Beyond the Border

Financial Globalization: Manna or Menace? The Case of Mexican Banking

While international capital markets have been developing for some time, direct foreign entry into the domestic banking sector of many countries has occurred only recently. Similarly, while consolidation of the financial services industry is not new, it is now beginning to transcend national borders in a more substantial way. These changes have occurred as a growing number of countries have considerably loosened long-standing restrictions on the foreign ownership of banks, thereby allowing financial globalization to advance on an unprecedented scale.

Most significant policy changes have their advocates and opponents, and the recent liberalization allowing global banking services is no exception. Advocates say global banking promotes improved practices and financial stability. But opponents claim foreign banks may lack commitment to the host country or be inordinately competitive with domestic banks, resulting in risk too great for domestic bank supervisors to control. As global banking grows, the debate continues.

The situation in Mexico may shed light on this debate. The globalization of Mexican banking began in early 1994 with the North American Free Trade Agreement (NAFTA), which represented a significant step away from the country’s history of a closed banking system. The peso devaluation of December 1994 subsequently put Mexico’s banks on the brink of failure. Since then, however, Mexico has made numerous moves to stabilize both its economy and financial system, including further liberalization of foreign banking restrictions.

This process of deregulation, coupled with technological and economic factors propelling a general trend toward globalization, recently culminated in the foreign acquisition of the three largest Mexican banks, all within less than 18 months. As a result, Mexico is the largest economy in the world where such an overwhelming majority of commercial bank assets—almost 80 percent—are controlled by foreign financial institutions. As such, Mexico provides a fertile testing ground for assessing the merits of the arguments for and against financial globalization. While this new chapter in Mexico’s modern history is only just beginning, the early evidence strongly favors an open policy toward global banking.

A Little History

Prior to NAFTA, individual foreign banks could hold no more than a 5 percent stake in a Mexican bank, and total foreign ownership in any single bank was limited to 30 percent. The only exception was granted to a U.S. institution, Citigroup, whose presence dates back to 1929, when it opened a branch bank in Mexico. This branch was allowed to continue operating, albeit under substantial regulatory restrictions.

NAFTA opened the Mexican banking system to foreign banks by permitting entry through the establishment of newly chartered subsidiaries. In 1994, Citigroup converted its branch into a separate legal subsidiary, and Banco Santander Central Hispano (BSCH) of Spain established a presence in Mexico. In 1995, 13 other U.S., European and Japanese banks entered the Mexican market through the establishment of new charters. Most of these banks formed a holding company, or grupo financiero, which held their banking interests in addition to other financial subsidiaries, such as leasing companies and broker-dealers.

Near the end of 1994, the Mexican peso was devalued, highlighting the growing strain in the banking system, which was damaged severely in the economic crisis that ensued. To attract much-needed capital, the Mexican Congress passed financial reform permitting foreign investors to acquire all or part of most existing banks. Still, foreign acquisition of the three largest banks was effectively prohibited. These reforms led to the acquisition of medium-sized commercial banks (between $5 billion and $10 billion) by Banco Bilbao Vizcaya Argentaria (BBVA) of Spain in 1996 and BSCH in 1997. In addition, Citigroup expanded through the acquisition of Banca Confía, a medium-sized bank, in 1998. Each acquisition involved some form of financial assistance from the Mexican government. The government, meanwhile, took management control of 14 additional troubled banks.

By year-end 1998, Mexico already had more foreign than domestic banks. However, foreign banks controlled only 20 percent of banking system assets. BBVA, BSCH and Citigroup controlled 7, 6 and 5 percent of total commercial bank assets, respectively. None of the other foreign banks had a market share greater than 1 percent.

Legislation removed all remaining market-share limitations on foreign ownership in December 1998 and created a deposit insurance and asset-resolution agency, Instituto para la Protección al Ahorro Bancario (IPAB), with stronger and well-defined powers, unlike its predecessor. Subject to overview by the Mexican Congress, IPAB immediately began resolving government-intervened banks through the auction of bank assets and, in some cases, entire banks, to domestic and foreign buyers.

Catalysts for Globalization

In addition to deregulation, other forces in Mexico and around the world have propelled the country toward greater integration with the international community.

The economic fundamentals Mexico currently enjoys, especially in comparison with those of many other developing markets, have further increased the bank-
ing system’s attractiveness to foreign suit-
sors. In addition to comprehensive finan-
cial system reform and modernization, 
Mexico has implemented and maintained 
strict monetary and fiscal discipline. Mexico 
has successfully hit inflation targets in 
recent years and anticipates an inflation 
rate of about 3 percent by 2003, com-
pared with 52 percent in 1995. The presi-
dent and Congress have exhibited a com-
mitment to reining in public spending, as 
evidenced by a shrinking budget deficit, 
and the political system itself has proven 
to be stable.

Common currencies, economic com-
unities and trading blocs are elimi-
nating obstacles to global expansion, a 
primary example being the European 
Community and the euro, which have 
facilitated merger activity among Euro-
pean banks. In this regard, while Mexico 
has a local currency, almost one-third of 
its bank assets and liabilities are denom-
inated in U.S. dollars, and the Mexican 
peso has been relatively stable in recent 
years. Moreover, trade with the United 
States has flourished under NAFTA.

Additionally, technological innova-
tions have changed bank products and 
revolutionized delivery systems. Advances 
in telecommunications and the Internet 
have especially benefited global expan-
sion by enabling financial transactions 
and managerial control to easily traverse 
geographic boundaries. Such develop-
ments have reduced the information bar-
rier traditionally associated with the dis-
tance between an organization’s head 
office and its subsidiaries.

Large-Scale Foreign Entry

Spurred by these developments, a 
rapid-fire sequence occurred in which 
foreign banks acquired Mexico’s three 
largest banks in less than a year and a 
half.5 In May 1999 IPAB took control of 
Grupo Financiero Serfin, and in May 2000 
this financial group was auctioned to 
BSCH. Immediately following this trans-
action, BBVA acquired a controlling in-
terest in Mexico’s second-largest financial 
group, Grupo Financiero Bancomer. The 
transaction was consummated in August 
2000, dramatically increasing BBVA’s stake 
in Mexico and making the newly formed 
Grupo Financiero BBVA Bancomer the 
country’s largest banking group. This 
aquisition was the first significant for-
egn acquisition completed without finan-
cial assistance from the Mexican govern-
ment. In the second quarter of 2001, Citigroup 
announced it would buy Grupo 
Financiero Banaccí Accival (Banacci), 
which owns Banco Nacional de México 
(Banamex). The transaction was com-

Reflecting these acquisitions, the Mexi-
can commercial banking system cur-
cently consists of 11 domestic and 19 for-
egn organizations.6 The foreign banks 
include nine U.S. institutions, two Span-
ish banks, six other European banks, 
one Canadian bank and one Japanese 
bank. Foreign banks now hold nearly 79 
percent of total commercial bank assets 
(Chart 1). Together, BBVA, Citigroup and 
BSCH hold 66 percent of these assets.

Mexico is not alone in these devel-
opments. Latin American banks in gen-
eral have often been targets for foreign 
acquisition in recent years. As shown in 
Table 1, foreign banks now maintain a 
substantial presence in most Latin Amer-
ican countries. However, Mexico stands 
out in terms of the extent of foreign 
banking, especially given the large size 
of its economy.

Benefits for Mexico

Insufficient time has elapsed to com-
prehensively assess any differences in 
overall banking system performance 
resulting from foreign institutions’ promi-
nence in the Mexican banking system. 
Nevertheless, the trends have been posi-
tive. Each of the acquired banks has 
reported success in cutting costs, result-
ing in improved earnings and increased 
pressure on domestic banks to rationalize 
their own operations in order to remain 
competitive. As the cost synergies associ-
ated with recent acquisitions are fully 
realized, further operating-expense reduc-
tions are expected. More important, the 
capital adequacy of the three largest banks 
has improved, in some cases through 
capital injections provided by the new 
foreign parent companies.

In broader terms, the institutional 
changes since Mexico opened its bank-

### Chart 1

**Market Share of Foreign-Owned Banks in Mexico**

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent</th>
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<tbody>
<tr>
<td>'93</td>
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SOURCE: Comisión Nacional Bancaria y de Valores.

### Table 1

**Foreign Bank Presence in Latin America**

<table>
<thead>
<tr>
<th>Country</th>
<th>2000 GDP (billions of U.S. dollars)</th>
<th>Foreign Bank Market Share (percent)</th>
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<tbody>
<tr>
<td>Brazil</td>
<td>1,194</td>
<td>24.0</td>
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<tr>
<td>Mexico</td>
<td>875</td>
<td>78.8</td>
</tr>
<tr>
<td>Argentina</td>
<td>403</td>
<td>54.7</td>
</tr>
<tr>
<td>Colombia</td>
<td>231</td>
<td>24.1</td>
</tr>
<tr>
<td>Chile</td>
<td>219</td>
<td>47.0</td>
</tr>
<tr>
<td>Venezuela</td>
<td>205</td>
<td>49.7</td>
</tr>
<tr>
<td>Peru</td>
<td>133</td>
<td>67.9</td>
</tr>
<tr>
<td>Ecuador</td>
<td>59</td>
<td>8.7</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>53</td>
<td>7.0</td>
</tr>
<tr>
<td>Uruguay</td>
<td>33</td>
<td>39.2</td>
</tr>
<tr>
<td>Bolivia</td>
<td>27</td>
<td>7.1</td>
</tr>
<tr>
<td>Panama</td>
<td>23</td>
<td>54.7</td>
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<tr>
<td>El Salvador</td>
<td>20</td>
<td>13.0</td>
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<tr>
<td>Jamaica</td>
<td>10</td>
<td>59.0</td>
</tr>
</tbody>
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NOTES: The Mexican market share is as of June 30, 2001, and reflects the pro forma Citigroup–Banamex combination. All other market shares are as of year-end 2000, but the Jamaican market share reflects the pro forma foreign acquisition of the country’s third-largest commercial bank in 2001.

SOURCES: GDP data are from the International Monetary Fund; market share data were compiled by various Federal Reserve Banks, through public information available from central banks and other supervisory agencies in individual countries.
Globalization Concerns Misguided

The path of progress has admittedly been a rough one for Mexico, as evidenced by the 1994 peso devaluation. But from a longer term perspective, even the peso crisis and its associated banking problems proved to be positive in that they helped spur the improvements and modernization subsequently undertaken by governing authorities and Mexican banks.

Opponents often emphasize the perceived weaknesses of an open financial system by referring to examples, such as Mexico’s, of financial liberalization followed by financial crisis. But this ignores the underlying institutional and policy problems that typically have accompanied financial crises. A more thorough assessment would consider the possibility that adverse financial developments in the context of a deregulated environment might reflect deeper problems, rather than being the direct result of financial liberalization itself.

In Mexico’s case, the 1994 peso crisis highlighted, among other things, the need to pursue the types of improvements to the financial infrastructure that Mexico has since successfully undertaken. Only through these efforts have domestic banking practices, the supervisory process, information quality and corporate governance been made commensurate with the demands of the global marketplace.

A Positive Direction

Mexico has established a strong foundation for economic growth and prosperity. Accompanying the banking sector’s openness to foreign ownership and competition has been a large-scale modernization of regulatory practices and accounting standards, together with significantly increased disclosure and corporate governance requirements. In addition to opening its banking sector, Mexico has signed 10 free trade agreements in recent years, encompassing 35 countries that account for more than half of the world’s GDP.

More time must elapse before the full effect of these changes on financial and economic performance can be assessed. Nevertheless, developments point firmly in a positive direction, especially in terms of the banking system’s capital adequacy.

Reflectioning Mexico’s financial success, the peso has remained fairly stable over the past three years, whereas the currencies of many other major Latin American countries have depreciated.

Within less than 18 months, Mexico’s three largest banks were bought by foreign institutions. Cause for concern? We think not. Rather, Mexico’s policy of openness is likely to result in continuing economic benefits far greater than what was widely expected only a few years ago.

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Notes

1 An excellent discussion of these opposing views and related points can be found in the remarks by Robert W. Ferguson, Jr., before the International Banking Conference, Federal Financial Institutions Examination Council, Arlington, Va., July 20, 1998. See www.federalreserve.gov, under the section titled “Testimony and Speeches.”

2 At the time, BBVA was known as Banco Vizcaya Bilbao and BSCH was known as Banco Santander.

3 The government does not report the assets of intervened banks, and therefore these assets are not included in the total. If the assets of intervened banks were counted, the market share calculated for foreign banks would be somewhat lower.

4 Entry is still permitted only through a separate, Mexican-chartered subsidiary. No branches or offices of foreign banks can be established in Mexico.

5 In addition, during 2000, a Canadian bank acquired a medium-sized Mexican bank it had managed for the government since 1995.

6 The government currently controls 11 intervened banks, including one small bank that was intervened in 2001. Resolution of the largest intervened banks has been arranged through agreements with local banks. The remaining intervened banks are essentially shells, as the most valuable assets and deposits have already been sold. Recently, IPAB announced that the licenses for seven of these banks will be formally revoked and the banks fully liquidated.