RCAP jurisdictional assessments: self-reporting monitoring template for RCAP follow-up actions

Jurisdiction: Mexico

Status as of: 31 December 2016

With reference to RCAP report(s): Assessment of Basel III risk-based capital and LCR regulations – Mexico (March 2015)

Part A[1]

Post-RCAP follow up: Changes applied to local regulations of the Basel Framework relating to risk-based capital standards (RCAP-Capital)

Table A

(1) Issue and/or relevant Basel paragraph number(s)	(2) Detailed description of finding (please indicate as precisely as possible the finding as identified in the relevant RCAP assessment report)	(3) Detailed reference to the domestic legislation/regulation that addresses the finding	(4) Summary description of amendment or rectification made
Basel III paragraphs 136–150.	Mexico had not incorporated neither of the countercyclical capital buffer requirements — the national countercyclical buffer or the bank-specific countercyclical buffer — into its regulations at the time of this RCAP assessment. Nevertheless, its banking act gives the power to the CNBV to impose a countercyclical capital buffer requirement based on the provisions that the CNBV issues in the Official Gazette of the Federation. Basel III indicates an implementation date on 1 January 2019 for the countercyclical	General Provisions Applicable to Credit Institutions Article 2 Bis 117 p; Article 2 Bis 117 q, and Annex 1-T Bis 1. English version is not available.	Final rule was published on April 7, 2016 with the following considerations: • The countercyclical capital buffer for credit exposures in Mexico was set up on 0%. • Reciprocity principle is applied only for those jurisdictions that are Basel members. • The countercyclical buffer will be on phased-in status during four years starting from 2016 to 2019.

[1] To be completed only for those findings where action has been taken or initiated. Any plans for addressing other findings may be indicated in Part B.

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	buffer regime, and as such the Assessment Team recommends this issue to be highlighted for post-assessment follow-up.		
Basel II paragraphs 757–758	Although Mexico's domestic regulations on risk management and capital management have covered the broad expectations under Pillar 2, discussions with the CNBV and representatives from local banks indicated that to date there has not been a full and thorough implementation of Pillar 2. The Assessment Team recommends a post-assessment follow-up to identify whether and to what extent Mexico is actively implementing a Pillar 2 regime.	General Provisions Applicable to Credit Institutions: Article 1, Chapter VI BIS of Title One Bis (From Article 2 Bis 117 up to Article 2 Bis 117 d), Article 66, Article 67, Article 68, Article 69, Article 71, Article 74, Article 75, Article 76, Article 78, Article 80, Article 82, Article 83, Article 86 Bis, Article 86 Bis 2, Article 87, Annex 12-B, Annex 13, and Annex 13-A.	In addition to the stress testing process which is carried on annually with supervisory scenarios, in December 31, 2014 the CNBV published the Pillar 2 provisions (ICAAP) in order to require banks to implement an annual stress test under their own scenarios. Such scenarios are based upon the principles and assumptions considered in the Basel rules. According to the transitional arrangements agreed during the RCAP, these outstanding Pillar 2 provisions are in force since July, 2016. Since December 2015, CNBV required banks to adopt the provisions in order to avoid deviations from the standard and implemented a revision process to assure the adequate implementation. As of December 2016, all Mexican banks have summited their ICAAPs to the CNBV. The results of these assessments have been discussed with the banks and supervisory actions are expected to be implemented during 2017.

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Post-RCAP follow up: Changes applied to local regulations of the Basel Framework relating to Liquidity Coverage Ratio (RCAP-LCR)

Table B

(1) Issue and/or relevant Basel paragraph number(s)	(2) Detailed description of finding (please indicate as precisely as possible the finding as identified in the relevant RCAP assessment report)	(3) Detailed reference to the domestic legislation/regulation that addresses the finding	(4) Summary description of amendment or rectification made
Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools: paragraphs 17 – 18.	Under Mexican regulations, a bank in Scenario II could technically fall below 100% and still be considered compliant with the LCR, meaning that, for this situation, the regulation cannot stipulate any formal corrective measures that the CNBV could apply to the bank. Whilst the team concluded that the scope for a bank to consistently breach the LCR within the Mexican LCR framework is – as a practical matter – unlikely to materialise, the team has listed the finding for a future follow-up assessment to review the Mexican authorities' experience with the approach taken and to re-evaluate the materiality of the finding.	Article 5, fraction V regarding to LCR Report and article 12 of General provisions on liquidity requirements for commercial banks.	As specified in the RCAP document, LCR regulations was amended to specify that it is not possible for banks to operate consistently slightly below the 100% LCR minimum required level and still be compliant. Particularly, local regulation require banks classified in Scenario II on three or more occasions within the last six previous months, to be automatically classified into Scenario III. Based on this amendment, a consistently breach of the LCR is unlikely to materialise as the automatic placement in Scenario III will stop banks from systematically trying to operate with a lower HQLA buffer. Furthermore, a monthly breach report from bank to the CNBV, and Bank of Mexico would, as a practical matter, lead to remedial action, additionally to the LCR general provision. The CNBV could still impose measures against a bank that falls into Scenario II, particularly if it repeatedly remains in the same category (but without falling into Scenario III), due to

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			insufficient internal controls. In this case, the CNBV could make use of its supervisory powersto start an investigation into the bank's liquidity controls.
Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools; Annex 4 Illustrative Summary of the LCR, Cash Outflows.	To determine collateral flows associated with derivative trades, the Basel standard prescribes a look-back based on realised collateral flows over the past 24 months. Under the Mexican regulations, the realised collateral flows are approximated by valuation changes in derivatives. The Assessment Team considers this consistent with the spirit of the Basel framework. However, the team considers that the topic should be reviewed in a future RCAP assessment to re-assess supervisory experiences and whether any issues have emerged in the banks' implementation of this rule.	Fraction III of the Annex 4, "Methodology for determine outflows and inflows in derivative transactions" of the General provisions on liquidity requirements for commercial banks.	The LBA in Mexico was based on the valuation changes of the derivatives portfolio rather than on the collateral flows. Which in turn implies that derivatives transaction outflows does not account for collaterals to hedge transactions. This approach was more conservative than the Basel Standard because changes in collateral are lower than valuation changes. In this sense, and to avoid overestimating outflows for fully collateralized derivatives transactions, the existing rule was amended in December 2016 to calculate the contingent outflow of collateralized derivatives transactions as the largest absolute net 30-day collateral flow realised during the preceding 24 months.

Part B

Risk-based capital standards

Credit risk:

- **Standardised Approach:** Mexican capital rules allows the application of zero risk weight to bank exposures to their sovereign or central banks assets that are denominated in foreign currencies. From a materiality point of view, the impact of the deviation is non-material neither on an individual nor a collective basis. Its potential materiality is restricted by the limits set onto banks' holdings of foreign currency exposures and the close FX monitored by CNBV and Bank of Mexico.
- **Internal Ratings-Based Approach:** According to the RCAP document, Mexican regulations do not provide all the asset class definitions as in the Basel standards. There is no specialised lending asset class.

  Regarding to this deviation, the limited use of IRB approach remains constant and as of December 2016. There are not exposures of specialize lending approved under the IRB portfolios. With the new amendments to the credit risk framework (revised IRB and standardized approach) the CNBV is considering to improve the standardized approach for credit risk and as consequence improve the IRB approach afterwards.
- **Securitisation framework:** The definition of re-securitisation exposures broadly complies with the Basel Standard, but lacks the detailed supporting description from the 2009 Basel enhancements that were intended to clarify the application of the definition. The CNBV will improve this definition once the new standardized approach is included according to the international implementation schedule.

Market risk:

- **Standardised Approach:** A few deviations regarding to the computation of foreign exchange exposures in a single currency, a specific risk capital charge for non-domestic currency denominated in sovereign debt, a specific risk capital charge for underlying credit derivatives. These items are considered non-material at the moment of the RCAP Report publication and for the next several years. The CNBV will improve these deviations once the new standardized approach is included in the Mexican rules according based on the international implementation schedule.