



## **I. INTRODUCTION**

The Institute for the Protection of Banking Savings (IPAB), created in 1999, is a decentralized agency of the Federal Government that has its own law(s) and budget. IPAB is the agency in charge of the DIS in Mexico, responsible for protecting bank deposits, providing an explicit limited coverage. IPAB also defines and implements banking resolution methods at commercial banks that run into solvency or liquidity problems and administers and sells assets associated with banking resolution programs, among others.

IPAB has implemented deposit payouts in four occasions, the last one occurred on December 2002 in *Banco del Sureste*. This paper focuses in the reimbursement process of *Banco del Sureste*.

## **II. FINANCIAL AND REGULATORY OVERVIEW**

There are mainly four government institutions involved in the Mexican financial safety net.

The Ministry of Finance and Public Credit (SHCP) is the one in charge of the planning, coordination, evaluation and oversight of the financial system. As of 2002, the SHCP authorized and revoked the operating licenses of the banks. The Central Bank, or Banco de Mexico, is an autonomous entity in charge of preserving the stability of the purchasing power of the currency, promoting a sound financial development, and of the functionality of the payments system. Also, in terms of its role on the financial safety net, Banco de Mexico is the lender of last resort. The National Banking and Securities Commission (CNBV) is the supervisor and regulator of the financial services industry. The role of the IPAB in the financial safety net is that of the deposit insurer. IPAB is also responsible for the implementation of bank resolution methods.

As of December 2002, the process of resolving a bank could be carried through liquidation using a deposit payout, or implement a bank open assistance, if the results of an in-depth analysis stated that a bank open assistance, would be the least-cost method and that the bank, after the assistance, could remain viable.

In 2002, the Mexican commercial banking industry consisted of 34 banks, including Banco del Sureste.

## **III. GOVERNING STATUES AND RECEIVERSHIP LEGAL POWERS**

In late 1994 and early 1995, Mexico experienced a financial crisis. In March 1998 the President sent several bills to the Mexican Congress designed to reduce the risk assumed by banks and the probability of another crisis and outlining the scheme to be used to manage asset and liability operations resulting from measures the authorities took in response to the crisis, seeking to minimize the associated fiscal cost.

In December 1998 the federal congress passed the Law of Banking Savings Protection (LPAB), it was published by the president in the Official Gazette of the Federation on January 19, 1999, taking effect on January 20 of the same year, making way for the creation of the IPAB.

The LPAB represented significant differences in relation to savings protection compared with previous legislation. Some of the most relevant changes were the following:



1. Limited and explicit insurance coverage:

When the LPAB was passed, IPAB introduced a program to reduce the coverage of guaranteed obligations that began in June 1999 and ended January 1 2005. The objective of this program was to gradually reduce the amount and types of accounts insured by IPAB. The program had seven stages: the first four consisted in the reduction in the types of accounts insured by IPAB, and the rest, beginning in January 2003, reduced the amount insured. On January 1, 2005, the permanent coverage regime for up to 400 thousand UDIs<sup>1</sup> per natural or legal person and per bank took effect.

2. Introduction of a clear payment process:

Before proceeding to pay guaranteed obligations, IPAB will publish the relevant payment procedure, within five business days after taking possession of the position of liquidator. IPAB will pay the bank's guaranteed obligations within ninety days after taking possession of the position of liquidator.

By virtue of its payment of the bank's guaranteed obligations, IPAB will be subrogated in creditor's rights in the bank's liquidation, with the privileges corresponding to the persons to which such payment is made, for up to the amount covered.

The amount that exceeds the insured limit in guaranteed obligations may be claimed by the owners of the accounts directly from the bank in liquidation, in accordance with applicable legal, regulatory, and administrative provisions.

#### **IV. RESOLUTION PROCESS AND TRANSACTIONS OVERVIEW**

*Banco del Sureste* was a regional bank with more than 42,000 clients and a structure of 22 branches distributed in Mexico City and in the southeast cities of Merida, Campeche, Ciudad del Carmen and Cancun.

Financial Group del Sureste (FG del Sureste) was created on December 1992, and consisted of a brokerage firm, a financial leasing company and a factoring firm. On June of 1993, FG del Sureste gains the authorization from the SHCP to create a bank called *Banco del Sureste*.

Due to the financial crisis of 1994, the financial group and specially Banco del Sureste and the brokerage firm called Bursamex, began to have solvency problems. With the object of helping Bursamex, Banco de Mexico, through the Securities Market Support Fund (FAMEVAL), gave Bursamex a 1,300 million loan, with a guarantee that consisted in all the stocks of the brokerage firm plus all the stocks except one of the rest of the entities that formed the financial group: Banco del Sureste, the financial leasing company and the factoring firm.

The administration of FG del Sureste presented several capitalization programs, however, for the CNBV and for Banco de Mexico these were insufficient because they didn't cover the necessary capital and the loan granted by FAMEVAL.

As a result, on may 1996, the CNBV declared the intervention of the financial entities that formed FG del Sureste, due to several irregularities that affected the stability and solvency of the institutions.

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1. UDIS are inflation adjusted units of account. As of December 31, 2009, 400,000 UDIS were equivalent to 1.7 million pesos (USD \$132,943)



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Since its intervention, Banco del Sureste closed its active operations and concentrated in granting a good service to its deposit clients. The reduction of market rates, the little business volume, and high administrative expenses in relation to the little business volume generated a negative financial margin that caused a monthly loss of approximately 20 million pesos since January 2001. As of March 2002, Banco del Sureste had accumulated a negative equity of 1,290 million pesos.

On November 26 of 2001, the CNBV required IPAB to decide which resolution method implement in Banco del Sureste. On May 20 of 2002, IPAB hired a specialized third party to make an in-depth analysis to determine the most convenient and least cost of the following resolution methods: an open bank assistance or a deposit payout. The result of this analysis was given to IPAB on July 18 of 2002, and stated that the best alternative was a deposit payout, since it represented with a higher certainty the least cost method in comparison with several open bank assistant scenarios.

The deposit payout process began on December 2 of 2002, and the legal time frame to present the claim forms ended on January 31 2003.

### Pre –closure activities

Given the fact that the bank was intervened by the CNBV, IPAB had access to the bank's database and files. Three months before the bank's license was revoked IPAB analyzed the information available concerning the bank's liabilities.

Several efforts were made in order to increase the quality of the depositors information. Also, the database was adjusted so it had the proper format and characteristics in order to be recognized by the deposit insurance systems that were in place at that time, allowing deposit's balance projections.

IPAB proceeded to analyze the installations branches access and inventories to make sure they had everything ready to receive the claim forms and to make the payments.

### Pre-payment arrangements

A total of 250 people were trained for the payment process, and the computer systems were improved. Also, IPAB had to evaluate the level of response, number of people in each branch, adjust the number of computers, and the space required to avoid depositor crowding. A system of appointments was implemented to control the number of depositors in the branches. A total of 6,859 appointments were made.

Announcements were attached in all the branches to inform the depositors of the process, and they were also distributed in malls and main gathering centers in Mérida, Valladolid, Ciudad del Carmen, Campeche and Cancun. Depositors that had in their files phone numbers were called to inform them of the process and other depositors were contacted through mail sent to them. Advertisements were published on local newspapers. A call center was prepared and it received 16,447 calls.

### Payment process

The reception of claim forms was made in the 22 branches that Banco del Sureste had, 9 of them were located in Mexico City and 13 were located in the southeast, mainly in the city of Merida, Yucatan. The claim forms were sent to Mexico City, and all the steps required to implement the payments were made in Mexico City.



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There were 42,997 clients, of whom 36,130 had 1,000 pesos or less in their banking accounts. For this reimbursement process, the version 3 of the Deposit Payout System was used, which incorporated, additionally to the simplified proceeding already used in past payouts, cash payments made directly in the bank’s branches for those clients with accounts that didn’t exceed 1,000 pesos. This made possible the immediate payment of 30% of all the depositors that presented their claim form.

The average time that IPAB took to deliver a response for the claim forms was 7 work-days, which included the travel time of the files from southeast Mexico to Mexico City.

From the 10,221 requests that were presented, 10,089 were resolved favorably, and amounted 1,863 million pesos, which corresponded to 99.8% of the total value of insured deposits. 90 requests were rejected because they fell under the exclusions that are stated in the LPAB.

To evaluate the level of attention that was offered to the depositors, 597 satisfaction surveys were implemented, from which more than 90% of the clients manifested that the process and attention received was excellent/good.

Due to the implementation of the new version of the process, it was calculated that a 10 million pesos saving was generated in comparison to the cost of utilizing past versions of the process.

It was approved that the operative costs and expenses of the process that could be generated due to the deposit payout, were going to be assumed as a liability for the banking institution in liquidation or receivership.

IPAB’s Governing Board established as policy, that in those cases in which the Institute has to implement a deposit payout and the funds from fees that banks have contributed to the preventive fund are insufficient to meet its obligations, IPAB is allowed to use the resources approved in the Expense Budget of the Federation (PEF) and if these resources are insufficient, then it can, by law, contract financing as necessary to overcome the shortage of funds.

From the 1,863 million pesos paid to the depositors, 250 million pesos were obtained from the preventive fund, and the rest, 1,613 million pesos were PEF resources.

Throughout the months that the payout was taking place, the areas responsible for the process provided continuous follow up, informing on a regular basis of all the actions taken, among others, to the Executive Secretary.

### Banco del Sureste: Deposit Payout – General Data

BEGINNING	FINAL DATE TO PRESENT CLAIMS	TOTAL CLIENTS	REQUESTS PRESENTED	GUARANTEED OBLIGATIONS (million pesos)	GUARANTEED OBLIGATIONS PAID (million pesos)	% TOTAL GUARANTEED OBLIGATIONS
Dec 2, 2002	Jan 31, 2003	42,997	10,213	1,866.4	1,863.5	99.8

## **V. ASSET RECOVERIES**

### Loans Portfolio

At the beginning of the payment process, the net value of the credit portfolio was 9 million pesos, after an analysis of the files it was determined to classify in the values concept the share investments guaranteed with provisional certificates, classified as defaulted in an amount of 32 million pesos. Accordingly, the credit risk preventive estimate was canceled. Therefore, the value of the credit portfolio was estimated in 41 million pesos.

Through judicial and extrajudicial instances, 91 million pesos were recovered, 9.87 times the net value of the portfolio at the beginning of the process and 119% of the recovery values estimated.

After all the possibilities of recovery were exhausted, the remaining loan portfolio was sold through a public auction, the amount of the loans and rights disposed was 37 million pesos, from which only 1 million pesos corresponded to performing loans (2.95%). The sale was made for 6 million pesos, which represented 14.88% of the total capital and ordinary and past-due interests and 15.6% of the capital.

### Reposessed assets and fixes assets

For the resolution of reposessed and fixed assets, several actions were carried out such as: an inventory analysis, a cross-check between the physical existences and the accounting registers, a valuation; the preparation of sales notifications, rules and necessary announcements for the auction process.

Some assets were destroyed or disabled in the presence of a public notary, due to their bad condition our outdated situation.

Reposessed assets (real estate, vehicles, machinery, furniture, fiduciary and credit rights) were valued to its possible net realizable value, according to its physical and legal situation, and also to its market demand.

The realizable value of the furniture and equipment was obtained through a valuation made by an expert of a Mexican development bank (Nacional Financiera).

The furniture's sales process was made in Mexico City and in Mérida, and the final stage was similar to a garage sale.

For the sale of real estate reposessed assets and used for banking operations, first they were offered through an invitation to the people that had offices in the same buildings. After that, seven public auctions were made and the remaining assets were sold through direct sales at the lower valuation prices.

Real estate assets were sold at equal or higher prices that the ones stated on the valuations. The total sales amount was 55 million pesos.

## **VI. IMPROVEMENTS IN LAW**

In an effort to strengthen the legal framework governing credit institutions, to protect the interests of the saving public and the Mexican system of payments, the Mexican congress passed several amendments to the Law of Credit Institutions, establishing a series of rules

that offer credit institutions a clearer legal framework in the areas of prudential regulation, supervision and oversight, and corporate governance.

### 1. Early corrective actions:

On December 3, 2004, the CNBV issued general provisions applicable to credit institutions, which defined the elements needed to classify commercial banks into 5 categories, based on a capitalization index quoted by the Mexican central bank.

The objective of classifying banks into these categories was to implement corrective measures to prevent banks that present early signs of capital deterioration from deteriorating even further.

Although the "early corrective actions" regime represented a fundamental tool for timely prevention and correction of banking institutions when they experience unfavorable movements in the indices that reflect their financial stability, it was especially important to have a legal framework for the timely resolution of those banking institutions whose financial deterioration leads to solvency and liquidity problems.

There is an international consensus in the sense that when a bank's management and shareholders are no longer capable of solving its financial problems on their own within a reasonable timeframe, the authorities must act to minimize systemic risk, protect depositors, maintain confidence in the financial system, and limit the resulting losses. The role of the financial authorities in such cases is to help insolvent banks implement an orderly exit strategy with minimal disruption for the rest of the financial system.

### 2. Bank resolution process:

In 2006, various provisions were added to the existing legal framework that clearly defined both the role of the financial authorities and the different processes to be used to assist banking institutions in withdrawing from the system. For this purpose, the financial authorities required various powers that will allow them to act rapidly and in a coordinated manner to identify the most appropriate resolution mechanism, on a lowest cost basis.

These changes allowed IPAB, responsible for implementing the resolution process, to have more options in cases in which the CNBV revoked the bank's authorization to organize and operate as such. The process of resolving a bank can be carried out through the following methods:

- i. The transfer of assets and liabilities to another operating bank (P&A)
- ii. A temporarily constituted IPAB-operated bank (bridge bank).
- iii. Deposit payoff.
- iv. An Open bank financial assistance (OBA) or partial payment of non-guaranteed obligations, whenever the bank entails a systemic risk.

The law stipulates that if the default of a commercial bank triggers a negative impact on other banks (known as the "domino effect") or put the functioning of the system of payments at risk; such bank will be considered systemic. In this case, to protect the interests of the saving public and the general public, IPAB must pay all or part of the bank's non-guaranteed obligations, to ensure that its default does not cause an interruption in the financial system.



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The decision regarding whether a bank is systemic or not will be made by a collegiate board known as the Committee on Financial Stability, which is made up by top ranking officers in the following financial authorities: SHCP, BANXICO, CNBV, and IPAB. The advisability of the decision's being made by a collegiate board lies in that, no financial authority alone has all the information necessary to make the decision.

The IPAB Governing Board determines the liquidation operations to be implemented for commercial banks, considering that the estimated cost of implementing such operations is less than the total estimated cost of payment of guaranteed obligations (deposit payout). The IPAB Governing Board may also consider the results of a technical study prepared for the purpose by IPAB itself, with its own personnel or through specialized third parties.

On 2008, IPAB established insured deposit classification rules in order to identify information regarding depositors and insured deposits, as well as joint accounts.

IPAB along with the Supervisor perform inspection visits to verify information regarding insured deposits to improve the quality of the information in the institutions' systems, as well as to gather relevant data in case an institution fails.

In order to accomplish such visits and to comply with the classification rules, IPAB has developed the Deposit Insurance Monitoring System (Spanish acronym, MOG) that allows the DIS to identify relevant information regarding insured depositors of institutions.

When a bank presents negative capital it is essential that it have effective rules that provide the greatest possible protection for the interests of its creditors. The legal framework in place, specifically the Law of Bankruptcies, establishes the steps to take in case of insolvency of a commercial bank; however, although they constitute exceptions to the general regime applicable to bankruptcy, they have not provided the most efficient means of addressing all the problems bankruptcy entails for a bank and are insufficient for achieving effective resolution.

Nowadays, the financial authorities are examining the laws in force and currently working to propose certain amendments to existing laws to create a regulatory framework that allows for more efficient and expeditious recovery of a commercial bank's assets, respecting due legal process at all times.