INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/339

MEXICO

FINANCIAL SECTOR ASSESSMENT PROGRAM

November 2022

TECHNICAL NOTE ON SELECTED ISSUES IN FINANCIAL SAFETY NET ARRANGEMENTS AND FINANCIAL CRISIS PREPAREDNESS

This Technical Note on Selected Issues in Financial Safety Net Arrangements and Financial Crisis Preparedness for the Mexico FSAP was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in October 2022.

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International Monetary Fund • Publication Services
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E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

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October 21, 2022

TECHNICAL NOTE

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Prepared by
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program (FSAP) in Mexico. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at
http://www.imf.org/external/np/fsap/fssa.aspx

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Glossary

Banxico	*Banco de México* (Central Bank)
BCP	Basel Core Principles for Effective Banking Supervision
BMV	*Bolsa Mexicana de Valores* (Mexican Stock Exchange).
CAR	Capital Adequacy Ratio
CEB	*Comité de Estabilidad Bancaria* (Banking Stability Committee)
CMG	Crisis Management Group
CNBV	*Comisión Nacional Bancaria y de Valores* (National Banking and Securities Commission)
COR	Conditional Operating Regime
CP	Core Principles for Effective Deposit Insurance Systems
DSIB	Domestic Systemically Important Bank
EC	Essential Criteria
ELA	Emergency Liquidity Assistance
FHC	Financial Holding Company
FLAO	*Facilidad de Liquidez Adicional Ordinaria* (Additional Ordinary Liquidity Facility)
FPAB	*Fondo de Protección al Ahorro Bancario* (Bank Savings Protection Fund)
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
GSIB	Global Systemically Important Bank
IADI	International Association of Deposit Insurers
IPAB	*Instituto para la Protección al Ahorro Bancario* (Bank Deposit Insurance and Resolution Agency)
KA	Key Attributes of Effective Resolution Regimes for Financial Institutions
MFAs	Mexican Financial Authorities
MOU	Memorandum of Understanding
NCWO	No Creditor Worse Off
PCA	Prompt Corrective Action
P&A	Purchase and Assumption
SHCP	*Secretaría de Hacienda y Crédito Público* (Ministry of Finance and Public Credit)
SIB	Systemically Important Bank
TLAC	Total Loss-Absorbing Capacity
TOBA	Temporary Open Bank Assistance

EXECUTIVE SUMMARY

The Mexican financial authorities strengthened the financial safety net since the last FSAP and need to continue and accelerate enhancements. Recovery and resolution plans are in place for all commercial banks, systemic banks are required to increase their loss absorbency complementing the critical Basel III reforms that the authorities have advanced, and the authorities progressed preparations for using the bridge bank tool, signed cooperation agreements with all major home jurisdictions of the Mexican systemic banks, clarified the emergency lending facilities including to banks in resolution, and improved the depositor payout process. Yet, accelerated enhancements are necessary, including by further improving the credibility and feasibility of banks' financial contingency arrangements, removing impediments to banks' resolvability and the use of the bridge bank and purchase and assumption transaction resolution tools, expanding the resolution regime's remit to financial holding companies, and reinforcing the resolution and deposit insurance agency's governance, autonomy, and resources.

Reinforcing the resolution and deposit insurance agency's governance, autonomy, and resources will enhance the overall credibility of the Mexican financial safety net. Vacancies for independent members on the agency's board should be filled swiftly to ensure an appropriate balance between the independent and ex officio members. Strengthening the safeguards for the autonomy of the agency's executive management would further enhance governance. The FSAP supports the ongoing evaluation of the agency's organizational structure and human resources needs, and how best to attract and retain key staff in an increasingly challenging political and market environment, so it can continue to deliver on its mandate. This is critical given the significant reductions observed in recent years in the agency's operating budget and staff levels. Furthermore, the agency's backup funding should be operationalized, and public awareness of deposit insurance increased.

Further enhancement of the resolution regime would enhance financial stability and give the Mexican financial authorities more flexibility and reduce the costs of resolution measures. The regime includes a range of resolution options, including administrative liquidation. Bail-in powers are the missing component and should be introduced while appropriately protecting creditors; the creditor hierarchy should be revised to make the newly introduced requirements for banks' loss-absorbing capacity more effective. The foregoing would ensure that shareholders and unsecured and uninsured creditors absorb losses prior to using public funds. Furthermore, the authorities should trigger resolution when they deem a bank 'nonviable' instead of waiting for certain quantitative thresholds to be met. Moreover, the authorities should remove barriers to the effective use of two critical resolution tools: purchase and assumption transactions; and bridge banks. A (partial) purchase and assumption transaction with a bridge bank—likely preceded by bail-in—will need to become the primary resolution strategy for systemic banks instead of open bank assistance. Lastly, financial holding companies dominate the Mexican financial system and should be brought under the resolution regime, which would address build-in contagion risk and reduce the risk of concurrently applying diverging liquidation procedures for distressed group members.

As the Mexican financial authorities have been operationalizing important past reforms to the recovery and resolution framework, deficiencies in banks' recovery plans and impediments to banks' resolvability have become clearer and need solving. The design of the recovery and early intervention frameworks implies that prior to resolution, several successive attempts by a distressed bank to improve its financial health may have failed over a prolonged period. To ensure timely and cost-effective resolutions, it is imperative to ensure the credibility and feasibility of banks' financial contingency arrangements, to reduce the time horizon over which they are executed, and to be conservative in approving successive plans. The resolution authority does not have the power to remove impediments to banks' resolvability, such as changes in banks' business practices, structure, or organization, to reduce the complexity and cost of resolution, and to ensure that critical functions can be segregated legally and operationally. Therefore, it should continue to identify impediments to resolvability and measures to mitigate these impediments—while shortening the resolution planning cycle for systemic and mid-size banks—and clearly articulate and discuss with banks the resolution capabilities that they should develop to effectively support their orderly resolution as planned by the resolution authority. While awaiting statutory powers for the resolution authority to remove impediments to banks' resolvability, the banking supervisor should actively support this process.

The Mexican financial authorities should continue to increase the deposit insurance fund for an effective and prompt response to the concurrent failures of larger banks. Despite the legacy debt from the 1990s financial crisis weighing heavily on its finances, the resolution and deposit insurance agency has built a fund that could cover the resolution and payout of most smaller banks. The authorities project that the deposit insurance fund will reach 3.4 percent of insured deposits in 2027 and 5.1 percent in 2032, which would position it better for the concurrent failures of several of the largest non-systemic banks. This process could be expedited by relieving the resolution and deposit insurance agency from the 1990s' legacy debt.

Benefitting from earlier crisis simulation exercises and the experience with recent bank failures, the Mexican financial authorities should continue to prepare for diverse failure scenarios. The Mexican financial oversight structure offers ample opportunities for interagency cooperation. This includes the supervisory and resolution agencies' boards with ex officio members from other agencies, and two interagency committees for banking and financial sector stability. This institutional framework should be supported with policy and operational documentation that is more accessible and practical than financial legislation. Furthermore, building on their experiences, the Mexican financial authorities should continue to enhance their operational preparedness, for example, with policy guidance, manuals, playbooks, and regular table-top and simulation exercises, for diverse failure scenarios, including fast-fail resolutions of systemic and midsize banks, and their concurrent failure. Such preparation is particularly important where impediments to resolvability exist (e.g., separability), operational continuity in resolution is challenging (e.g., due to a cybersecurity incident in resolution), or resolution methods (e.g., temporary open banking assistance) keep distressed banks engaging with markets and the public.

Table 1. Mexico: Recommendations on Financial Safety Net and Crisis Preparedness		
Recommendations and Responsible Authorities	**Timing***	**Priority****
1. Continue to enhance the authorities' operational preparedness for diverse failure scenarios. (all; ¶40)	C	H
2. Continue reinforcing IPAB's governance and autonomy with practical adjustments and swiftly filling all vacancies for independent members on its Governing Board, while working to enhance its autonomy more fundamentally through statutory amendments. (SHCP, IPAB; ¶30, ¶31)	I/M	H
3. Further strengthen mechanisms to ensure the credibility and feasibility of banks' plans for recovery and capital conservation and restoration, while ensuring that the execution of said plans would not impede banks' resolvability and cost-effective resolutions. (CNBV; ¶13, ¶14)	C	H
4. Eliminate deficiencies in recovery plans and continue to enhance the consistency of recovery plan reviews and the effectiveness of feedback on these plans. (CNBV; ¶20, ¶21)	C	H
5. Clearly articulate and discuss with banks the capabilities that they must have to effectively support their orderly resolution as planned by IPAB. (IPAB; ¶23)	I	H
6. Shorten the resolution planning cycle for DSIBs and midsize banks, eliminate impediments to banks' resolvability, and awaiting statutory powers for IPAB to remove impediments to banks' resolvability, establish an effective interagency mechanism to start removing these impediments. (SHCP, CNBV, IPAB; ¶22, ¶23)	C/M	H
7. Eliminate barriers to the effective use of the P&A and bridge bank tools and continue to prepare for their application; allow for more time to divest a bridge bank. (SHCP, IPAB; ¶16, ¶17)	M	H
8. Complete reviewing IPAB's organizational structure and resource and skillset needs to ensure that these are commensurate with the need for preparing and managing bank resolutions in an increasingly complex financial system. (IPAB; ¶32, ¶33)	C	M
9. Introduce statutory bail-in powers with a NCWO safeguard; allow departure from *pari passu* treatment; amend the creditor hierarchy to expand the universe of TLAC-eligible instruments. (SHCP; ¶15, ¶25)	M	M
10. Adopt a recovery and resolution regime for FHCs. (SHCP; ¶19)	M	M
11. Continue growing the deposit insurance fund to an appropriate level; relieve IPAB from the 1990s' legacy debt; operationalize IPAB's backup funding sources. (IPAB, SHCP, Banxico; ¶35–37)	M	M
12. Building on existing communications efforts, aim to increase the public awareness level for deposit insurance to a large majority of both depositors and unbanked adults. (all; ¶38)	M	M

* C: continuous; I: immediate (<1 year); NT: short term (1–2 years); MT: medium term (3–5 years).

** H: high; M: medium; L: low.

INTRODUCTION

A. Scope of Assessment

1. This note sets out the analysis and detailed recommendations of the 2022 FSAP pertaining to the financial safety net and financial crisis preparedness in Mexico.[1] The note summarizes the FSAP findings, including the mission undertaken in March–April 2022, during which meetings were held with officials and senior staff of *Instituto para la Protección al Ahorro Bancario* (IPAB), *Secretaría de Hacienda y Crédito Público* (SHCP), *Banco de México* (Banxico), and *Comisión Nacional Bancaria y de Valores* (CNBV)—together the Mexican financial authorities (MFAs). The mission also met with private-sector stakeholders, including banks, industry associations, and consultancy firms. The note considers developments since the 2016 FSAP, and it is based on the regime in place and the practices employed as of July 1, 2022; the data cut-off date is end-2021.

2. The FSAP analyzed the Mexican financial safety net and financial crisis preparedness arrangements,[2] considering the domestic financial sector landscape, country-specific challenges, and international standards and good practices. The note focuses on the arrangements that apply to banks and financial holding companies (FHCs). While the note does not assess compliance with any standard, two international standards in particular informed the analysis: Key Attributes of Effective Resolution Regimes for Financial Institutions (KA) adopted by the Financial Stability Board (FSB);[3] and Core Principles for Effective Deposit Insurance Systems (CP) adopted by the International Association of Deposit Insurers (IADI)—with their assessment methodologies.[4] Although emergency liquidity assistance (ELA) is a component of the financial safety net, it is discussed in another technical note ('Systemic Liquidity Management Framework'); the current note does discuss funding in resolution.

3. Other FSAP notes cover the preconditions that international standards identify for effective bank resolution and deposit insurance: (1) a well-established framework for financial stability surveillance and policy; and (2) an effective system of bank supervision, regulation, and oversight. The standards also call for a robust accounting, auditing, and disclosure regime, and a well-developed legal framework and judicial system—all of which fall outside the scope of this note.

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[1] This technical note is prepared by Atilla Arda (IMF, Monetary and Capital Markets Department, Financial Crisis Preparedness and Management Division). The FSAP thanks the Mexican financial authorities for the constructive dialogue and the many insights that they have shared.

[2] The FSAP did not assess the MFAs' business continuity planning that aims to ensure the continuity of their own operations, staff, and facilities when affected by external events, such as, a cyber-attack or an epidemic.

[3] Most of the KAs apply not only to global systemically important banks (GSIBs) but to any financial institution that could be systemically significant or critical if it fails—see, for example, Chapter IV of the KA Assessment Methodology for the Banking Sector. This includes the systemicness of a domestic bank at the time of distress—not only in 'normal' times.

[4] Consistent with the methodologies, the FSAP did not have access to confidential firm-specific plans, and the FSAP made no judgment on individual firms' resolvability.

B. The Mexican Financial System and Safety Net Members

4. Financial holding companies (FHCs) and foreign-owned banks dominated the Mexican financial system at end-2021. Financial institutions' total assets stood at about 100 percent of GDP. The largest four financial holding companies (FHCs)—three of which are foreign owned—held 38.3 percent of financial sector assets;[5] FHCs are led by commercial banks (Box 2). Banks accounted for 43.6 percent of total financial sector assets. The banking sector is concentrated with 6 domestic systemically important banks (DSIBs)[6] and the top 10 commercial banks holding respectively 74 and 84 percent of commercial banking sector assets. Mexico does not permit foreign banks to operate branches; their activities in Mexico are organized through subsidiaries, which the MFAs regulate as any other domestically incorporated bank. Five of the six DSIBs are foreign subsidiaries, accounting for 62 percent of commercial banking sector assets. The six development banks[7]—that are mandated with public policy objectives—held 17 percent of banking sector assets, which is more than the largest 6 non-SIBs.

5. The Mexican financial safety net comprises four key members.

- SHCP has regulatory and policy responsibilities for financial stability, including the overall planning and monitoring of the banking system comprising development banks and credit institutions such as commercial banks. It has authorization and regulatory powers over FHCs.

- CNBV is responsible for the regulation and supervision, including the authorization and sanctioning, of a broad range of financial institutions, including commercial banks and other credit institutions. It decides on banks' license revocations, triggering their resolution and liquidation. CNBV supervises FHCs' regulatory compliance and has complementary powers for corrective action, intervention, liquidation, and bankruptcy.

- IPAB is the deposit insurance agency and the resolution authority for commercial banks with responsibility for resolution planning and execution. It may appoint third parties as bank liquidators on its behalf and manages the public debt incurred during the 1994 Banking Crisis.

- Banxico is the central bank and lender of last resort for credit institutions, including—under certain conditions—when they are in resolution.

[5] The four FHCs are: Grupo Financiero BBVA; Grupo Financiero Santander; Grupo Financiero Banorte; and Grupo Financiero Citibanamex.

[6] The six DSIBs are: BBVA México; Citibanamex; Banco Santander México; Banorte; HSBC México; and Scotiabank Inverlat.

[7] The six state-owned development banks are: NAFIN, Bancomext, Banobras, SHF, Banco del Bienestar, and Banjercito.

Table 2. Mexico: Ownership and Systemicness of the Top Ten Commercial Banks

Bank	Assets (%)*	Deposits (%)*	Ownership & Systemicness
BBVA Mexico	23.0	22.2	DSIB in Mexico. Wholly owned by Grupo Financiero BBVA Mexico (FHC), itself wholly owned by BBVA. While BBVA is not a GSIB anymore, it is a DSIB in Spain. The group includes a brokerage, mortgage, complementary services, asset management, and insurance companies, and investment funds.
Santander	12.9	14.8	DSIB in Mexico. Wholly owned by Grupo Financiero Santander (FHC), itself owned mainly by Santander, a Spanish GSIB. The group includes a bank, brokerage, factoring, asset management, and services companies, and a multi-purpose financial company[1] (mortgage, consumer loans, microcredits business). Listed on the *Bolsa Mexicana de Valores* (BMV; Mexican Stock Exchange).
Citibanamex	13.1	12.4	DSIB in Mexico. Wholly owned by Grupo Financiero Citibanamex (FHC), itself wholly owned by Citigroup, a U.S. GSIB. The group includes a brokerage, asset management and insurance companies, pensions, and a multi-purpose financial company (leasing and credit card business).
Banorte	11.9	11.2	DSIB in Mexico. Wholly owned by BMV-listed Grupo Financiero Banorte (FHC). The group includes brokerage, pensions, insurance investment funds, and a multi-purpose financial company (leasing and factoring business).
HSBC	7.6	6.5	DSIB in Mexico. Wholly owned by Grupo Financiero HSBC (FHC), itself wholly owned by HSBC Holdings, a U.K. GSIB. The group includes brokerage, asset management, insurance, and corporate service companies, and investment funds.
Scotiabank Inverlat	7.0	6.1	DSIB in Mexico. Wholly owned by Grupo Financiero Scotiabank Inverlat (FHC), 97.4 percent owned by Bank of Nova Scotia, a DSIB in Canada. The group includes a brokerage, investment funds, and a multi-purpose financial company (non-revolving microloans to consumers).
Inbursa	3.9	3.7	Wholly owned by BMV-listed Grupo Financiero Inbursa (FHC) controlled by Carlos Slim. The group includes a brokerage, insurer, surety company, pension fund manager, and corporate services company. In 2015, it acquired Standard Bank Brazil, a non-systemic bank in Brazil. Inbursa was a DSIB in Mexico until December 2019.
BanBajío	3.2	2.5	Listed on the Mexican Stock Exchange and owned 20 percent by its founder, Salvador Oñate. Not an FHC. The bank focuses on corporate loans.
Azteca	2.6	2.3	Wholly owned by Grupo Salinas, a mixed conglomerate (not an FHC) with retail and financial companies. The group owns 100% of Banco Azteca in Mexico, Guatemala, Honduras, Panama, and 100% of Advance America (a Mexican insurer, pension fund management company, and brokerage firm).
Afirme	1.0	1.6	Wholly owned by Grupo Financiero Afirme (FHC) that owns a leasing and factoring business, asset management and insurance companies, and investment funds.

[1] A multi-purpose financial company (SOFOM) is a non-deposit-taking bank that is regulated and supervised by CNBV.

* End-2021 percentage of commercial banking sector assets and deposits.

Source: Mexican financial authorities.

6. Two interagency committees provide a platform for coordination and cooperation among the MFAs and other authorities.

- The *Comité de Estabilidad Bancaria* (Banking Stability Committee; CEB) comprises appointed members (principals and deputies) from all MFAs; it decides if a distressed bank's failure can negatively affect financial system stability.
- The *Consejo de Estabilidad del Sistema Financiero* (Financial Stability Council) comprises members from the MFAs and the insurance and pension fund supervisory agencies; it identifies and evaluates financial stability risks, and it recommends risk-mitigating policies.

C. Developments Since the 2016 FSAP

7. While several critical reforms remain outstanding, the MFAs implemented many of the 2016 FSAP recommendations (Appendix). Of the 22 recommendations, the MFAs implemented 12 and partially implemented 4. Specifically, recovery and resolution plans are in place for all commercial banks, and the authorities progressed preparations for using the bridge bank tool, signed cooperation agreements with all major home jurisdictions of the Mexican DSIBs, introduced total loss-absorbing capacity (TLAC) requirements for DSIBs, clarified Banxico's protocols for the Additional Ordinary Liquidity Facility (*Facilidad de Liquidez Adicional Ordinaria*; FLAO) and Loans of Last Resort (*Créditos de Liquidez de Última Instancia*), and improved the depositor payout process. However, progress on more fundamental reforms remained elusive, including, for example, IPAB's governance and finances, the resolution regime's remit, and impediments to the use of critical resolution tools and to banks' resolvability.

8. IPAB has had opportunities to try out its deposit payout and communication capabilities under difficult circumstances. Two banks failed during 2020–21 for reasons unrelated to the COVID-19 outbreak. In both cases, three months after license revocation, over 95 percent of insured deposits were paid out.[8] International best[9] practice calls for the deposit insurer to be able to reimburse most insured depositors within seven working days, however, these efforts were achieved while most of the country was in lockdown and banks operated at very low operational capacity. IPAB's newly developed web-based payout system, allowing, for example, no-card withdrawals, was instrumental in achieving this result. In the most recent bank failure, IPAB also used its newly developed communications management system.

9. The MFAs enhanced the bank recovery and resolution framework. CNBV introduced a TLAC requirement for DSIBs (phased in from 2022 through 2025). IPAB has started updating the earliest resolution plans and updated the resolution planning guidelines in December 2021. Based

[8] In the first month, 84 percent was paid out in the case of Accendo, and 70 percent in the case of Famsa. While IPAB immediately made funds available through the agent bank, the liquidators had to make extra efforts to ensure payouts to the smallest depositors with less than 50 USD in deposits who were reluctant to claim their deposits. The total insured amount is around 143,000 USD for each depositor at each member bank.

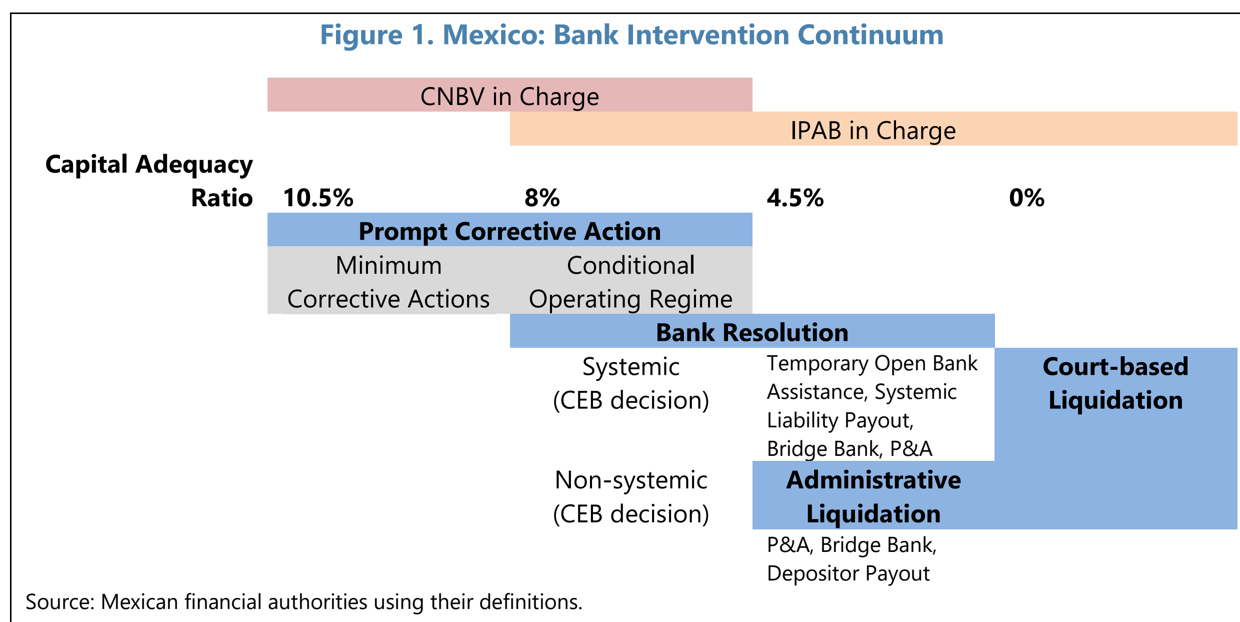
[9] Core Principle 15 (essential criteria 1) of IADI's Core Principles for Effective Deposit Insurance Systems.

on their experience with reviewing recovery plans since 2016, in September 2022, the MFAs updated the recovery planning requirements (effective January 2023). In response to the COVID-19 outbreak, Banxico temporarily amended the FLAO protocol during 2020–21, with, for example, expanded eligible securities (with lower credit ratings) and expanded eligible counterparts (including also state-owned development banks). [10]

10. Mexico's precautionary Flexible Credit Line with the IMF was renewed. The November 2021 Article IV Staff Report noted that despite the overall strength of the banking sector, some smaller banks remained vulnerable, the banking system is concentrated, lending by the system is subject to concentration risk, and most of Banxico's COVID-related liquidity and credit support facilities had expired. IMF staff concluded that progress on outstanding recommendations of the 2016 FSAP would help boost resilience, including adequate access to funding for deposit insurance, an enhanced resolution regime for FHCs, and strengthened autonomy and governance of IPAB, with flexibility within the framework continuing to be used to cope with challenges.

WHEN BANKS ARE FAILING

Figure 1. Mexico: Bank Intervention Continuum



Source: Mexican financial authorities using their definitions.

A. Supervisory Forbearance

11. Banks with capital adequacy ratios (CARs) below the regulatory requirements can use the Conditional Operating Regime (COR) under the prompt corrective action (PCA) framework.[11] Banks can apply to CNBV for the COR—which has never been used—when their CAR is between 8 and 4.5 percent, subject to two conditions: the bank must transfer at least 75 percent

[10] These modifications were withdrawn without disruptions. Development banks had access to the FLAO during April 2020–February 2021; the expanded eligible collateral regime was in place during April 2020–September 2021.

[11] The FSAP banking oversight workstream comprehensively discusses the PCA framework.

of its shares to an irrevocable trust and submit a capital restoration plan to meet the 10.5 percent CAR requirement within 270 days. Under the COR, banks' management and board retain their powers, but CNBV may impose restrictions on dividend payments, stock buybacks, and bonuses, and prescribe write-down or conversion into equity of subordinated convertible debt instruments if this is allowed under the contractual conditions. Resolution is automatically triggered when a bank with a CAR below eight percent does not apply for the COR, CNBV does not approve its application, when a bank fails to execute its capital restoration plan, or its CAR falls below 4.5 percent.

12. Distressed banks can potentially operate under several financial contingency arrangements. Prior to a capital restoration plan under the COR, a bank would have had to submit a capital conservation plan when its CAR fell below 10.5 percent but was above 8 percent—in some cases a liquidity recovery plan too would have been submitted.[12] The bank's CAR falling below eight percent implies that most likely the preceding capital conservation plan had failed. Furthermore, considering that banks' recovery plan triggers for both the liquidity and capital ratios sit well above the regulatory requirements, a capital conservation plan implies that most likely the recovery plan's implementation too had failed.

13. CNBV will need to assure itself of a capital restoration plan's credibility and feasibility—at which time the bank will have seen two plans fail over a prolonged period (without statutory limits). This is particularly important as the Banking Single Rulebook sets similar requirements for both the capital restoration plan and for the capital conservation plan, both aiming to increase a bank's CAR to 10.5 percent or higher. Furthermore, a failing bank would have up to an additional 270 days to implement the capital restoration plan—with possibly a 90-day extension.[13]

14. CNBV should assume a conservative approach in assessing a bank's COR application. The COR's design puts a premium on enhancing arrangements that preserve value and support the orderly resolution of failing banks. Setting clear and strict intermediate targets and deadlines for the implementation of recovery plans and capital conservation and restoration plans could help in maintaining value and mitigating the risk of triggering resolution at too late a stage.[14] Establishing policies and procedures to assess the several plans' credibility and feasibility, and to set appropriate targets and deadlines would support timely and effective decision-making.[15] To help trigger resolution at an early stage—and to also make up for the lack of a qualitative non-viability resolution trigger—CNBV should assume a conservative approach in assessing a bank's COR application, particularly where a bank's implementation of an earlier recovery or capital restoration plan has failed. A rejection from CNBV would trigger resolution by IPAB. Irrespective of a bank's CAR suddenly falling below eight percent or slowly while working through a recovery and/or capital

[12] The recent two bank failures demonstrate that not all plans need to be implemented sequentially.

[13] This would be in addition to the time for banks to submit a capital restoration plan (7 days) and the time CNBV needs to review and approve the plan (60 days).

[14] These targets and deadlines could emulate and expand on the requirements for capital restoration plans.

[15] Ideally, the MFAs should have more statutory discretion to determine that a bank is not viable and likely to fail, resulting in triggering resolution much earlier than is now prescribed under Mexican legislation.

conservation plan, arguably such bank would be likely nonviable. Moreover, CNBV, in consultation with IPAB and with information from the banks, should assess whether the capital conservation and restoration plans include potential measures that could negatively impact a bank's resolvability.

Box 1. Mexico: Temporary Open Bank Assistance Regime

When the Banking Stability Committee deems a failing bank systemic and requires that the bank's liabilities are protected excluding holders of TLAC and capital instruments, IPAB can extend financial assistance to the bank under two scenarios.

Assistance to Systemic Banks That Were Previously Under the Conditional Operation Regime

- While the bank is implementing a capital restoration plan, the shareholders transfer at least 75 percent of the bank's shares to a trust with IPAB as second beneficiary.
- IPAB takes control of the shares in the trust and appoints a conservator in the following three events:
    - CNBV does not approve the bank's capital restoration plan or determines that the bank has not complied with the plan's requirements;
    - the bank's CAR is equal to or falls below the minimum requirement of 4.5 percent; or
    - in any of the cases set out in Article 28, paragraphs IV, VI, or VIII, of the Credit Institutions Law.
- If the implementation of the capital restoration plan fails, IPAB commissions a third-party share valuation, the bank's capital is written down as required by the valuation, and IPAB recapitalizes the bank to meet regulatory capital requirements.
- IPAB has two years to sell the bank's shares—those within and outside the trust. Shares outside the trust are entitled to the prorated proceeds from the sale regardless of whether the sale was executed below book value. If no sale is possible within these two years, the bank will most likely be liquidated.

Assistance to Systemic Banks That Were Previously Not Under the Conditional Operating Regime

- IPAB commissions a third-party for the shares' valuation, the bank's capital is written down by the loss determined by this valuation. A second valuation is commissioned by IPAB and the shareholders if the latter challenge the first valuation.
- IPAB extends a loan to the bank to meet regulatory capital requirements; the loan is secured with all the banks' shares.
- If the shareholders cannot fully recapitalize the bank by subscribing to newly issued shares within 15 days, IPAB acquires the existing shares against book value as determined by the external valuation.
- A conservator must commission another valuation to determine the amount that is needed for IPAB to recapitalize the bank.
- IPAB has two years to sell the bank's shares. If no sale is possible within these two years, the bank will most likely be liquidated.

Source: IMF Staff.

B. Bank Resolution

15. Except for statutory bail-in powers, the Mexican resolution regime comprises a range of resolution options, including administrative and judicial liquidation. The regular resolution options are purchase and assumption (P&A) transactions with a private-sector purchaser or a bridge bank, and reimbursement of insured deposits. For banks that are not systemic in resolution, IPAB must choose the resolution method that is the least costly for IPAB. In the case of a systemic bank—as determined by the CEB at the time of a bank's failure—the temporary open bank assistance

(TOBA) option is the authorities' preferred resolution option (Box 1).[16] Under TOBA, shareholders could incur some losses—after the bank receiving financial assistance from IPAB—but creditors are not affected unless the securities' contractual terms allow a conversion to equity or write-down, which IPAB-appointed administrators could use.[17] Introducing statutory bail-in powers will require legislative change; together with changes in the statutory creditor hierarchy to allow bail-inable subordinated debt, the bail-in powers would further align the Mexican resolution regime with the FSB KA (KA3.2 and KA3.5). Bail-in powers should be complemented with the power to depart from the principle of equal (*pari passu*) treatment of creditors of the same class (KA5.1) and a no creditor worse off (NCWO) than in liquidation safeguard (KA5.2)—this safeguard is missing for any resolution measure. The foregoing would facilitate that shareholders and both unsecured and uninsured senior creditors absorb losses prior to receiving financial support from IPAB.

16. Operating costs associated with bridge banks in Mexico reduce the likelihood of IPAB using this important resolution tool. A bridge bank allows more time to market a sale (P&A) and is particularly needed for the resolution of SIBs and in systemic events.[18] IPAB can establish, own, and operate a bridge bank,[19] without a banking license or capital requirements. A bridge bank can operate for two terms of six months during which IPAB must aim to divest itself of the bridge bank (shares, or certain assets and liabilities, with the subsequent liquidation of the remainder of the bank). Depending on market conditions, one year may be insufficient to divest a bridge bank, and as the final deadline approaches, IPAB's leverage in negotiations could be significantly undermined. A total of two years would give IPAB more flexibility. IPAB has established processes and prepared documentation for setting up a bridge bank, annually updates a list of experienced persons who could serve as bridge bank managers, and a bridge bank was included in a 2016 resolution simulation, albeit for non-SIBs only. However, IPAB explained that in none of the resolution planning it undertook, a bridge bank met the least-cost requirement due to the high costs associated with operating a bridge bank. It should be noted, though, that a bridge bank would typically be used for SIBs and in systemic events, in which case the least-cost rule does not apply. Especially as a bridge bank should be preferred over TOBA, it remains important to reduce bridge bank costs by carefully revisiting the modalities for its operations and governance, including the incentive structures for the bridge bank managers.

17. Bank secrecy rules hamper the use of P&A transactions in resolution. P&A is a time-tested and cost-effective resolution method; it is the preferred resolution tool for many resolution

[16] TOBA has not been used since it was introduced in 2006. The other options would be systemic liability payouts (effectively creating a blanket guarantee), P&A, and a bridge bank (which should be the preferred option for SIBs).

[17] Appointing administrators at a distressed bank that continues its operations—and when its viability is potentially unclear—will require complementary actions by the MFAs to mitigate any potential adverse responses from the markets and the public while, for example, valuations are being undertaken (over several months) or the bank is implementing a capital restoration plan (up to almost a year).

[18] For a discussion of good practices for bridge banks, see Box 7 in Marc Dobler, et al., "Managing Systemic Banking Crises—New Lessons and Lessons Relearned,' IMF 2020, Departmental Paper No. 20/05.

[19] SHCP would own one share in a bridge bank to comply with corporate law requiring at least two shareholders.

authorities.[20] A critical part of executing a P&A transaction is marketing the failing bank to prospective private-sector purchasers. The latter will want to undertake due diligence, which requires reviewing the failing banks' finances and potential legal liabilities. However, bank secrecy rules prevent IPAB from sharing this information with prospective purchasers before the failing bank's license is revoked. Consequently, either P&A cannot be prepared in advance, or its sale will only be possible with a steep discount, which will most likely render it too costly for IPAB under the least-cost rule. Although not time-effective, a P&A with an IPAB-owned bridge bank, then a further sale to a private-sector purchaser seems a good second-best solution. This underlines the importance of the bridge bank option's usability as discussed above. Additionally, IPAB could consider using the conservatorship for rapidly preparing a P&A, where the conservator substitutes a bank's management and board, and/or IPAB could incentivize a failing bank's shareholders to market the bank (e.g., prepare the data room etc.). Continuing to update a list of potential buyers before contingencies materialize can help expeditiously execute P&A transactions. These practical avenues will need to be explored while seeking a more structural solution through a statutory exception to bank secrecy for resolution purposes—similar to a public policy exception to property rights protection.

C. Bank Insolvency

18. Balance sheet insolvent banks are liquidated through a court-based insolvency procedure. IPAB plays a key role in this procedure as the 'judicial liquidator,' either directly or through a third party—a person or a specialized firm—of its choice and under its oversight. The courts' role is limited to confirming a banks' insolvency within 24 hours after IPAB's application for insolvency, determining (on the judicial liquidator's advice based on the statutory creditor hierarchy) the creditors' claims and ranking, resolving any legal challenges from the bank or its creditors, and declaring (at the judicial liquidator's request) the closure of the judicial liquidation process. During this process, a failed bank's assets are shielded from third-party legal actions, and any legal challenges would not suspend the liquidation process.[21]

D. Financial Holding Companies

19. Bringing FHCs under the resolution regime would address build-in contagion risk and reduce the risk of concurrently applying diverging procedures for distressed group members. As noted above, FHCs are a distinct feature of the Mexican financial system. The FSAP banking oversight workstream discusses the lack of an effective consolidated supervision framework in Mexico. As Section 01.18 of the Basel Core Principles for Effective Banking Supervision framework observes, "group entities…may be a source of strength but they may also be a source of weakness…adversely affecting the financial condition, reputation and overall safety and soundness of the [group's] bank." Indeed, Mexican FHCs are liable for group entities' losses through 'liabilities assumption agreements.' If an FHC were unable to meet its financial obligations, it is required to use all its assets, including selling its holdings in group entities on a prorated basis. Consequently,

[20] A P&A can secure higher going-concern values for the assets of a failed bank than would be possible in liquidation—often also with a small premium from the purchaser for the deposit book.

[21] Similarly, legal challenges would not suspend resolution measures.

contagion is inherent to the Mexican FHC regime. Furthermore, FHCs are subject to the corporate bankruptcy regime, and the group entities would be 'resolved' under their distinct regimes. Considering these challenges, a recovery and resolution regime for FHCs should be adopted.[22] This would further align the Mexican resolution regime with the FSB KA (specifically KA1.1), which apply to both operating and non-operating holding companies.[23] To support their efforts to improve banks' resolvability, the MFAs should also be able to require the establishment of FHCs in mixed-activity groups (KA Assessment Methodology for the Banking Sector, Explanatory Note EN10(b)).

PLANNING FOR BANK FAILURES

A. Recovery Planning by Banks

20. While banks' recovery planning has progressed well, continued efforts to reduce deficiencies in these plans remain necessary. Recovery planning in Mexico commenced in March 2016. While particularly the DSIBs have progressed in developing their plans and integrating the recovery (planning) process in their business-as-usual risk management framework, some midsize and smaller banks continue to find this challenging. The MFAs observed that the main deficiencies in banks' recovery plans concern the identification of critical functions, sources and uses of financing, and recovery estimations (e.g., the measures' costs, mutual incompatibilities, and impact on operations, liquidity, and solvency). In September 2022, the MFAs updated the recovery plan requirements (effective in January 2023) that are enshrined in Annex 69 of the Banking Single Rulebook (*Circular Única de Bancos*) to offer more granular guidance particularly on the aforementioned issues and banks' communication efforts accompanying recovery measures.[24] Developing the MFAs' internal review policies and reducing—and eventually eliminating—deficiencies in banks' recovery plans will be important to enhance the plans' credibility and feasibility, to increase insights in potential mutually negatively reinforcing recovery actions when several banks are concurrently distressed, to continue to provide valuable input for resolution planning, and to ensure that the recovery process and actions do not impede banks' resolvability.[25]

21. The updated recovery plan requirements will also help in continuing to improve the consistency of plan reviews by the MFAs. Building on the first three cycles with recovery plan reviews,[26] the MFAs have discussed how best to codify their experience and increasing convergence of their views about banks' recovery planning approach. The update of the recovery plan requirements (that is, Annex 69) was concluded in September 2022, after a delay due to the Covid-19 outbreak. The granularity of the updated Annex 69 will not only benefit banks but also the MFAs in reviewing the plans, including with a supporting scoring framework and a memorandum of

[22] A resolution regime for FHCs would have two key advantages: (i) undertaking resolution at the parent level without affecting the operating companies; and (ii) giving the supervision and resolution authorities the power to force continuity of intragroup services (e.g., for data support).

[23] See also Explanatory Notes EN1(d) and EN 3(b) of the KA Assessment Methodology for the Banking Sector; see further the definitions for 'Bank,' 'Financial conglomerate,' and 'Holding company.'

[24] The FSAP assessed the draft of the updated requirements that were published during the assessment.

[25] The banks' recovery plans should offer insights in the impact of potential recovery measures on their resolvability.

[26] DSIBs are subject to an annual cycle; other banks submit their plans every two years.

understanding (MOU) to make the interagency review consultations more efficient. The review process is led by CNBV where the review responsibility is decentralized at the level of the supervisory teams and centralized for signing off on the plans. The sign-off concludes the review process that includes consultations with the other MFAs where dedicated teams review all recovery plans. While the latter helps maintain a certain level of consistency in the review process, it should be noted that each MFA's review of the recovery plans is informed by their respective policy mandates, which cannot substitute for the CNBV's responsibility. CNBV is ultimately responsible for the review of recovery plans, the overall consistency of the reviews, and the effectiveness of the feedback that is given to the banks. A centralized team at CNBV should help execute this responsibility by managing the (interagency) review and scoring process and act as a sounding board for the supervisory teams undertaking the reviews and the officials signing off on the reviews and the feedback to banks.

B. Resolution Planning by IPAB

22. IPAB has started updating the initial resolution plans that it adopted. During the previous FSAP, IPAB had just started developing the first two resolution plans; now, there is a resolution plan for each commercial bank, and IPAB has updated eight plans, including two for DSIBs—the plans for the other four DSIBs are expected to be updated by end-2022. In December 2021, the guidelines for resolution planning were revised. Under the new guidelines IPAB is expected to update DSIBs' resolution plans (and other banks at its discretion) every 3 years, for midsize banks every 2–4 years, and for small banks every 4–5 years. Considering the importance of having up-to-date plans for the most important banks and the FSB KA's requirement to undertake resolution planning annually, the planning cycles should be shortened, specifically for DSIBs and the largest midsize banks. The planning process should be supported by clear arrangements between IPAB and CNBV to exchange pertinent information that could result in an earlier update of a resolution plan due to changes at a bank that affect its resolvability—other than those included in the updated guidelines (i.e., change of business model or significant financial deterioration).

23. Establishing an effective mechanism to remove impediments to banks' resolvability is critical for orderly and less costly resolution. The new resolution planning guidelines elaborate on, for example, operational continuity and public communications strategies. The guidelines also require that IPAB identify specific impediments to a bank's resolvability and propose measures to remove these impediments. However, IPAB does not have statutory powers to instruct a bank to make changes that could improve its resolvability. IPAB should clearly articulate and regularly discuss with the banks the capabilities (e.g., operational continuity, restructuring, communications) that it expects banks to have to effectively support their orderly resolution as planned by IPAB. Furthermore, while awaiting statutory powers for IPAB to remove impediments to resolvability, CNBV should actively use its supervisory powers to support IPABs resolution planning strategies.

24. Five of the six DSIBs, are subsidiaries of foreign SIBs, therefore their resolution planning is partly undertaken at the international level.[27] Three of the Mexican DSIBs are owned by a foreign SIB with a multiple point of entry resolution strategy (i.e., BBVA, Santander, and HSBC).

[27] There are 22 foreign-owned banks in Mexico. 13 of these are owned by GSIBs.

These groups have subsidiary-based corporate structures, aiming for self-sufficient subsidiaries. IPAB will manage their resolution directly at the subsidiary level, while the resolution of the other subsidiaries that are owned by foreign SIBs are planned to be undertaken at the parent level by the home resolution authority following a single point of entry resolution strategy.[28] Irrespective of the resolution strategy, there is a high degree of cross-border cooperation between resolution authorities. In the case of GSIBs in crisis management groups (CMGs), IPAB, Banxico, and CNBV are members of three CMGs (Citigroup, HSBC, Santander) and an observer in a resolution college (BBVA).[29] IPAB has concluded bilateral cooperation arrangements with the resolution authorities and deposit insurance agencies in many jurisdictions, specifically those that are home to owners of Mexican DSIBs; and Mexican legislation allows for a high degree of cooperation and information exchange with foreign authorities. Moreover, foreign bank branches are not allowed in Mexico, which reduces the probability of cross-border resolution challenges. That said, while Mexico is signatory to several treaties on the recognition and enforcement of foreign judgements, these treaties do not apply to bankruptcy, insolvency, liquidation, or other similar proceedings, including bank resolution. Furthermore, Mexican legislation does not provide for a framework to recognize foreign resolution decisions. Therefore, the MFAs should evaluate how best to complement existing supportive measures (by particularly CNBV and IPAB) and contractual approaches with a specific administrative and/or judicial recognition process—with appropriate exceptions—to give prompt, transparent, and predictable effect to foreign bank resolution decisions, as prescribed by KA7.5 and elaborated upon in the FSB Principles for Cross-border Effectiveness of Resolution Actions.

RESOLUTION FUNDING

A. Banks' Loss-Absorbing Capacity

25. Since 2022, Mexican DSIBs are subject to TLAC requirements—in addition to existing Basel III requirements. Under the new rules, DSIBs are required to hold a TLAC amount that meets or exceeds the higher of 6.5 percent of risk-weighted assets or 3.75 percent of the Basel III leverage ratio denominator (Figure 2). The TLAC requirements will be phased in over four years until end-2025—with 25% annual increments. Considering their high capitalization, many DSIBs are not expected to need the full four years to reach the required levels. The TLAC requirements were introduced as an amendment in CNBV's capital regulations. Without amending the statutory creditor hierarchy (see ¶15 above), only common equity and capital instruments (Additional Tier 1, Tier 2) are eligible to meet the TLAC requirements.[30]

[28] The recent experience with Sberbank in Europe where the planned single-point-of-entry resolution strategy was not followed demonstrates the importance of preparing alternative multiple-point-of-entry plans, which the MFAs are undertaking.

[29] For many international groups, the Mexican subsidiaries are not considered material; therefore, the MFAs do not participate in all CMGs and resolution colleges.

[30] Under the current statutory creditor hierarchy other potential instruments would be ranked equal to instruments that are ineligible for TLAC purpose as per the FSB TLAC Term Sheet.

Figure 2. Mexico: TLAC Requirements

(In percent of risk weighted assets)*

Basel III

Cumulative	Requirement	Component
11.1–14.5	0.6–1.5	DSIB Buffer
10.5–13.0	0–2.5	CCyB
10.5	2.5	CCB
8.0	2.0	Tier 2 Capital
6.0	1.5	AT1 Capital
	4.5	CET1 Capital

Basel III + TLAC

Component	Requirement	Cumulative
DSIB Buffer	0.6–1.5	17.6–21.0
CCyB	0–2.5	17.0–19.5
CCB	2.5	17.0
Additional TLAC Instruments	6.5	14.5
Tier 2 Capital	2.0	8.0
AT1 Capital	1.5	6.0
CET1 Capital	4.5	

TLAC** (Additional TLAC Instruments through CET1 Capital)

CCyB: countercyclical capital buffer
CCB; capital conservation buffer
AT1: additional tier 1
CET1: common equity tier 1

* The capital requirements in blue apply to all commercial banks; DSIBs must meet also the DSIB buffer and TLAC requirements.

** 14.5 risk weighted assets (or 6.75% of assets used to calculate leverage exposure measures).

Source: IMF Staff.

B. Funding from Banxico

26. In addition to Banxico's standing facilities, commercial banks can access two other facilities while undergoing resolution.[31] Banxico's intraday and overnight standing facilities are available to all banks provided they meet the requirements, including bridge banks and banks under COR or TOBA. Banxico has two other facilities that are of particular interest to banks in resolution:

- **Additional Ordinary Liquidity Facility** (*Facilidad de Liquidez Adicional Ordinaria*; FLAO). Solvent banks facing short-term liquidity needs can 'automatically' access this overnight facility against eligible collateral that is broader than for the standing facilities but still of high quality (e.g., securities denominated in foreign currency issued by public sector entities)

- **Emergency Liquidity Assistance** (*Créditos de Liquidez de Última Instancia*; ELA). This is extended on a case-by-case basis for up to 90 days (that can be renewed for additional 90-day periods) to banks facing extreme liquidity stress and that have insufficient collateral for the standing facilities. Banks must submit a credible liquidity restoration plan with the ELA request. ELA is provided at the discretion of Banxico's Governing Board, which may require that the bank's shares are pledged to supplement other collateral. Banks requesting ELA must have a CAR over 8 percent, be under the COR, or the CEB deems the bank systemic for resolution purposes.

[31] The FSAP workstream on systemic liquidity management comprehensively discusses Banxico's facilities.

C. Funding from IPAB

27. IPAB funding in resolution would typically be extended through a bridge bank or under TOBA. IPAB can establish, own, and operate a bridge bank, which it will need to capitalize. As discussed above, considering the operating costs of a bridge bank, IPAB views TOBA as the primary resolution strategy for SIBs and in systemic events. Prior to TOBA, a bank may have been under COR or not (the latter would be the case when it is unable or unwilling to apply for COR, or CNBV rejects a COR application). Either of these alternatives would involve a different way for IPAB to provide funding under TOBA (Box 1). For a bank that had previously not been under COR, the funding would be through a 15-day loan after which either the loan is repaid or, in case it is not repaid, IPAB would acquire the banks' shares against the adjusted book value as determined by an external valuation (within 120 days after being commissioned by IPAB). For banks that had previously been under COR, the process could take up to a year while the bank is implementing a capital restoration plan; if the bank is unsuccessful, IPAB can provide financial support through the subscription of shares and recapitalize the bank based on an external valuation. In either case, if IPAB acquires a bank's shares, it has one year (that can be extended for one year) to sell the shares. If a sale is not possible within this period, the bank will most likely be liquidated. TOBA implies that the CEB deems that most—if not all—of the failing bank's liabilities need protecting, except for TLAC and capital instruments, as otherwise appointing a conservator to an open bank would likely trigger or exacerbate liquidity pressures (due to the signaling effect). This approach goes against the raison d'être of the international reform agenda in the aftermath of the global financial crisis and would expose IPAB to significant uncertainty and risk, potentially eroding depositor confidence. While TLAC is being phased and bail-in powers are introduced, the MFAs should reconsider TOBA.

D. Funding from the Government

28. Direct funding in resolution by the Mexican government should only be considered after introducing statutory bail-in powers. In a large-scale financial crisis, government funds may be needed to recapitalize SIBs. At times of acute contagion risks when markets are dislocated or frozen—or these risks would be exacerbated by putting a bank in resolution—it will be difficult for the private sector to generate new private capital for banks, requiring the temporary deployment of public funds. This would be the case, for example, if the loss-absorbing capacity of a bank is insufficient to cover potential losses or if doing so would trigger contagion. Using public funds for bank recapitalization should be a last resort, used only when financial stability is severely threatened, and subject to strict conditions, including losses first being recognized.[32] The Mexican resolution regime does not envisage such temporary government support.[33] Government funding would only be provided indirectly by supporting IPAB when its funds are insufficient. Ideally, ownership interests in banks following full or partial recapitalization should be SHCP's responsibility (or a specialized agency). Deposit insurers have a conflict of interest in owning an entity whose depositors they are

[32] See Box 8 in Marc Dobler and others, "Managing Systemic Banking Crises—New Lessons and Lessons Relearned," IMF 2020, Departmental Paper No. 20/05.

[33] Using regular budgetary processes, SHCP can request Congress for funding for financial stability measures.

insuring, and competitiveness and fairness concerns arise for other banks. Such ownership could also result in losses, potentially undermining deposit insurers' balance sheet and credibility. These arguments could inform future discussions on allowing direct SHCP funding to banks in resolution, but only after introducing bail-in powers as discussed earlier in this note.

DEPOSIT INSURANCE

A. IPAB Governance and Staffing

Governing Board

29. The IPAB Governing Board comprises three ex officio public officials—including the Minister of Finance as chair—and four independent members. IPAB is a decentralized parastatal entity;[34] it is part of the federal public sector—under SHCP's coordination—but with its own legal personality and finances separate from SHCP, albeit subject to the federal rules for public financing and remunerations, and subject to continuous federal audits. As required by the Federal Parastatal Entities Law, the Minister of Finance chairs the Governing Board; the IPAB Law further provides that the Banxico Governor and the CNBV President sit on the Board. Four independent members hold a majority on the Governing Board; they are appointed by the Republic's President with the Chamber of Senators' approval. The independent members serve four-years terms; they are appointed on a staggered schedule—one each year—with replacements serving the remainder of a term so the staggered schedule is maintained, supporting continuation of expertise at the board level. The Governing Board is vested with the statutory power to take key decisions on IPAB's functioning,[35] including budgetary decisions, the appointment and dismissal of IPAB's Executive Secretary and Deputy Executive Secretaries, and firm-specific resolution decisions.[36]

30. Filling the vacancies of independent members on the IPAB Board should be given the highest priority. Unlike the ex officio members, the independent members do not have alternates. More importantly, for some time, three of the four independent positions have been vacant.[37] The FSAP recognizes that IPAB's position as a parastatal entity makes it hard to pursue a more structural strengthening of its governance structure, for example, with the Executive Secretary or an

[34] For comparison, CNBV is a deconcentrated entity, which is an extension of SHCP, without its own legal personality and finances; Banxico is one of several public entities that is recognized by the federal constitution, enjoying the highest degree of autonomy (including a board comprising only independent members).

[35] The regular board meetings are held every other month. Four members constitute a quorum, provided that the Minister or its alternate is present. To carry a motion, a majority of members in attendance suffices. Decisions on resolution measures require support from at least four members including one ex officio member.

[36] The Governing Board receives resolution plans for information, and it decides—under the Finance Minister's leadership—on the resolution measures that the Executive Secretary proposes to undertake in the case where a bank is actually failing. Ideally, SHCP should only be involved in firm-specific resolution decisions when funding from the government budget is (at risk of being) needed.

[37] The Chamber of Senators is considering the President's nominees for two of the three positions.

independent member chairing the Board, and subject to less intrusive federal audits.[38] Therefore, filling these three vacancies with new independent board members should be given the highest priority.

Executive Secretary

31. The safeguards for the autonomy of IPAB's executives should be strengthened. The Executive Secretary, IPAB's chief executive, is responsible for the day-to-day management of IPAB and for preparing and executing the Governing Board's decisions, including preparing IPAB's budget, developing its organization, the appointment and dismissal of the Deputy Executive Secretaries, and appointing and dismissing IPAB's staff. The Executive Secretary is appointed by the Board—the last three Secretaries from among IPAB's staff—for an undefined term, but they serve an average of three years. In practice, the IPAB Executive Secretary has been replaced when new governments have taken office. Contrary to the four independent board members who enjoy strong protections against dismissals under several federal laws, the Executive Secretary can be removed from office on a "reasonable proposal" from any board member; there are no statutory grounds at all for the dismissal of the Deputy Executive Secretaries. The board members and the executives have recourse to courts to challenge their dismissal, and courts could award monetary compensation. The Parastatal Entities Law does not appear to prevent policies or statutory requirements under the IPAB Law to set a fixed term of appointment and more objective grounds for dismissal of IPAB's Executive Secretary and the Deputy Executive Secretaries, possibly emulating the grounds that apply to the four independent members of the IPAB Board or the members of the Banxico Board. The authorities should enhance IPAB executives' autonomy along these lines.

Staffing Levels & Skillset

32. Recent federal policy changes have significantly reduced IPAB's operating budget and staffing resources. Staffing levels at IPAB have been stable over the last decade, after being halved relative to the previous decade. The measures, introduced by the government in 2019, led to reductions in IPAB's operating budget by 45 percent—now using about one percent of collected fees—while staffing fell by 10 percent.[39] In this context, IPAB has overall experienced a major turnover of staff in 2020 and 2021: in some critical units 20–33 percent (e.g., resolution planning and execution, and dispute prevention and litigation), with the Finance and Treasury Unit experiencing a 75 percent turnover.

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[38] Like for other public entities, Mexico's supreme audit institute (*Auditoría Superior de la Federación*) has jurisdiction over IPAB, undertaking financial, compliance, and performance audits. Due to its parastatal entity status, IPAB has two further government auditors: the head of its internal audit body (*Órgano Interno de Control*) appointed by and reporting to the Ministry of Public Affairs; a public commissioner (*Comisario*) appointed by the President through said Ministry. The internal auditor and the public commissioner attend the meetings of the IPAB Board and more generally opine on an ongoing basis on policy and operational matters that IPAB is considering.

[39] IPAB is a self-financing agency with budgetary autonomy (subject to certain government rules and procedures). Therefore, the amounts saved because of the 45 percent cut in IPAB's operating budget are added to the Bank Savings Protection Fund (*Fondo de Protección al Ahorro Bancario*; FPAB).

33. With an increasingly complex financial system requiring new skillsets, the ongoing evaluation of IPAB's organizational structure and human resources needs is welcome. The recent loss of experience, reflecting the staff turnover, comes at a time when the financial system's complexity is increasing, pointing to new resource challenges. For example, financial innovation is changing the business structure of banks that may need to be resolved; cybersecurity challenges may further hamper operational continuity in resolution. This complexity will require IPAB to build new resource skillsets in competitive labor markets. Amplifying these challenges, more resources are needed to reduce impediments to resolvability and to undertake contingency preparations, which will require increased reprioritization by IPAB. In Mid-2000, IPAB created a special reserve fund for commissioning external resources to support its staff in times of increased work demands. The FSAP welcomes this important effort, while noting that IPAB will also need to develop and maintain certain experience and expertise among its career staff for business-as-usual work and to ensure appropriate management and quality control of external resources.[40] Therefore, reflecting these emerging and continuing challenges, the FSAP supports the ongoing evaluation of IPAB's organizational structure and human resources needs and how best to attract and retain key staff to ensure that it can continue to deliver on its mandate.

Legal Protection

34. IPAB's current and former officials, staff, and agents enjoy legal protection for (in)actions if they acted in good faith. This protection is enshrined in legislation supported by internal policies and procedures and complemented by internal funds and external insurance for liabilities and legal aid. Importantly, said persons can choose their own legal representation, enjoy legal and financial protection throughout appeals processes, and are protected against repayments of costs made by IPAB unless these persons have acted in bad faith. Resolution measures are more intrusive than regular supervisory measures, and stakeholders (e.g., shareholders and creditors) are more vocal and litigious when affected by resolution measures, which can have high financial costs. Therefore, IPAB should regularly assess whether the levels of internal funds and external insurance for liabilities and legal representation are adequate.

B. IPAB Finances

35. IPAB has two sources of income and several backstops that have yet to be operationalized. The sources comprise fees paid by banks and returns on investments made with the funds under IPAB's management. IPAB collects ordinary fees and can—but never did—collect extraordinary fees. IPAB's Governing Board decides on the fee levels within statutory parameters: the ordinary fees cannot be lower than 0.4 percent of a bank's liabilities; the extraordinary fees cannot exceed 0.3 percent; and together, both fees cannot exceed 0.8 percent. IPAB has always kept the ordinary fee level at 0.4 percent. In case its funds are (likely to be) insufficient to deal with a resolution or payout (that is imminent), IPAB can borrow from the market up to an amount equal to six percent of commercial banks' total liabilities (amounting to 28,478 million USD at end-2021).

[40] In addition, the IPAB Law allows for secondments from other MFAs at IPAB in times of need. However, no arrangements are in place to make this possibility easily accessible.

IPAB can also borrow from Banxico or development banks. Moreover, IPAB can request—through SHCP—extraordinary funding from Congress to repay market funding or to payout insured deposits. Although accessing markets or borrowing from individual financial institutions could be difficult in times of system-wide distress, it would still be good to establish advance arrangements (e.g., a line of credit with a consortium of banks and bridge financing from Banxico before accessing other funding) "to ensure effective and timely access [to funding] when required" (IADI CP9, EC4).

36. Despite the legacy debt weighing heavily on its finances, IPAB has built a fund that could cover the individual resolution and payout of many smaller banks. IPAB carries the debt stemming from the systemic crisis of the mid-1990s (the 'tequila crisis'). Each year 75 percent of banks' contributions to IPAB are allocated to service this debt; with a matching contribution from the government for another 30 years, this debt is projected to be fully repaid in 2069. The remaining 25 percent of annually collected fees are used for IPAB's operating expenses (around one percent of the fees) and for FPAB. This resulted in a fund that stood at 1.4 percent of insured deposits at end-2021,[41] which can fund the resolution/payout of the smallest 75 percent of commercial banks.

37. The FPAB is steadily growing to a level that is more appropriate for the Mexican financial system, considering also IPAB's dual mandate for deposit insurance and resolution funding. Currently, the FPAB would be insufficient to cover the concurrent failure of the largest 3–4 non-SIBs or the largest 6–8 smaller banks. IPAB calculations point at the need for a fund equivalent to 2.8–4.5 percent of insured deposits, which would be more appropriate for the aforementioned scenarios—especially considering that IPAB is also responsible for the resolution funding of SIBs. IPAB projects that under the current funding structure, FPAB would reach 3.4 percent of insured deposits in 2027 and 5.1 percent in 2032.[42] This process could be expedited by relieving IPAB from the legacy debt, which would also help preempt potential setbacks to the FPAB if more banks were to fail in the near future—the recent two failures reduced FPAB from 2 percent to 1.4 percent of insured deposits.

C. Public Awareness

38. IPAB has a comprehensive communications (management) infrastructure that served it well during the two recent bank failures but there is room to further increase public awareness of deposit insurance. Together with the other MFAs, IPAB engages in national financial education and inclusion programs, utilizing traditional and modern means of audio-visual communication. IPAB's communication strategy differentiates between demographic groups (e.g., the elderly or youth) and—together with the liquidators—particularly focused its communications campaign on the depositors of the two banks that failed in 2020 and 2021. Despite these efforts, the 2021 edition of a triennial national financial education survey showed that only 28.5 of the surveyed adults are aware that savings are insured by IPAB—slightly increasing from 24.9 percent in 2015 when questions on deposit insurance awareness were introduced in the survey. These numbers

[41] Before the two recent bank failures, the FPAB stood at two percent of insured deposits.

[42] In terms of eligible deposits, these projections translate to 2.2 percent in 2027 and 3.6 percent in 2032.

should be understood against the background of a country where about one-third of the adult population is unbanked—possibly, unawareness of deposit insurance being one of many factors for the latter. Building on existing communications efforts, the MFAs should aim to increase the public awareness level for deposit insurance to a large majority of both depositors and unbanked adults.[43]

FINANCIAL CRISIS PREPAREDNESS AND COOPERATION

39. The Mexican financial oversight structure offers ample opportunities for interagency cooperation. The IPAB and CNBV boards include high-level representatives from the other MFAs. The CEB is a platform where all MFAs meet to decide on the systemicness of a failing bank and the extent to which liabilities will need to be protected in resolution, which determines the resolution options and gives direction to their use by IPAB. To support the CEB's decisions, IPAB and Banxico have adopted internal guidelines for the information that it will provide the CEB. This institutional framework is complemented with MOUs on information exchanges between IPAB and Banxico (2012), IPAB and CNBV (2015), and guidelines concluded among all MFAs (2000). To support the updated recovery plan guidelines, the MFAs are preparing an MOU for the interagency consultations on recovery plans and the scoring framework for the plan reviews. The MFAs should consider whether any of the existing MOUs need updating, whether CNBV too should detail the information it will provide the CEB (and whether the MFAs should elaborate on the statutory criteria for determining a failing bank's systemicness), and whether any other components of the resolution framework (such as the COR and TOBA) could benefit from jointly agreed procedures and policies. More generally, the FSAP encourages the MFAs to consider policy and operational documentation that is more accessible and practical than financial legislation.

40. Benefitting from earlier crisis simulation exercises and the experience with recent bank failures, the MFAs should continue to prepare for diverse failure scenarios. IPAB—and the other MFAs—have shown that they can manage the failure of a very small bank (Accendo in 2021 with about 1,500 insured depositors and US$ 66 million in insured deposits) and a midsize bank (Famsa in 2020 with 633,000 insured depositors and US$ 1.2 billion in insured deposits). Fortuitously, in 2019, IPAB had simulated the payout process for a bank with over 600,000 depositors,[44] which resulted in lessons learned that were successfully used in the Famsa failure. Less fortunately, well-advanced preparations for an interagency systemic crisis simulation were halted by the COVID-19 outbreak. This simulation will test the Mexican authorities' response to a cybersecurity incident and its financial fallout. Benefitting from these experiences, the MFAs should continue preparing (with, e.g., policy guidance, operational manuals, playbooks, and regular table-top and simulation exercises) for diverse failure scenarios, including fast-fail resolutions of SIBs and midsize banks, and

[43] For example, the Dutch deposit insurer is aiming to increase the public awareness level from currently 58 percent to 65 percent in 2022 and 70 percent in 2024. Following its research showing that an awareness level of 60–65 percent is needed to help prevent a bank run, the Canadian deposit insurer is implementing an awareness strategy to reach this level in 2023—in September 2021, the awareness level was 61 percent (but with women at 52 percent).

[44] For a description of this simulation see "Contingency Plan Testing in North America," IADI, June 2021.

their concurrent failure, particularly where impediments to resolvability exist (as identified by IPAB), operational continuity in resolution is challenging (e.g., due to a cybersecurity incident in resolution), or resolution methods (i.e., COR and TOBA) keep distressed banks engaging with markets and the public. These preparations should also include a swift P&A transaction with a bridge bank, followed by a sale to a private sector purchaser, which could reduce the MFAs' dependence on liquidations with payouts even for larger midsize banks.

Appendix. Status Update 2016 FSAP Recommendations

2016 Recommendations *Bank Resolution, Crisis Preparedness, Deposit Insurance*	**Implementation Status in 2022** *Of the 22 recommendations, 12 were implemented and 4 were partially implemented.*
1. Strengthen IPAB's independence: appoint an independent Board member as Chair, and include in the IPAB law (1) a timeframe for the mandate of the Executive Secretary; (2) objective revocation criteria; and (3) public disclosure of reasons for early dismissal.	**Not Implemented**. The Mexican authorities explained that IPAB's governance structure appropriately follows Mexico's framework for federal parastatal entities (such as IPAB).
2. Relieve IPAB from its legacy debt, adopt a well-considered target fund ratio that can be achieved within a reasonable period of time; finalize the IPAB-Banxico agreement giving IPAB access to bridge funding from Banxico prior to using IPAB's powers under Article 46 of the IPAB Law to borrow from the banking sector.	**Not Implemented**. The legacy debt continues to weigh heavily on IPAB finances: each year 75 percent of banks' contributions to IPAB are allocated to repay this debt. This debt is projected to be fully repaid in 2069. While IPAB has not set a formal target ratio for the FPAB, it is projected to stand at around 3.4 percent of insured deposits in 2027 and 5.1 percent in 2032. The modalities for IPAB borrowing from Banxico have not been worked out.
3. Conduct an internal and external review of whether IPAB is meeting its public policy objectives, and whether IPAB's several public policy objectives (e.g., dealing with legacy debt and assets, and effective contribution to payouts and resolutions) are consistent.	**Implemented**. IPAB undertakes and publishes biannual self-assessments; IPAB also publishes annual activity and financial reports. Furthermore, like for other public entities, Mexico's supreme audit institute (*Auditoría Superior de la Federación*) has jurisdiction over IPAB, undertaking financial, compliance, and performance audits. Due to its parastatal entity status, IPAB has two further government auditors: the head of its internal audit body (*Órgano Interno de Control*) appointed by and reporting to the Ministry of Public Affairs; and a public commissioner (*Comisario*) appointed by the President through said Ministry.
4. Conduct a carefully constructed public awareness survey to determine the level of knowledge of deposit insurance existence, coverage level and activities to inform IPAB's public awareness strategy.	**Implemented**. As part of the National Survey for Financial Education, CNBV and the National Institute of Statistics and Geography, in collaboration with other members of the National Council for Financial Inclusion (including IPAB), undertake a comprehensive triennial survey. The 2021 survey showed that 28.5 percent of the surveyed adults are aware that their savings are insured by IPAB—slightly increasing from 24.9 percent in 2015 when questions on deposit insurance awareness were introduced in the survey. Additionally, IPAB has launched several public awareness campaigns.
5. Strengthen the recovery planning process by issuing expectations for banks' recovery capacity, considering a risk-based approach, and taking into account the group-dimension where relevant and the role of the Competition Commission.	**Implemented**. All commercial banks are subject to recovery planning requirements that are set in Article 119 of the Credit Institutions Law and elaborated on in Annex 69 of the Banking Single Rulebook (*Circular Única de Bancos*). In September 2022 (effective January 2023), Annex 69 was updated for more granular guidance for the banks' recovery planning and for the

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	MFAs' plan reviews. Annex 69 and the authorities' reviews cover intra-group considerations.
6. Accelerate the resolution planning program to cover more banks, giving priority to complex local banks.	**Implemented**. IPAB has developed resolution plans for all commercial banks, some of which—including for two SIBs—have been updated once.
7. Develop written guidelines to facilitate timely collective decisions through the CEB on systemic determinations for resolution purposes and increase the CEB's flexibility in specifying liabilities to be protected, including to better enable the use of bridge banks for resolving systemic.	**Not Implemented**. CEB members continue contributing to systemicness decisions based on their respective mandates and methodologies. The CEB follows—without discretionary powers—the creditor hierarchy set out in the Credit Institutions Law, Articles 64, 180, 241, and 242.
8. Include IPAB in the licensing process for banks or the process for conversion of a non-bank financial institution into a bank.	**Implemented**. CNBV consults IPAB in the licensing process on the suitability of bank shareholders and managers. The two agencies also meet with the prospective bank to discuss a bank's obligations under the deposit insurance system.
9. Preposition a bridge bank and prepare for the use of bridge banks for resolving systemic banks, minimizing the use of TOBA and the risk of bailout of shareholders and subordinated debt holders; use the 2016 systemic bank resolution planning exercise to test the use of bridge banks.	**Implemented**. IPAB has adopted internal procedures for the "Establishment, organization and operation of commercial banks by IPAB (Bridge Bank)," setting out the model corporate charter and model contracts for asset and liability transfers, and the provision of services; IPAB has also developed methodologies for valuations for purposes of a bridge bank. The ex-ante incorporation of a bridge bank without using it in the near term would be costly. IPAB's 2016 systemic bank resolution simulation covered using bridge banks for non-SIBs.
10. Adopt policies for use of TOBA framework (for example, regarding valuations, level of capitalization, potential liquidity support, desired restructuring, and downsizing).	**Implemented**. The Credit Institutions Law sets out the conditions and procedures for TOBA. IPAB has operational manuals for TOBA covering, e.g., the communications strategy, the appointment of and oversight over conservators, the conditions for loan and capital support, the calculation of capitalization levels, and accountability toward Congress. IPAB has a valuation methodology; third parties that it engages for valuations follow a similar methodology. Furthermore, some banks under TOBA will likely avail themselves of the COR, requiring a CNBV-approved capital restoration plan, including also measures to improve the bank's operational efficiency and to reduce certain transactions.
11. Plan for the use of additional resolution tools beyond payout and liquidation; take steps to increase the practicality of using P&A transactions with third parties.	**Partially Implemented**. While preparations were made for the bridge bank tool, legal constraints hinder the use of P&A transactions.

2016 Recommendations *Bank Resolution, Crisis Preparedness, Deposit Insurance*	**Implementation Status in 2022** *Of the 22 recommendations, 12 were implemented and 4 were partially implemented.*
12. Expand the special resolution regime to cover FHCs; consider whether deposit-taking development banks should become part of the deposit insurance system.	**Not Implemented**. The MFAs have not planned to introduce a resolution regime for FHCs, arguing that the holding companies' have mainly a non-operational role. See ¶17 of this Note. Only two development banks take deposits—the largest of which serves members of the armed forces—and held 4.1 percent of total bank deposits at end 2021; in addition, development banks are fully guaranteed by the federal government. Therefore, the MFAs do not deem it necessary to introduce deposit insurance for deposit-taking development banks. This is inconsistent with IADI CP7, EC1, that requires membership of a deposit insurance system for all banks, "including state-owned banks (with or without explicit guarantees)."
13. Increase the level of collaboration and consultation among the authorities, including between IPAB and Banxico (a shared understanding) on banks' access to ELA in resolution, and between IPAB and CNBV on, for example, the treatment of pre-2013 subordinated debt issuances and removing impediments to resolvability.	**Partially Implemented**. Banxico has published its rules for the Additional Ordinary Liquidity Facility and Credits of Last Resort, and its internal protocols prescribe informing the other MFAs about ELA requests and decisions. The new Guidelines on Resolution Planning require that all plans identify impediments to resolvability and the measures to mitigate or eliminate these impediments. IPAB and CNBV have not agreed on approaches for mitigating or removing these impediments. Due to their 10-year time horizon, there are no outstanding pre-2013 subordinated debts.
14. Develop internal written policies on the conditional operation regime and conservatorship (including an IPAB-CNBV MOU) to limit regulatory forbearance, consult with IPAB when granting forbearance, and trigger resolution in advance of the mandatory 4.5 percent CET1.	**Partially Implemented**. The Credit Institutions Law sets out the conditions and procedures for COR and conservatorship. Neither CNBV nor IPAB have internal COR policies—or a joint MOU; they would decide on COR authorizations on a case-by-case basis, with CNBV consulting IPAB. In 2016, IPAB adopted internal rules for the selection and appointment of conservators, including their responsibilities and the objective of conservatorship. A bank with a CAR below 8 percent and above 4.5 percent can be resolved if it is unwilling or unable to use the COR.
15. Prepare formal contingency plans for dealing with a systemic crisis or systemic bank in resolution, test, and enhance the plans via simulation exercises.	**Partially Implemented**. While the MFAs individually undertake simulation exercises, there are no collective system-wide contingency preparations, and no collective simulation exercise for a systemic event was undertaken since 2011. Preparations for an interagency crisis simulation were well advanced when it had to be postponed due to the COVID-19 outbreak. This

2016 Recommendations *Bank Resolution, Crisis Preparedness, Deposit Insurance*	**Implementation Status in 2022** *Of the 22 recommendations, 12 were implemented and 4 were partially implemented.*
	exercise will test the MFAs' response to a cybersecurity incident and the resulting financial fallout.
16. Analyze optimal deposit insurance and resolution funding arrangements.	**Implemented**. Despite the legacy debt weighing heavily on its finances, IPAB has built a fund that could cover the individual resolution and payout of many smaller banks A 2017 IPAB assessment concluded that a target range between 2.0 and 4.5 percent of eligible deposits would be appropriate, the lower level is projected to be reached in 2027. IPAB is updating its analysis and projections in the aftermath of two recent bank failures.
17. Determine the potential for IPAB to provide liquidity funding in resolution.	**Implemented**. IPAB has determined that it cannot provide liquidity funding in resolution. Subject to conditions, banks in resolution can access liquidity funding from Banxico.
18. Require banks to issue loss-absorbing debt instruments and remove restrictions on issuance of subordinated debt.	**Implemented**. TLAC was introduced in 2021, which will be phased in through 2025. The 400 million *Unidades de Inversión* (units of investment) limit of capital instruments that could be included in the regulatory capital of banks whose shares (or those of their FHC) were not listed on a stock exchange was eliminated in 2017.
19. Conclude agreements with relevant deposit insurers for all foreign banks operating as subsidiaries in Mexico to allow for the sharing of information about failing or failed institutions in the home country.	**Implemented**. IPAB has concluded MOUs with all major home jurisdictions of the Mexican DSIBs. These bilateral agreements complement the firm-specific cooperation arrangements supporting international banks' CMGs.
20. Develop (i) the necessary agreements and processes for using a paying agent bank, and (ii) methods of deposit reimbursement other than issuing checks to have the ability to reimburse most depositors within seven working days.	**Implemented**. Since April 2020, IPAB uses a major commercial bank with an extensive branch network as its agent for payouts. Together with this bank, IPAB has developed several payout processes with cheques, payment orders, wire transfers, and cardless withdrawals at automated teller machines. These new reimbursement methods were used for the two banks that failed in 2020 and 2021.
21. Develop a policy to address the situation where, after a merger or purchase and assumption, a depositor whose funds may exceed the deposit insurance limit because of such action would have a set period of time to restructure accounts to obtain full insurance coverage.	**Not Implemented**. No legislative changes were introduced to cover temporary high deposits due to a merger or P&A as required by IADI CP8, EC6.
22. Enable departure from pari passu treatment.	**Not Implemented**. The Mexican legal system does not allow departing from pari passu treatment under any circumstances.