of Deputies, confirmed allegations by opposition parties that the Comision Nacional Bancaria y de Valores (CNBV) and other government regulators allowed and even encouraged corrupt practices that led to the collapse of FOBAPROA. Deputy Fauzi Hamdan of the center-right Partido Accion Nacional (PAN), who heads the committee that requested the report, said regulators allowed Mexican banks to issue thousands of imprudent loans and doctor books to disguise the poor financial health of some of these banks.

Marco Provencio Munoz, a spokesman for the Secretaria de Hacienda y Credito Publico (SHCP), said President Ernesto Zedillo's administration was not concerned about the report because it did not present any evidence that banking regulators acted outside the existing legal framework to rescue the financially troubled banks. Still, Provencio acknowledged the reprivatization of Mexican banks after 1991 left financial institutions with a lack of banking regulations that created the problems that led to the collapse of FOBAPROA.

Finance Secretary Jose Angel Gurria took a more confrontational stance, accusing the opposition parties of using Mackey's report as another excuse to attack the government and to "distort" public opinion. He criticized opposition legislators for publicizing portions of the report before the audit was released to the public. "These legislators should have used discretion and not publicized this material before its release," Gurria said.

Government refuses to turn over information on Banco Union

Mackey's report lacked documentation on certain transactions conducted by Banco Union, once owned by Tabasco businessman Carlos Cabal Peniche. In an interview with The Miami Herald in early June, Cabal accused the Partido Revolucionario Institucional (PRI) of using FOBAPROA to channel US\$25 million through Banco Union to fund the presidential campaigns of Luis Donaldo Colosio and Ernesto Zedillo and the campaign of Tabasco gubernatorial candidate Roberto Madrazo Pintado in 1994 (see SourceMex, 1999-06-09).

In follow-up interviews with The New York Times and with the Mexico City daily Reforma in early July, Cabal gave details on how campaign-financing laws were violated. Cabal said PRI treasurer Oscar Espinosa Villarreal and other party officials pressured him to use funds from his troubled banks Banco Union and Banca Cremi to pay US\$4 million in campaign expenses, including posters for Zedillo. If true, this would have been a violation of campaign-finance laws prohibiting donations by banks, said officials for the Instituto Federal Electoral (IFE). But Mackey's report did not confirm these allegations because the SHCP and the CNBV refused to turn over the relevant documents.

Deputy finance secretary Martin Werner said releasing these documents would violate banking secrecy laws. "By releasing this information, we would erode public confidence in our financial system," Werner said. The SHCP's stance outraged legislators from the PRD, PAN, and other parties, who threatened to take legal action to force the government to release the Banco Union information.

The PRD and the Partido del Trabajo (PT) said they would refuse to recognize the legitimacy of Mackey's report without the pertinent information on Banco Union. PAN legislators, however, said they would accept the auditor's report in its current form but would also continue to press for the release of the missing data. Hamdan said the PAN made this decision to avoid a prolonged confrontation with the government regarding the audits, which could slow efforts to rescue the financial system.

The PAN's willingness to accept Mackey's report without the Banco Union information created a rift with the PRD and the PT. They accused the center-right party of "granting impunity" to the executive branch and the PRI. With the Banco Union information absent from the Mackey report, opposition parties took matters into their own hands. In a press conference on July 6, Deputies Dolores Padierna and Jorge Silva of the PRD, Pedro Cortes of the PT, and independent legislator Marcelo Ebrard released financial documents confirming that more than 2.5 million pesos (US \$267,000) were donated to the PRI via Mexico's commercial banking system.

Meanwhile, the PAN kept its promise to press for the release of information relevant to the Banco Union case. On July 11, Deputy Santiago Creel and other PAN legislators presented documents to independent auditor Mackey confirming that the PRI channeled US\$5 million via Banco Union to the PRI's electoral organization in Tabasco state in 1994 to be used both for the gubernatorial and the presidential races.

The release of the information drew immediate criticism from the SHCP, which threatened a "political trial" against Creel for "improper use" of government documents, which were obtained from a previous case involving a challenge in the Tabasco gubernatorial election. "The PRI and the government are fighting to keep these matters secret because we're discovering how they used the banks like the party's own funding agencies," said Andres Manuel Lopez Obrador, the PRD candidate who lost the Tabasco gubernatorial race to Madrazo in 1994.

Bank-rescue costs expected to increase further

Meanwhile, concerns are growing that the mistakes that occurred under FOBAPROA will be repeated under IPAB. In early July, IPAB assumed control of Banca Serfin after the institution's

board of directors decided it was not in a position to inject fresh capital into the bank. By taking over Serfin, IPAB will have to inject 13 billion pesos (US\$1.4 billion) in fresh capital into the bank just to keep it solvent. Many legislators, including members of the PRI, have opposed the Serfin rescue (see SourceMex, 1999-06-30). Some banking-industry estimates indicate that the combined costs of FOBAPROA and new rescue operations under IPAB could total 951 billion pesos (US\$101.8 billion), the equivalent of almost 22% of Mexico's annual GDP. "Mexicans are going to be paying this off forever," said banking analyst Phil Guarco of Moody's Investors Service in an interview with Reuters.

Some PRD legislators raised concerns that the PRI will use the Serfin rescue to fund the 1999 presidential campaign in much the same way that Banco Union was used in 1994. "This operation, besides being a case of preferential treatment for one institution, could be used to manipulate and divert financial resources," said PRD Deputy Dolores Padierna. Meanwhile, IPAB executive secretary Vicente Corta said the government hopes to sell Serfin to a private buyer by the first quarter of 2000. One of Serfin's minority shareholders, British-based Hong Kong Shanghai Bank Group (HSBC), has already announced its intention to seek majority ownership of the institution. HSBC holds a 19.9% share in Serfin.

Corta said other foreign banks have expressed interest in Serfin, but he declined to identify these institutions. Reuters news service said Spain-based banks Bilbao Vizcaya (BBV) and Santander and Mexico's Banorte have been mentioned as possible suitors for Serfin. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on July 14, reported at 9.34 pesos per US \$1.00] (Sources: Associated Press, 07/06-08/99; The Dallas Morning News, 07/08/99; The New York Times, 07/07/99, 07/09/99; Proceso, 07/04/99, 07/11/99; Reuters, 07/06/99, 07/08-10/99, 07/13/99; Notimex, 07/13/99; La Jornada, 07/01/99, 07/07-09/99, 07/12-14/99; El Universal, 07/02/99, 07/06-09/99, 07/12-14/99; Novedades, 07/07/99, 07/08/99, 07/09/99, 07/12/99, 07/14/99; El Economista, 07/07/99, 07/08/99, 07/12/99, 07/14/99; Excelsior, 07/07/99, 07/08/99, 07/12/99, 07/14/99; The News, 07/09/99, 07/14/99)

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