8-11-2004

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LADB Latin America Data Base News & Educational Services SourceMex
LADB Article Id: 52325
ISSN: 1054-8890

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by LADB Staff
Category/Department: Mexico
Published: 2004-08-11

President Vicente Fox's administration has reached an agreement with the country's four largest banks to settle a longstanding dispute regarding disposal of debt related to the economic crisis that followed the 1994 peso devaluation. The crisis forced the federal government to acquire about US $20 billion in bad debt from the banking system to prevent a major banking crisis (see SourceMex, 1995-03-15).

Under the agreement reached in mid-July with the Secretaria de Hacienda y Credito Publico (SHCP) and the Instituto de Proteccion al Ahorro Bancario (IPAB), the four banks will forgo 9.5 billion pesos (US$830 million) in bailout notes in exchange for a government pledge to limit the audit on loans that were transferred to the Fondo Bancario de Proteccion al Ahorro (FOBAPROA).

In 1998, Congress created the IPAB to replace the financially ailing FOBAPROA (see SourceMex, 1998-12-16). The banks will receive about 107 billion pesos (US$9.3 billion) in new bonds issued by IPAB and return around 226 billion pesos (US$19.8 billion) in FOBAPROA notes. They also agreed to open sealed working papers from a 1998 audit. Three of the four banks Banamex, Bancomer, and Bital have since been acquired by foreign institutions. Banamex is now a subsidiary of US-based Citigroup, Bancomer is an affiliate of Spain's Banco Bilbao Vizcaya Argentaria, and Bital is owned by Britain's HSBC Holdings. The fourth bank, Banorte, is fully owned by Mexican investors.

The administration's agreement with the four banks elicited mixed reactions in Congress. "This is the beginning of the end," said Manuel Perez Cardenas, a member of Fox's center-right Partido Accion Nacional (PAN). "This a very good agreement for everyone. I don't see any need for Congress to intervene."

Critics say banks should not get any more public funds

Critics included prominent legislators from the center-left Partido de la Revolucion Democratica (PRD) and the former governing Partido Revolucionario Institucional (PRI). Some of these critics had pushed to cancel some bailout operations on the grounds that banks did not qualify for the rescue loans.

As recently as 2003, Congress tried unsuccessfully to force the banks to return bank-rescue funds (see SourceMex, 2003-09-04). The critics also point to a report by independent Canadian consultant Michael Mackey, which found some bailout operations to be questionable (see SourceMex, 1999-07-14). Mackey was hired by Congress to review the FOBAPROA operations. "How can they authorize this agreement if the previous requirement [that the banks be audited] has not been fulfilled?" said PRI Sen. Luis Rico Samaniego. "They negotiated this [agreement] very quietly."

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Deputy Alfonso Ramirez Cuellar, economic coordinator of the PRD in the lower house, criticized the use of additional public funds to settle with the banks. "This represents the largest assault on public finances during the Fox government," said Ramirez. PRD Deputy Dolores Padierna dismissed the administration's assertion that the agreement would save overall costs to the Mexican Treasury. "This is absolutely false," said Padierna, who noted that the government in the end would assume 75% of the losses related to FOBAPROA. "The taxpayers are being cheated."

Finance Secretary Francisco Gil Diaz, who was summoned to testify before Congress in late July, defended the agreement with the four banks, saying it helped reduce the fiscal costs of the bank-rescue program by more than 50%. He also denied that the administration was favoring the banking sector over society. "It is absurd to allege that we have acted to protect the interests of the banks," Gil told Congress. Whether or not the administration intentionally sought to favor the four financial institutions, the agreement will benefit the Mexican banking sector because it eliminates uncertainty related to the original FOBAPROA loans. "This is a potentially positive development for the Mexican banking sector in general," said Paul Tucker, a banking analyst at Merrill Lynch.

Five foreign-owned banks report strong profits

The agreement comes at time when the banking sector is facing continued criticism for severely limiting credit and charging high fees, particularly on credit cards. The banks acknowledge that the high commissions have resulted in higher profits. In the first half of the year, the five banks that are fully or mostly owned by foreign institutions reported net profits of 18.5 billion pesos (US$1.6 billion), an increase of 49% from January-June 2003.

The list includes Banco Santander Central Hispano (BSCH), which acquired Grupo Financiero Serfin in 2000, and ScotiaBank Inverlat, which has majority Canadian ownership. In contrast to the high profits, the banking sector has come under criticism for contributing little to the Mexican economy. In a recent report, the Banco de Mexico (central bank) said the Mexican manufacturing and service sectors rely on banks for only 18% of their loans, compared with 57.4% from other sources. This pattern has changed little during the past two years despite the increasing ability of banks to provide loans (see SourceMex, 2003-03-12).

Some critics say the influx of foreign capital to the Mexican banking system has made financial institutions less responsive to customers. "There is ample evidence that the failure of the bank-rescue program forced financial authorities to turn to foreign entities [for an influx of capital]," said Mario Di Costanzo, who serves as a financial adviser to the PRD. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Aug. 11, reported at 11.41 pesos per US $1.00] (Sources: Notimex, Reuters, 06/02/04; Dow Jones news service, Bloomberg news service, The New York Times, 07/15/04; Revista Vertigo, 07/25/04; El Financiero, 06/03/04, 07/15/04, 07/16/04, 07/27/04; Unomasuno, 07/27/04; La Cronica de Hoy, 06/02/04, 06/03/04, 06/17/04, 07/13/04, 07/16/04, 07/19-21/04, 07/27/04, 07/28/04; La Jornada, 06/02/04, 06/15/04, 06/16/04, 07/06/04, 07/14-16/04, 07/19/04, 07/20/04, 07/27-29/04, 08/02/04; Agencia de noticias Proceso, 07/19/04, 07/27/04, 08/04/04; The Herald-Mexico City, 06/24/04, 07/16/04, 07/27/04, 08/10/04; El Universal, 06/03/04, 06/07/04, 07/14-16/04, 07/20/04, 07/28/04, 08/10/04, 08/11/04

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ISSN: 1054-8890

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