Basel Committee
on Banking Supervision

Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel III LCR regulations (RCAP-LCR) -Mexico

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Glossary

BCBS	Basel Committee on Banking Supervision
BdM	Bank of Mexico (Banco de México)
CEM	Current Exposure Method
CNBV	Comisión Nacional Bancaria y de Valores
COFEMER	Comisión Federal de Mejora Regulatoria
EL	Expected loss
FAQs	Frequently asked questions
G-SIB	Global systemically important bank
HQLA	High-quality liquid assets
IPAB	Instituto para la protección al ahorro bancario
LBA	Look-back approach
LCR	Liquidity Coverage Ratio
MTM	Mark to market
MXN	Mexican peso
RCAP	Regulatory Consistency Assessment Programme
RCLF	Restricted Committed Liquidity Facilities
SHCP	Secretaría de Hacienda y Crédito Público
SMEs	Small and medium-sized enterprises
UDI	Unidad de Inversión
UMS	United Mexican States bonds
USD	US dollar

Preface

The Basel Committee on Banking Supervision (Basel Committee) sets a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits from adopting Basel standards can only fully accrue if these are implemented appropriately and consistently by all member jurisdictions. The Committee's Regulatory Consistency Assessment Programme (RCAP) thus helps monitor, assess and evaluate its members' implementation practices including follow-up steps taken by individual members.

This report presents the findings of the RCAP Assessment Team on the domestic adoption of the Basel LCR standards in Mexico.[1] The assessment focuses on the regulatory adoption of Basel LCR standards applied to the Mexican banks that are internationally or regionally active and of significance to its domestic financial stability.

The RCAP LCR assessment was based primarily on the draft LCR rule that was issued by the Mexican authorities in October 2014. In the course of the assessment, the authorities made a number of revisions to the draft rule based on issues identified by the Assessment Team. The final rule on Basel LCR standard was issued by the Mexican authorities in December 2014. This report has been updated where relevant, to reflect the progress made in the Mexican final rule.

The RCAP Assessment Team was led by Mr Charles Littrell, Executive General Manager of the Australian Prudential Regulation Authority (APRA). The Assessment Team comprised seven technical experts drawn from Canada, India, Malaysia, Singapore, Spain, Sweden and the United States. The LCR assessment was covered by two assessors from the Assessment Team (Annex 1). The main counterpart for the assessment was the Comisión Nacional Bancaria y de Valores (CNBV). The Bank of Mexico (BdM) was also closely engaged in the assessment process.

The assessment relied upon the data, information, translations and materiality computations provided by the Mexican authorities for the period ended December 2014. The assessment findings are based primarily on an understanding of the current processes in Mexico as explained by the counterpart staff and the expert view of the Assessment Team on the documents and data reviewed. The overall work was coordinated by the Basel Committee Secretariat with support from APRA staff.

The assessment began in July 2014 and consisted of three phases: (i) completion of an RCAP questionnaire (a self-assessment) by the Mexican authorities; (ii) an off- and on-site assessment phase (July to November 2014); and (iii) a post-assessment review phase (January to mid-February 2014). The on-site visit included discussions with Mexican counterparts and representatives of Mexican banks. These exchanges provided the Assessment Team with a deeper understanding of the implementation of the Basel LCR standard in Mexico. The third phase consisted of a two-stage technical review of the assessment findings: first, by a separate RCAP Review Team and feedback from the Basel Committee's Supervision and Implementation Group and, second, by the RCAP Peer Review Board and the Basel Committee. This two-step review process is a key instrument of the RCAP process to provide quality control and ensure integrity of the assessment findings.

The focus of the assessment was on the consistency and completeness of the domestic regulations in Mexico with the Basel minimum requirements. Issues relating to prudential outcomes,

[1] The report complements the RCAP assessment report of Mexico's adoption of the Basel risk-based capital standards.

adequacy of liquidity ratios of individual banks or the effectiveness of the Mexican authorities' liquidity risk management were not in the scope of this RCAP assessment exercise.[2]

Where domestic regulations and provisions were identified to be non-conforming with the Basel framework, those deviations were evaluated for their current and potential impact (or non-impact) on the reported liquidity ratios for a sample of internationally and regionally active Mexican banks. Some findings were evaluated on a qualitative basis. The overall assessment outcome was based on the materiality of findings and the use of expert judgment. The assessment also identified areas for follow-up actions by the RCAP, which are listed in Annex 12.

The report has two sections and a set of annexes: (i) an executive summary with a statement from the Mexican authorities on the material findings; (ii) the context, scope and methodology and the main set of assessment findings; and (iii) details of the deviations and their materiality along with other assessment-related observations.

The RCAP Assessment Team acknowledges the professional cooperation received from Mexican counterparts throughout the assessment process. In particular, the team thanks the staff of CNBV for playing an instrumental role in coordinating the assessment exercise. The Assessment Team would also like to thank the staff of the Bank of Mexico involved with the RCAP assessment work, as well as representatives of Mexican banks that provided data and information. The series of comprehensive briefings and clarifications provided by the Mexican counterparts helped the RCAP assessors to arrive at their expert assessment. The Assessment Team is hopeful that the RCAP assessment exercise will contribute to the sound initiatives that have already been taken by the Mexican authorities and to further strengthening the prudential effectiveness and full implementation of the recent reform measures in Mexico.

[2] The most recent assessment of Mexico's financial system under the IMF-World Bank FSAP was published in 2012. A detailed assessment of Mexico's compliance with *Basel Core Principles* on supervisory issues was also carried out as part of the FSAP assessment and published.

Executive summary

The Mexican framework for LCR requirements was issued in December 2014 through the publication of the *General Provisions on Liquidity Requirements for Commercial Banks* (Annex 3). The LCR applies to all commercial banking institutions and state-owned institutions.

In September 2014 the Mexican authorities completed an extensive self-assessment of their draft LCR rules as part of their preparation for the RCAP exercise. The draft rules were issued for public consultation in October 2014. Based on the self-assessment and the published draft rules, the RCAP Assessment Team identified a number of material variations in the proposed LCR rules from the Basel framework. The Mexican authorities used the RCAP findings to amend the draft rule to the extent feasible and consistent with Mexican national interests. This was done in close coordination with the BdM and the Ministry of Finance (SHCP by its Spanish acronym), and has resulted in a significant strengthening of the Mexican liquidity regime.

Overall, as on the cut-off date for the RCAP assessment, the final LCR requirements in Mexico are assessed as compliant with the minimum Basel liquidity standards. The two graded components of the LCR framework, the LCR and the LCR disclosure requirements, are both assessed as compliant with the Basel standard. The amendments made by the Mexican authorities to the final LCR rule considerably improved the level of compliance with the Basel minimum standards.

The Mexican authorities and banks now face the challenge of implementing the LCR standard in practice (see Annex 7 for the key liquidity indicators of Mexican banking system). The Mexican authorities have developed and implemented the necessary reporting templates and systems. However, while the focus of the RCAP exercise was mainly on the consistency and completeness of regulatory LCR requirements, the achievement of the intended prudential outcomes in Mexico will depend on how effectively the regulations are put into practice, monitored and supervised. The Assessment Team notes that the 2012 Mexican FSAP assessment of the Basel Core Principles identified supervisory independence and empowerment as critical areas for improvement. The RCAP team's experience has been consistent with these findings as they relate to the implementation of the Basel framework. Statutory support for greater flexibility in its regulatory and Pillar 2 powers would help the CNBV more easily meet or exceed international regulatory expectations (see also the RCAP capital assessment for Mexico for further discussion).

In addition to the formal assessment of the LCR standard and disclosure requirements, this report also summarises Mexico's implementation of the Basel Principles for sound liquidity risk management (Sound Principles) and the LCR monitoring tools (Annexes 9 and 10). The Sound Principles have been implemented in Mexico's regulation through the General Provisions Applicable to Credit Institutions (the General Provisions). Guidance for supervisors in assessing liquidity risk management in banks has been implemented through the National Banking and Securities Commission Law and the Credit Institutions Law. The liquidity monitoring tools will be implemented in Mexico in the first quarter of 2015 through amendments to the Risk Management Framework. Further, a summary is provided of the key national discretions and approaches that the Mexican authorities have adopted in their implementation of the LCR standard (Annex 14).

These help to clarify how national authorities implement certain aspects of the Basel standards that are not in scope of the formal RCAP-LCR assessment at this point of time. Over time, the information detailed in the annexes to the report will provide a basis for designing best practices and additional supervisory guidance that will benefit the regulatory community and the banking industry to raise consistency of the implementation of the LCR and to improve the effectiveness in practice.

The Assessment Team compliments the Mexican authorities for their implementation of and alignment with the Basel LCR framework. The implementation work on many reforms, however, has only just begun. Looking ahead, the Assessment Team also noted a few items for post-RCAP follow-up or when another RCAP assessment is undertaken (Annex 12). This will help ensure that Mexico effectively deploys its new LCR framework to supervise the Mexican banking system and maintain financial stability. The team also identified an item that would benefit from further clarification by the Basel Committee (Annex 11).

Response from the Mexican authorities

The National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores) and the Bank of Mexico (Banco de Mexico) appreciate the opportunity to comment on the RCAP Assessment of Basel III LCR Regulations for Mexico.

The regulation that implements the LCR in Mexico was issued on 31 December 2014 and entered into force on 1 January 2015. The regulation includes several amendments with respect to the original version reviewed by the RCAP Assessment Team. Such modifications, which greatly improved the Mexican rule, would not have been possible were it not for the detailed revision undertaken by the Assessment Team. Thus, we would like to thank Charles Littrell and the rest of the Assessment Team for their work and their findings with respect to previous drafts of the rule, as well as for the discussions on how to improve the Mexican regulation.

The Mexican regulation was prepared using the Basel standard as guidance. However, the Assessment Team identified certain deviations of the Mexican regulation from the Basel standard. These deviations were discussed extensively during the meetings. The Mexican authorities made the proper changes in the regulation to fully comply with Basel or explained the rationale behind the differences when they were found to be super-equivalent or non-material (eg definition of SMEs).

One such discussion was the treatment of derivatives operations. The Mexican authorities had decided to implement a methodology which was thought to be more conservative than the Basel standard and better reflected the banks' current derivatives exposures. However, the Assessment Team expressed some important concerns that had not been taken into account. The Mexican authorities made further adjustments to the rule by requiring banks to apply the more conservative treatment between the Mexican proposed methodology (an adapted version of the Current Exposure Method (CEM)) and the Basel standard (outflows and inflows for 30 days plus the look-back approach). Other observations were made which are described below. Most of them led to modifications to the Mexican rule to ensure full consistency with the Basel standard.

It is important to highlight that the majority of Mexican large banks are subsidiaries of foreign global banks. Subsidiaries of global banks consolidate their balance sheets with those of their parent banks. Hence, for these local subsidiaries, home-country LCR regulations tend to prevail over local regulations. A local level playing field for countries with a large presence of foreign banks can only be attained when home jurisdictions fully follow the Basel standards consistently. We have identified some important differences in the regulations of the home countries of subsidiaries operating in Mexico (eg the recognition of local deposit insurance schemes) which could have an impact on the way Mexican subsidiaries of foreign banks meet the LCR.

1. Assessment context and main findings

1.1 Context

Status of implementation

In Mexico, the Committee of Banking Liquidity Regulation determines the general guidelines and reference structure for the liquidity requirements for Mexican banks. The members of the committee include the Ministry of Finance (SHCP), the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores; CNBV) and the Bank of Mexico (Banco de México; BdM). Based on these general guidelines, CNBV and BdM draft the detailed liquidity rules, which are issued as a joint regulation.[3]

The general guidelines were approved and issued on 17 October 2014. Subsequently, on 31 October 2014 CNBV and BdM jointly issued for public consultation the draft LCR regulation, including the LCR disclosure requirements. The final LCR regulation was issued on 31 December 2014 and came into force on 1 January 2015.[4]

Along with the LCR regulations, in 2014 the Mexican authorities also implemented regulation which includes the Basel Principles for sound liquidity risk management and supervision, and are in the progress of implementing, during the first quarter of 2015, the LCR monitoring tools. A factual description of how each of these frameworks is or will be implemented in Mexico is provided in Annexes 9 and 10, respectively.

Regulatory system and model of supervision

In Mexico all commercial banking institutions, including subsidiaries for foreign bank institutions, are subject to the Basel III LCR standards. The CNBV and BdM are jointly responsible for issuing and enforcing the LCR regulation in Mexico, although all supervisory aspects are assigned to the CNBV. However, these institutions report their liquidity ratios to both authorities, along with the necessary information to verify it.

In case of breaches of the LCR regulation, the CNBV has the powers to impose corrective measures, as detailed in the LCR regulation and general banking regulations. In doing so, the CNBV needs to seek the opinion of the BdM. Similarly, the CNBV needs to seek approval from BdM for decisions regarding specific outflow and inflow factors that may not be provided for in the regulation. In periods of systemic stress, the Committee of Banking Liquidity Regulation may also determine whether to relax or lower the LCR requirements.

Further, the CNBV and BdM jointly issue the data collection template with the information required to calculate the LCR for each bank. Based on the submitted LCR and accompanying data, BdM verifies the LCR of each bank and informs the result to the CNBV. This verification will take place on a

3 The CNBV is a decentralised agency of the Ministry of Finance and Public Credit, with technical autonomy and executive powers under the terms of its own law. Its duty is to supervise and to regulate Mexican banks, development banks, brokerage houses and mutual funds. BdM is the autonomous central bank of Mexico.

4 For the assessment, the Assessment Team relied on English translations provided by the Mexican authorities of the domestic regulations and regulatory documents. In a few specific instances, the team assessed the appropriateness of the English translation of the Mexican rules through comparison with the original text in Spanish. For those sections, the translation was generally found to be appropriate.

monthly basis during 2015 and on a daily basis from 2016 onwards. Given the amount of information needed, and the need for homogeneous and consistent reporting, banks are also provided with technical guidance on completing the data template and computing the LCR. This technical guidance is explicitly referenced in the Mexican LCR regulation.

1.2 Structure and enforceability of prudential regulations

The liquidity regulation is subject to the same well defined regulatory process as for capital regulation. As part of this process, draft regulations are subject to a public consultation and a review by the Federal Commission for Regulatory Improvement (COFEMER by its Spanish acronym).

The following table provides an overview of the legal hierarchy of prudential regulations in Mexico (details on the structure and binding nature of prudential regulations in Mexico are outlined in the RCAP assessment report on the Mexican risk-based capital requirements for banks).[5] The LCR requirements issued in a final form on 31 December 2014 meet the RCAP criterion of being enforceable and binding in nature.

Hierarchy of banking regulations in Mexico — Table 1

Laws and regulation	National Banking and Securities Commission Law
	Bank of Mexico Law
	Bank of Mexico Internal Regulation
	Credit Institutions Law
	National Banking and Securities Commission Internal Regulation
	National Banking and Securities Commission Supervision Regulation
	Financial Groups Law
Internal regulation derived from the above laws and regulations	Instrument by which the Commission's President delegates authority to various of the Commission's officers
	Institutional Manual for Supervision
	Ratings for financial entities based on their risks
	On-site visit annual programme
	Official communications
Regulation issued by the Commission	Regulation applicable to banking institutions (General Provisions Applicable to Credit Institutions)

1.3 Scope of the assessment

The assessment was made of the LCR requirements as applicable to all commercial banks in Mexico. In evaluating the materiality of the findings, the quantification was limited to the agreed five banks subject to the RCAP review (see Annex 8). These banks hold 71% of the assets in the Mexican banking system.

[5] Available at www.bis.org/bcbs/implementation/l2.htm.

Assessment grading and methodology

As per the RCAP methodology approved by the Basel Committee, the outcome of the assessment was summarised using a four-grade scale, both at the level of each of the two components of the Basel LCR framework (LCR and LCR disclosure requirements) and overall assessment of compliance: compliant, largely compliant, materially non-compliant and non-compliant.[6]

The materiality of the deviations was assessed in terms of their current or, where applicable, potential future impact (or non-impact) on the liquidity coverage ratios of the banks. Wherever relevant and feasible, the Assessment Team, together with the Mexican authorities, attempted to quantify the impact based on data collected from Mexican banks in the agreed sample of banks. The non-quantifiable aspects of identified deviations were discussed and reviewed with the Mexican authorities, in the context of the prevailing regulatory practices and processes.

Ultimately, the assignment of the assessment grades was guided by the collective expert judgment of the Assessment Team. In doing so, the Assessment Team relied on the general principle that the burden of proof rests with the assessed jurisdiction to show that a finding is not material or not potentially material. A summary of the materiality analysis is given in Section 2 and Annex 8.

In a number of areas, the Mexican liquidity requirements go beyond the minimum Basel standards. Although these elements provide for a more rigorous implementation of the Basel framework in some aspects, they have not been taken into account for the assessment of compliance under the RCAP methodology as per the agreed assessment methodology (see Annex 13 for a listing of areas of super-equivalence).

1.4 Main findings

A summary of the main findings is given below. Overall, the Assessment Team considers the LCR regulation issued in December 2014 compliant with the Basel standard. Both the components assessed by the RCAP Assessment Team (LCR regulation and the disclosure standards) are also considered compliant with the minimum Basel standard. More detail is provided in the main findings section below.

Summary assessment grading — Table 2

Key components of the Basel LCR framework	Grade
Overall grade	C
LCR subcomponents (as agreed by the Basel Committee in September)	
Liquidity Coverage Ratio regulation	C
LCR Disclosure Standards	C

Compliance assessment scale (see Section 1.3 for more information on the definition of the grades): C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).

[6] This four-grade scale is consistent with the approach used for assessing countries' compliance with the Basel Committee's *Core principles for effective banking supervision*. The actual definition of the four grades has been adjusted to take into account the different nature of the two exercises. In addition, components of the Basel framework that are not relevant to an individual jurisdiction may be assessed as not applicable (NA). For further details, see www.bis.org/publ/bcbs264.htm.

Main findings by component

Scope of application and transitional arrangements

Transitional arrangements

Overall, the Assessment Team finds the Mexican transitional arrangement to be compliant with the Basel standards. The LCR as well as related disclosure requirements were introduced in Mexico on 1 January 2015. For large banking institutions, Mexico's implementation of the LCR minimum level follows the transitional arrangements as stipulated in the Basel standard. The minimum requirement for the LCR will be increased in equal steps starting from 60% in 2015 to 100% from 1 January 2019. For smaller banks, the phase-in period will start six months later.[7]

Objective of the LCR and use of HQLA

The Basel requirements are that the LCR should be met on a continuing basis. However, banks facing liquidity stress may be allowed to use their stock of HQLA and fall below the minimum required level for the LCR. Differing from the Basel standard, the Mexican regulation uses a predetermined scheme to classify banks into five different categories of compliance, or "scenarios", based on predefined thresholds. According to this scheme, a bank will, after the transitional period is over, be classified in Scenario I (fully compliant) if its LCR is at least 100% on every day during the month. A bank that has an LCR below 100% on one or more days will be classified into one of Scenarios II to IV depending on (i) the minimum level of LCR on any day that the bank reported during the month, and (ii) the sum of the daily percentage deviations from the LCR below the minimum requirement during the month. During the transitional period the thresholds are set according to the minimum requirements specified in the Basel standard.

Scenarios III and IV describe situations when a bank has an LCR significantly below the minimum requirement and for several days. In these scenarios the bank is legally not complying with the LCR, which according to Mexican law is punishable with (among other potential penalties) a fine. Further, the Mexican LCR regulation specifies corrective measures that will be imposed on the bank. For each scenario a set of corrective measures are specified. Scenario IV is associated with stronger measures than Scenario III, as this scenario means a more serious violation of the LCR minimum requirement.

The Assessment Team considers that Scenarios I, III and IV are Basel-compliant, although they may impose less supervisory flexibility in response than might be global best practice. Scenario II is potentially non-Basel-compliant, but the Assessment Team does not consider Scenario II a material deviation.

Scenario II describes a situation where (a) a bank's minimum LCR observed on any one of the days of the preceding calendar month falls below 100% but not lower than 85%, and (b) the sum of its total daily deviations from LCR below 100% in the previous month is less than or equal to 25 percentage points. In a legal sense, a bank in Scenario II is still considered compliant with the LCR, meaning that, for this situation, the regulation cannot stipulate any formal corrective measures which the CNBV could apply to the bank. This restriction applies even if the bank were to fall below 100% due to its own miscalculation, rather than through any more general market liquidity issue. In Scenario II, the bank must

7 In addition, the Mexican regulation also applies transitional arrangements after January 2015 for new banks that establish in Mexico, provided their credit portfolio does not exceed a certain threshold. This has been identified as a non-material finding (see Section 2).

immediately report the 100% LCR breach to its board, to the CNBV and to the Bank of Mexico, and it must provide an explanation as well as an action plan for how it will restore its LCR to a level above the minimum (this is also the case in Scenarios III and IV).

Mexican authorities have explained that the reason for this arrangement is that the legal framework in Mexico does not give the authorities discretion to apply different measures to banks depending on the reasons why the bank did not meet a requirement. Breaching a requirement by a certain margin must always trigger the same corrective measures. Therefore, in order to provide some flexibility for banks to use their buffer when they experience mild liquidity stress, a bank falling slightly below 100% for a short period would not face any formal corrective action other than the reporting requirements referred to above. In a systemic stress event, the Mexican authorities can decide to relax or reduce the requirement for all banks.

Following discussions with the Assessment Team, the Mexican authorities have amended the LCR regulations to specify that it is not possible for banks to operate consistently slightly below the 100% LCR minimum required level and still be compliant. Specifically, they have specified that when banks fall below 100% in Scenario II on three or more occasions within six months, this will automatically put them into Scenario III.

Based on this amendment the team has 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. First, the automatic placement in Scenario III after more than three breaches will stop banks from systematically trying to operate with a lower HQLA buffer. Further, a monthly breach report from a bank's executives to each of its board members as well as the CNBV, and BdM would, as a practical matter, quickly lead to remedial action, outside the LCR general provision. Separately from the LCR regulation, the CNBV could still impose firm measures against a bank that falls into Scenario II, particularly if it repeatedly does so (but without falling into Scenario III), by concluding that the breaches are due to insufficient internal controls. In such a case, the CNBV could deploy its general supervisory powers to start an investigation into the bank's liquidity controls, which would open up the whole suite of supervisory powers available to the CNBV. The team has noted the finding for a future follow-up assessment (Annex 12).

High-quality liquid assets (numerator)

The definition of different classes of HQLA in the LCR is a key element of the Basel standard. The Mexican implementation follows the Basel standard with the following exceptions.

Non-peso-denominated sovereign bonds

In the Mexican regulation, non-peso as well as peso-denominated Mexican sovereign bonds can be included in Level 1 HQLA without any limits. This is at variance with the Basel standard, which states that sovereign debt, where the sovereign has a non-0% risk weight and the debt is denominated other than in the sovereign's currency, is only eligible as Level 1 assets up to the amount of the bank's stressed net cash outflow in the corresponding currency. Holdings of such bonds in excess of matched currency net cash outflows would be treated as Level 2B and limited to 15% of the total stock of HQLA.

The Assessment Team has seen data for the past two quarters that show that Mexican banks' holdings of non-peso sovereign debt are significantly less than the net cash outflows in the relevant non-sovereign currencies for three of the five banks in the RCAP sample. For the remaining two banks, non-peso holdings are greater than their non-peso currency net cash outflows. These differences do not exceed the amount that would have been allowed to count as HQLA according to the Basel standard when taking together the net cash outflows in foreign currency (ie as Level 1 assets) and the amount allowed within the 15% limit of Level 2B assets. For the latter two banks, their "excess" holdings of non-peso sovereign bonds correspond to approximately 30% and 5% respectively of the amount allowed to be included in HQLA as Level 2B assets. Neither of these two banks uses more than 5% of the available room for Level 2B assets. So, while these banks have substantial Level 2B assets available, they included only a limited amount in their LCR calculation. Data provided to the RCAP Assessment Team further show that Mexican banks' total holdings of non-peso currency denominated bonds have been stable or have decreased over the last four years. Also, in the last three years, the proportion of peso-denominated sovereign bonds vs non-peso currency sovereign bonds has been stable at approximately 85% vs 15%. The Assessment Team has no reason to believe that this outcome would change under the Basel III LCR requirements. In addition, relative to Mexican banks' total stock of HQLA, only 5% is non-peso-denominated Mexican sovereign bonds, meaning that Mexican banks today rely only to a limited extent on these assets to cover their overall liquidity needs. This variance is therefore assessed as immaterial, and highly likely to remain immaterial.

Operational requirements

The Basel standard specifies a number of bank operational requirements. Mexico has implemented most but not all of these requirements. The Mexican authorities have chosen not to implement the requirement for banks to regularly monetise a portion of their HQLAs.[8] This requirement is meant to ensure that banks have an effective process in place to use their buffer when needed, and to mitigate the risk of negative signalling effects if they were to face a liquidity stress situation and need to sell or repo HQLA assets.

For the materiality assessment of this deviation, the Assessment Team examined the composition of HQLA of the five Mexican banks in the RCAP sample. The main assets held by the banks in their stock of HQLA are Mexican government bonds and central bank deposits. Over the five months for which the Assessment Team received data (May–September 2014), sovereign bonds and central bank deposits constituted on average 86% of total Level 1 assets, ranging from 68% for the bank reporting the lowest proportion of sovereign bonds and central bank deposits to 91% for the bank reporting the highest proportion. Relative to total HQLA, the corresponding numbers are 73% of total HQLA on average for the whole sample of banks, where sovereign bonds and central bank deposits were 62% of HQLA for the bank with the lowest share and close and 90% for the bank reporting the highest share. Other Level 1 assets account for approximately 17% of HQLA on average, ranging from a 9% share for the bank reporting the lowest share and 30% for the bank reporting the highest share.

As deposits in the central bank are available for banks to use and Mexican sovereign bonds are regularly repo'd with BdM, the omission of this requirement will mainly affect the ability of banks to test the liquidity of other Level 1 assets and Level 2A and 2B assets. Mexican banks tend to include relatively few Level 2A and 2B assets. The share of Level 2A and 2B assets in total HQLA ranges from approximately 3% to 20%, well below the 40% limit. The share of other Level 1 assets and Level 2 assets in total HQLA ranges from 12% to 38% (average 28%).

The Assessment Team also included in its deliberations that the Mexican regulation requires banks to "assess, on a continuous basis, the acceptance of their assets for their most important counterparties and guaranteed financing sources". Overall, therefore, as all Mexican banks in a stress situation will be able to use the substantial majority of their reserve by transacting with the central bank, while being required to proactively assess the acceptance of collateral for financial transactions, the Assessment Team has come to the view that this deviation is unlikely to become material.

8 Basel paragraphs 28–43 specify operational requirements; paragraph 30 states that banks should monetise a portion of HQLA regularly.

Outflows (denominator)

Foreign currency deposits

The Basel standard specifies that supervisors will determine the run-off factor for foreign currency deposits, which should be considered as "less stable" if *there is a reason to believe that such deposits are more volatile than domestic currency deposits*.[9] The Mexican authorities consider that deposits denominated in foreign currency are not less stable. Hence, foreign currency deposits receive the same outflow factor as peso-denominated deposits.

Foreign currency deposits, like peso deposits, are covered under the Mexican deposit insurance programme. In addition, not every Mexican can open a deposit account in a foreign currency. The depositor must either be a natural person living within 20 km of the northern Mexican border (or in the states of Baja California and Baja California Sur), a judicial person domiciled within the Mexican territory or offices of representation of foreign governments, multilateral institutions and similar institutions, or foreign persons working for such representative offices or institutions. The amount of retail deposits in foreign currency, as a proportion of total retail deposits, is about 4%. Data provided by the Mexican authorities have shown that foreign currency deposits of banks in the sample are not significantly more volatile than domestic currency deposits. Most of the decreases in such deposits are within the 5% threshold, even for periods of stress (2008–09). As with deposits in domestic currency, the few exceptions where there have been decreases larger than 5% in the amount of retail deposits typically follow large increases in such deposits. The Assessment Team, thus, concurs with the approach taken by the Mexican authorities and considers it appropriate for the Mexican situation.

Inflows (denominator)

Operational deposits

The Basel LCR standard defines the concept of operational deposits in paragraphs 93–104 of the outflow section by specifying the criteria for a deposit to qualify as operational deposit. Additionally, banks are required to model any excess balances in the identified operational deposits. The lower run-off factor of 25% can only be applied to the operational deposit amount and not to the excess balances. The modelling of operational deposits and excess balances is subject to supervisory approval. Further, paragraph 98 states that operational deposits would receive a 0% inflow factor assumption for the depositing bank. This is also repeated in paragraph 156 of the inflow section with reference to the outflow section. However, neither paragraph 98 nor 156 states how excess balances of operational deposits should be defined or treated for the depositing bank. Further, the criteria for determining excess amounts are phrased from the perspective of the receiving bank. Hence, it is not clear if the same treatment is to be used for the depositing bank as well.

The Mexican regulation applies a 0% inflow factor for the operational amount of deposits held at another bank and a 100% inflow factor for any excess amounts held in the operational account, ie the excess amount is treated as a non-operational (normal) deposit. Further, if a bank wants to apply the

9 Basel LCR para 81: states: "*Foreign currency retail deposits are deposits denominated in any other currency than the domestic currency in a jurisdiction in which the bank operates. Supervisors will determine the run-off factor that banks in their jurisdiction should use for foreign currency deposits. <u>Foreign currency deposits will be considered as "less stable" if there is a reason to believe that such deposits are more volatile than domestic currency deposits</u>. Factors affecting the volatility of foreign currency deposits include the type and sophistication of the depositors, and the nature of such deposits (eg whether the deposits are linked to business needs in the same currency, or whether the deposits are placed in a search for yield)*" [underscore added].

more favourable in- and outflow factors, the Mexican authorities require banks to model and identify the operational and excess amount of deposits in an operational account that they hold with other banks using a methodology corresponding to that which is required for identifying operational deposits for the purpose of calculating outflows. The rationale for the Mexican approach is to provide balanced incentives for banks to identify and account for operational deposits on both sides of the balance sheet. This could help the Mexican authorities in assessing the assumptions made by banks for calculating excess amounts. The same strict criteria are applied for banks when they define excess operational deposits for inflows as for outflows. The CNBV may reject any model that they find inappropriate. The Assessment Team views the Mexican approach as compliant, but notes that the Basel Committee may wish to clarify this issue in the rules text.

Treatment of derivative cash flows

The Basel standard contains several reference paragraphs for treating contractual derivative cash flows, as well as potential changes in mark to market (MTM) values (ie paragraphs 116–119, 123 and 158–159). In summary, the standard specifies that banks should calculate their cash flows from derivatives, cash outflows and inflows, in accordance with their existing valuation methodology. The sum of all net cash outflows and inflows receives a 100% factor. Where a valid master netting agreement exists, cash in- and outflows may be calculated on a net basis by counterparty (ie inflows can offset outflows for that counterparty). Further, the Basel standard specifies that cash flows should be calculated for the next 30 days (paragraph 69) and that no contingent inflows (paragraph 142) should be included.

Under the initial draft regulation, the Mexican authorities required banks to include all derivative cash flows irrespective of their timing, ie all cash flows within and beyond the 30-day horizon. According to this methodology, banks should calculate the market value of all inflows and outflows from their derivative portfolios plus an add-on for outflows using an adapted version of the Current Exposure Method (CEM). In addition, the Mexican authorities have introduced a cap to the amount of derivative inflows that banks can include in the LCR calculations. The cap is equal to the amount of total derivative outflows calculated by the bank. While the cap ensures that Mexican banks cannot report a net positive inflow from derivative operations, the team considered the implementation deviating from the Basel standard as Mexican banks could still include inflows beyond the 30-day horizon (up to the amount of the cap).

Following discussions with the team, the Mexican authorities amended the rule to also include the Basel methodology, which considers expected contractual inflows and outflows from derivatives within 30 days plus collateral flows related to valuation changes. The collateral flows related to valuation changes are determined using the look-back approach. That is, banks are required to identify the largest absolute net 30-day collateral flow realised during the preceding 24 months. Where the Basel standard is based on realised collateral flows, however, the Mexican rule is based on valuation changes as a proxy for collateral flows. The Mexican authorities explained that realised collateral flows may underestimate the potential for collateral outflows, as collateralisation is not commonly used by Mexican banks. The Assessment Team considers the use of valuation changes as a proxy for realised collateral flows to be compliant with the intent of the Basel standard.

Under the final Mexican LCR rule, banks are requested to calculate the net derivative flows using both the original Mexican methodology – considering inflows and outflows for the whole portfolio of derivatives, regardless of maturity, plus an add-on based on CEM – and the Basel methodology including the look-back approach. Banks are required to compare the outcomes under both methodologies and apply the most conservative net cash outflow when computing the LCR. The Assessment Team considers this approach to be compliant with the Basel standard – and in many instances likely to be more conservative than the Basel standard.

Disclosure requirements

Mexico has implemented the disclosure requirements for the LCR in accordance with the Basel standard. It adopts the same scope and implementation date. Further, Mexican banks will be required to report their average LCR based on daily observations starting in 2016 and, hence, will not use the transitional period for disclosure which allows reporting of averages based on less frequent observations until 1 January 2017.

The minimum disclosure requirements are with one exception compliant with the Basel standard template. The Mexican template includes one deviation related to the disclosure of unconditionally revocable liquidity lines. The Assessment Team considers this deviation is not material.

2. Detailed assessment findings

The detailed component-by-component findings of the RCAP-LCR assessment are provided below. The focus of Sections 2.1 to 2.3 is on findings that were assessed to be deviating from the Basel minimum standards, including materiality assessment.

2.1 LCR

Section grade	Compliant
Summary	The adoption of the LCR is assessed as compliant. Taking into account the amendments made by the Mexican authorities, the team did not identify any material or potentially material deviations (see also Annex 5).

2.1.1 Scope of application and transitional arrangements

Summary	Overall, the Assessment Team finds the Mexican transitional arrangement to be compliant with the Basel standards. The LCR as well as related disclosure requirements were introduced in Mexico on 1 January 2015. For large banking institutions, Mexico's implementation of the LCR minimum level follows the same transitional arrangements as stipulated in the Basel standard. However, for small start-up banks the Mexican regulations deviate from the Basel standard, albeit not in a way expected to be material. Concerning the application of the LCR, the team identified a non-material deviation from the Basel standards related to the Mexican approach when banks fall below the minimum LCR ratio.
Basel paragraph no	Basel III LCR paragraph 10
Reference in domestic regulation	General provisions on liquidity requirements for commercial banks, transitional articles, fourth provision
Findings	The Basel standard states that the LCR should be introduced starting from 1 January 2015, but the minimum requirement will be set at 60% and rise in equal steps to reach 100% on 1 January 2019 (the bank will still be required to report its LCR, however). Differing from the Basel standard, the Mexican regulation also applies these transitional arrangements after January 2015 for any small new bank starting operations in Mexico. For example, if a new bank enters the Mexican market in 2020 that bank will not be subject to the LCR or disclosure requirements during its first year in operation and will during the following five years face a progressive increase in the LCR requirement starting from 60% in year two and going to 100% in year six. The disclosure requirement applies from year two. The Mexican authorities have clarified that such transitional arrangements only apply to new banks, whose credit portfolio is lower than 30 billion UDIS (approximately USD 10 billion) (see Annex 5). That is, if a new bank exceeds this threshold, it will have to comply with the LCR standard according to the Basel transitional arrangements. This also applies if such bank starts below the threshold and exceeds it at some point. As soon as the threshold is exceeded, such a bank would have to abide by the Basel transitional arrangement. That is, a new bank in 2020 would have to comply with a minimum LCR of 100% if its credit portfolio is (or just becomes) higher than 30 billion UDIS.
Materiality	Not material The threshold introduced in the Mexican regulation of 30 billion UDIs effectively prevents this finding from becoming material. In addition, the team notes if a new bank is established through a merger with or an acquisition of an already established bank that would not be seen as a new establishment in this context and that bank could not apply the Mexican transitional arrangements.
Basel paragraph no	Basel III LCR paragraph 17
Reference in domestic	General provisions on liquidity requirements for commercial banks, Article 5, fraction

regulation	IV and Article 12
Findings	The Basel standard requires that, absent a situation of financial stress, the LCR be met on an ongoing basis. The Mexican regulation uses a predetermined scheme to classify banks into five different categories of compliance, or "scenarios", based on predefined thresholds. According to this scheme, a bank will, after the transitional period is over, be classified in Scenario I if its LCR is at least 100% every day during the month. A bank that has a LCR below 100% during one or more days will be classified into one of Scenarios II to IV depending on (a) the minimum level of LCR on any day that the bank reported during the month, and (b) the sum of the deviations from the LCR below the minimum requirement during the month in percentage points (during the transitional period the thresholds are set according to the steps specified in the Basel standard). A bank that foresees or finds itself in a scenario other than Scenario I has to report to the supervisor and its board of directors and provide an explanation for the breach as well as an action plan for how it will restore its LCR to a level above the minimum. The first scenario that a bank falls into when breaching the minimum LCR level is "Scenario II". Scenario II describes a situation where (a) a bank's minimum LCR observed on any one of the days of the preceding calendar month falls below 100% but not lower than 85%, or (b) the sum of its daily deviations from LCR below 100% in that month is less than or equal to 25 percentage points (using calendar days). However, in a legal sense a bank in Scenario II is still considered compliant with the LCR, meaning that, for this situation, the regulation cannot stipulate any corrective measures (in addition to requiring the report and action plan from the bank) which the CNBV can apply to the bank even if the bank were to fall below 100% for other reasons besides it experiencing liquidity stress. However, if a bank falls into Scenario II on three or more occasions within a six-month period it automatically falls into Scenario III and is no longer compliant. Hence, it is possible for banks to drop below 100% occasionally and still comply, but not to operate consistently with a lower margin to the 100% LCR level. In Scenarios III and IV a bank has an LCR significantly below the minimum requirement and for longer periods. In these scenarios the bank is legally not complying with the LCR, which according to Mexican law is punishable with a fine. Further, the Mexican LCR regulation specifies corrective measures that will be imposed on the bank. For both scenarios a set of corrective measures are specified which the authorities must impose. Scenario IV is associated with stronger measures than Scenario III as this scenario means a more serious violation of the LCR requirement. The Mexican authorities have explained that the reason for this arrangement is that the legal framework in Mexico does not allow the authorities discretion to apply different measures to banks depending on the circumstances that cause a bank to breach a requirement; thus, any breach of a requirement of certain magnitude must always trigger the same corrective measures. Consequently, the Mexican authorities could not relax or exempt an individual bank from the LCR requirement if that bank is experiencing stress. Therefore, in order to provide some flexibility for banks to use their buffer when they experience idiosyncratic liquidity stress, a bank falling slightly below 100% or for a shorter period would only have to report such situation to the authorities but the bank would not be considered non-compliant as that would automatically force the CNBV to take corrective measures. In a systemic stress situation, the Committee on Banking Liquidity Regulation can decide to relax or lower the LCR requirement for all banks. The Assessment Team finds that the Mexican approach to be a deviation from the Basel standard, in particular the provision that a bank in Scenario II can fall under the minimum LCR level for other reasons than liquidity stress and still comply with the local standard. However, because repeated breaches automatically lead to banks not complying, this flexibility cannot be systematically abused by banks. Further, the CNBV can still impose measures against a bank that falls into Scenario II if the report provided by the bank to the CNBV to explain the event indicates that the breach was due to defective internal controls or similar. In such cases the CNBV could deploy its general supervisory responsibility and powers to start an investigation against the bank, which would then open up the whole set of supervisory powers to the CNBV.

Materiality	Not material The specification of Scenario II means that a bank could have a LCR one percentage point below the minimum for the majority of days during the month (ie 25) and up to 5 percentage points on five days during a month and still comply with the LCR requirement in Mexico. Deviations that could affect the LCR by up to 2–5 percentage points would according to the RCAP methodology be classified as material. However, CNBV could take supervisory actions, and is viewed to be likely to do so, if a bank in its report shows a lack of internal controls or repeatedly falls under the LCR minimum. Furthermore, there would not be a total absence of action, since such a bank would have to report to its Board and to the CNBV and BdM the reasons for such a level of LCR as well as an action plan to restore the LCR above 100%. The practical implication of Scenario II not being legally non-compliant is assessed as limited. Banks in Mexico appear to be well aware that the CNBV would not accept unjustified breaches of the LCR minimum. The Assessment Team therefore finds it unlikely that banks would target a lower LCR level than if this was a binding requirement. Accordingly, the finding is assessed as not material.

2.1.2 High-quality liquid assets (numerator)

Summary	The definition of different classes of HQLA in the LCR is a key element of the Basel standard. The Mexican implementation follows the Basel standard, with a few non-material exceptions.
Basel paragraph no	Basel III LCR paragraph 24
Reference in domestic regulation	General provisions on liquidity requirements for commercial banks, Article 1 fraction I and II and Article 9 and Annex 1
Findings	The Basel standard requires supervisors to exclude assets from HQLA which do not or cease to fulfil certain general characteristic of HQLA, per paragraph 24, despite meeting the specific criteria specified in paras 49 to 54 of the LCR standard. That is, the rules are not completely mechanistic but can and should be altered by supervisors depending on circumstances. The Mexican regulation provides an exhaustive list of asset classes eligible for inclusion in the liquidity buffer, tied to a number of formal criteria. However, the Mexican regulation does not give the Mexican authorities the flexibility to exclude assets based on their assessment that the general characteristics are not fulfilled. Instead, if the Mexican authorities find that an asset's liquidity is reduced while still fulfilling the formal conditions set up by the regulation, they would have to issue an amended rule. According to the Mexican authorities, this could be done within four weeks. Changes will start to apply from the day the new regulation is published.
Materiality	Not material According to the Mexican authorities, if deemed urgent, the regulation could be amended within four weeks. This is the same period of time that the Basel standard allows banks to keep assets in the liquidity buffer after they fail to fulfil the specific criteria in the regulation. Further, the Mexican authorities confirmed that amendments can be enforced directly from the day they are approved by the parliament. At the same time, paragraph 43 of the Basel standard allows banks to keep assets that become ineligible in their stock of HQLA for an additional 30 days to avoid cliff effects. Therefore, the practical difference between the Basel requirement and Mexico's implementation is assessed as small. Also, the Mexican authorities have provided examples to the team to demonstrate that they are able to change their regulation within the specified four-week period.
Basel paragraph no	Basel III LCR paragraph 30
Reference in domestic regulation	General Provisions Applicable to Credit Institutions, Article 81 fraction I, fraction II item d) and fraction IV items a), b) and f) and last paragraph.
Findings	The Basel standard states that a bank should periodically monetise a representative proportion of the assets in the stock through repo or outright sale, in order to test its access to the market, the effectiveness of its processes for monetisation, the

	availability of the assets, and to minimise the risk of negative signalling during a period of actual stress. Mexican regulations did not implement this paragraph.
Materiality	Unlikely to become material Mexican sovereign bonds and central bank reserves constitute approximately 65–90% of Level 1 assets (and 62–90% of total HQLA). Sovereign bonds that are part of Level 1 assets can be repo'd with the Bank of Mexico. Consequently, for these assets the practical consequences of omitting this requirement are limited. Banks will still test their process and a negative signalling effect would not arise as the counterparty is the central bank. Hence, the potential materiality with respect to paragraph 30 will be limited to Level 2A and 2B assets, for which the banks in a stressed situation could risk not being able to sell the assets. There is also the consideration that Mexican banks hold very few Level 2A and 2B assets (which range from 3% to 20% of banks' total HQLA holdings), and in a stress situation they could first monetise some of their Level 1 assets. Further, the team also considers that there is a general provision in Mexican regulations that requires banks to assess on a continuous basis the acceptance of their assets for their most important counterparts and guaranteed financing sources in the market. Based on these considerations the Assessment Team has come to the view that this deviation is unlikely to become material.
Basel paragraph no	Basel III LCR paragraph 34
Reference in domestic regulation	No reference
Findings	The Basel standard specifies that banks that hedge the market risk of their HQLA should take into account in the market value of that asset (ie the cash outflow that would arise) if the hedge were to be closed out early, ie in the event the asset is sold. The Mexican regulation does not require banks to reduce the market value of HQLA with the outflows related to hedges that are terminated early. This is compensated through the denominator as banks are required to include the outflows from such hedges in the calculation of outflows from derivative contracts (that is, in the case where the Mexican CEM approach generates the greatest outflows – see also finding for Basel para 158). Provided that all assets in the bank's HQLA would be affected proportionally by outflows from hedges, the Mexican approach would be comparable to the Basel approach (under this approach, banks are required to calculate outflows from derivatives based on the contracts' total maturity, not only for the next 30 days). However, in the case that different HQLA assets are hedged differently, this approach could affect how the caps affect the banks stock of liquid assets. If instead of the Mexican CEM approach for derivatives, the Basel look-back approach (LBA) for derivative cash flow calculation is applied, cash flows from such hedges may not be included in the outflow.
Materiality	Unlikely to become material Regarding the potential effect on the cap for Level 2A and 2B assets, the Assessment Team has not been able to assess directly to what extent banks hedge HQLA, or parts of their HQLA. However, the cap on Level 2A and 2B assets does not bind for any of the Mexican banks in the RCAP sample at present and all banks have a significant margin to the caps (current total holdings of Level 2A and 2B assets are 3% to 20% of total HQLA holdings). Therefore, to the extent that Level 2A and 2B assets would be proportionally more affected by hedges for market risk, this is nevertheless unlikely to have any material consequences for the calculation of banks HQLA and LCR. Regarding the possible impact if the Basel LBA is used, the team considers this not very likely, as the materiality assessment made in order to assess Mexico's approach to derivatives (Basel para 158) suggests that the Mexican CEM approach will usually generate greater cash outflows than the Basel LBA-based methodology.
Basel paragraph no	Basel III LCR paragraph 50
Reference in domestic regulation	General provisions on liquidity requirements for commercial banks, Annex 1, fraction I C.
Findings	The Basel standard states that, where the sovereign has a non-0% risk weight,

	domestic sovereign debt issued in foreign currency is eligible as Level 1 assets up to the amount of the bank's stressed net cash outflow in that specific currency. Holdings of such bonds in excess of that would be treated as Level 2B. Under Mexican regulations, Mexican sovereign bonds denominated in foreign currencies (United Mexican States bonds, UMS) are included as Level 1 HQLA, without any restriction.
Materiality	Unlikely to become material The holdings of UMS correspond to 60% of average cash net outflows in foreign currency. For some banks holdings of UMS exceed their foreign currency outflows, but the excess holdings are still within the 15% Level 2B limit. Changing market conditions could affect banks' willingness to hold UMS. Historically banks' average holdings of UMS have been stable at about 5% of banks' total HQLA. Consequently, even if Mexican rules allow banks to hold more UMS than Basel standards would allow, it is assessed as unlikely that banks would increase their UMS holdings substantially and as part of their total HQLA. The impact on the LCR should therefore be limited. The team also notes that UMS can be repo'd with the central bank, which further limits the materiality of the finding. The team has listed the finding for a future follow-up assessment to monitor the amount of UMS included in HQLA by Mexican banks.
Basel paragraph no	Basel III LCR paragraph 52(a) and (b), and 54(a) and (b)
Reference in domestic regulation	General provisions on liquidity requirements for commercial banks, Article 1 fraction I and II and Article 9 and Annex 1
Findings	The Basel standard includes a number of conditions that should be satisfied in order for assets to be eligible for Level 2A and 2B in a banks' stock of HQLA. For corporate debt in HQLA Level 2A and several assets in HQLA Level 2B, one condition is that the asset should be traded in a large, deep and active repo markets. The Mexican regulation does not include this condition. The reason given by the Mexican authorities is that the condition is implicitly implemented through other requirements. The authorities also indicate that this condition would be difficult to evaluate as it is subject to judgment. If the Mexican authorities find that an asset's liquidity is substantially reduced while still fulfilling the other conditions, they could issue an amended rule within four weeks.
Materiality	Not material According to the Mexican authorities, if deemed urgent, the regulation for eligible assets could be amended within four weeks. This is the same period of time that assets could still remain in the banks' liquidity buffer after they fail to fulfil the specific criteria in the regulation according to the Basel standard. Therefore, given that an amendment in the regulation can be enforced without any notice (ie the grace period of 30 days in the regulation can be deviated from in such a case), the difference in practice in Mexico's case from what would happen if the Mexican authorities had discretion to exclude assets without issuing new legislation is small.

2.1.3 Outflows (denominator)

Summary	The Mexican approach is broadly consistent with the Basel minimum standard, with a few non-material exceptions.
Basel paragraph no	Basel III LCR paragraph 81
Reference in domestic regulation	No explicit reference
Findings	The Basel standard states that supervisors will determine the run-off factor for foreign currency deposits, which should be considered as "less stable" if there is a reason to believe that such deposits are more volatile than domestic currency deposits. The Mexican authorities consider deposits denominated in foreign currency are not less stable, thus applying the same outflow factors for these deposits as those for domestic currency deposits. Foreign currency deposits in Mexico are covered by the same deposit insurance scheme as deposits in domestic currency. In addition, not everyone can open a deposit account in foreign currency in Mexico. The client must

	either be a natural person living within 20 km of the northern border (or in the states of Baja California and Baja California Sur), a judicial person domiciled within the Mexican territory or offices of representation of foreign governments, multilateral institutions and similar institutions, or foreign persons working for such representation offices or institutions. Thus the amount of retail deposits in foreign currency, as a proportion of total retail deposits is small, at about 4%.
Materiality	Not material Data provided by the Mexican authorities show that foreign currency deposits of banks in the sample are not significantly more volatile than domestic currency deposits. Most of the decreases in such deposits are within the 5% threshold measured on a month-to-month basis, even for periods of stress (2008–09). As with deposits in domestic currency, the few exceptions where there have been decreases larger than 5% during a month in the amount of retail deposits typically follow large increases in such deposits.
Basel paragraph no	Basel III LCR paragraph 90–91
Reference in domestic regulation	General provisions on liquidity requirements for commercial banks, Annex 2
Findings	The Basel standard includes both quantitative and qualitative criteria for “small business customers”: • the total aggregate funding raised from the customer is less than EUR 1 million (on a consolidated basis where applicable); and, • the deposit is managed as a retail deposit, ie that the bank treats such deposits in its internal risk management systems consistently over time and in the same manner as other retail deposits, and that the deposits are not individually managed in a way comparable to larger corporate deposits. Mexican regulations do not explicitly define “small business customers” separately from “retail deposits”. However, deposits that do not exceed 400,000 investment units (around USD 150,000) from all natural and judicial persons are fully covered by deposit insurance. This appears more conservative than the Basel standard, at least quantitatively. In addition, since there is no definitional split between retail and small business customers to begin with, banks are likely to treat and manage these deposits together in the same pool.
Materiality	Not material Without a definition for small business customers, the risk is that large corporate customers (which are judicial persons) could be receiving a lower outflow factor if their deposits are indeed below USD 150,000. This scenario is however unlikely as it is generally understood that large corporate customers would maintain balances larger than USD 150,000.

2.1.4 Inflows (denominator)

Summary	The Mexican approach is broadly consistent with the Basel minimum standard, with a few non-material exceptions.
Basel paragraph no	Basel III LCR paragraph 98
Reference in domestic regulation	General provisions on liquidity requirements for commercial bank, Annex 3.
Findings	The Basel standard applies a 0% inflow factor for operational deposits held at other banks, given that these deposits are required for operational reasons, and are therefore not available to the depositing bank to repay other outflows. The Basel standard, however, does not specify whether and how to determine excess amounts of operational deposits held at other banks. The Mexican regulation applies a 0% inflow factor for operational deposits held at another bank, but with an option to apply a 100% inflow factor for any excess amounts held in the operational account. Banks are required to model and identify the operational amount of deposits in an operational account that they hold with other banks and that they receive from other

	banks. This is to provide balanced incentives for banks to identify and account for operational deposits on both sides of the balance sheet.
Materiality	Not applicable There is no clear guidance in the Basel standard on how to treat inflows from excess balances on operational deposits. The Mexican authorities adopt the same rigid criteria as for outflows: to model and identify excess operational deposits (which would receive a more favourable treatment). The Mexican regulation gives the CNBV the power to reject an approach suggested by a bank and require them to use a more conservative treatment. Data on operational deposits that banks received from other banks (which determines outflows) suggest that these amounts have been volatile so far. By incentivising banks to model both operational deposits that they receive from other banks and those that they themselves have deposited will help supervisors to assess the numbers provided by banks and may serve as a quality check on bank calculations. Overall, the Assessment Team views this as a fair interpretation and implementation of the Basel standard. The team notes that the Basel Committee may wish to clarify this issue in the rules text.
Basel paragraph no	Basel III LCR paragraphs 140, 145, 147
Reference in domestic regulation	None
Findings	Several paragraphs in the standard specify the treatment of cash inflows related to bank short positions and customer collateral. The Mexican provisions do not include the parts of these provisions related to short positions. Mexican banks are not allowed to cover short positions with customers' collateral. Hence, these paragraphs are not applicable.
Materiality	Not applicable
Basel paragraph no	Basel III LCR paragraph 158 (with reference to paragraph 116)
Reference in domestic regulation	General provisions on liquidity requirements for commercial banks, Annex 3 III.1 and III.2, and Annex 4.
Findings	The Basel standard specifies that expected contractual derivative inflows over the next 30 days may be included in the calculation. Under the Mexican regulations, the entire MTM values are used to calculate cash flows, without distinction between a less than 30-day and more than 30-day tenor. This means that the cash flows calculated are to perpetuity, rather than just to 30 days. The Mexican rules also include a cap that limits inflows at the level of derivative outflows. Banks will not be able to report a net inflow from derivative operations. Following discussions with the team, the Mexican authorities amended the rule to also include explicitly the Basel methodology. Mexican banks are now requested to calculate the net derivative flows using both the original Mexican methodology – considering inflows and outflows for the whole portfolio of derivatives, regardless of maturity, plus an add-on based on the CEM – and the Basel methodology. Banks are then required to apply the most conservative treatment between the two methodologies (ie the one resulting in the greatest net cash outflow) when computing the LCR. The team considered this approach to be in compliance with the Basel standard.
Materiality	Not applicable
Basel paragraph no	Basel III LCR paragraph 160
Reference in domestic regulation	No reference available
Findings	The Basel standard gives supervisors discretion to determine which inflow rate should apply to banks' other contractual inflows. At the same time, banks are required to explain what is categorised as "other contractual cash inflows". The requirement to explain is not explicitly included in the Mexican LCR regulation.

Materiality	Not material In Mexico, the category "all other contractual inflows" receives a 100% inflow factor. The authorities have the power to request banks to specify what claims are included in this category. Further, the General Provisions Applicable to Credit Institutions (after amendments made by the Mexican authorities) require banks to monitor the concentration of their inflows. This information is also shared with supervisors. The Assessment Team has taken the view that Mexican supervisors have the information to analyse banks' inflows and can ask for further detail if needed. This would allow the authorities to identify contractual inflows that they consider not eligible for the 100% inflow factor. This deviation is therefore assessed as not material.

2.2 LCR disclosure requirements

Section grade	Compliant
Summary	The minimum disclosure requirements are with one exception compliant with the Basel standard template. The Mexican template includes one deviation related to the disclosure of unconditionally revocable liquidity lines. The Assessment Team considers this deviation not material.
Basel paragraph no	Basel LCR disclosure standards paragraph 12 and LCR common disclosure template
Reference in domestic regulation	General provisions on liquidity requirements for commercial banks, Annex 5, Table I.1 and Table I.2
Findings	The disclosure of quantitative information about the LCR should follow the common template included in the standard. The Mexican regulation includes a template with a similar format and content but which nevertheless includes the following difference: • Credit and liquidity lines (row 13 in the Mexican disclosure template): the Mexican standard does not differentiate between unconditionally revocable and conditionally revocable facilities, but applies (by national discretion) the same run-off factor to unconditionally revocable facilities as to conditionally revocable lines for which the Basel standard specifies a run-off factor. This means that all revocable facilities will be grouped together in the Mexican disclosure template, whereas they are disclosed in different rows in the Basel template (in credit and liquidity lines and other non-contractual outflows). According to the Mexican authorities, the distinction between unconditionally revocable and conditionally revocable facilities does not exist in Mexico, which is the reason why they have chosen to treat them together for the purpose of this standard.
Materiality	Not material The fact that separate definitions for these types of facilities do not exist in Mexico, makes it difficult for the Mexicans to adopt the Basel template in this respect. Rather, making such a distinction in the template could lead to Mexican banks reporting different transactions within the same category and thus making misleading disclosures. As these commitments are unlikely to comprise a major part of bank total outflows the impact is assessed as not being material. However, the Assessment Team suggests that a footnote in the disclosure template that there is a difference between the Mexican template and the Basel template would make this more transparent.

Annexes

Annex 1: RCAP Assessment Team and Review Team[10]

Assessment Team

Mr Charles Littrell, Australian Prudential Regulation Authority (Team Leader)

Name	Affiliation
Ms Johanna Eklund	Riksbank, Sweden
Mr Carl Kaminski	Office of the Comptroller of the Currency, United States
Mr Gim Hoe Lim	Monetary Authority of Singapore
Ms Marian Nieto	Bank of Spain
Mr Santosh Kumar Pandey	Reserve Bank of India
Mr Hafiz Abu Samah	Central Bank of Malaysia
Ms Mary Thomas	Office of the Superintendent of Financial Institutions, Canada

Supporting members

Ms Jane O'Doherty	Australian Prudential Regulation Authority
Mr Maarten Hendrikx	Basel Committee Secretariat

Review Team

Mr Joachim Keller	National Bank of Belgium
Mr Neil Esho	Basel Committee Secretariat
Mr Nkosana Mashiya	South African Reserve Bank
Mr Karl Reitz	Federal Deposit Insurance Corporation, United States

[10] The RCAP Assessment Team worked closely with Mr Udaibir Das, Head of Basel III Implementation at the Basel Committee Secretariat. It has also benefited from the feedback of the RCAP Review team and the Peer Review Board. The Review Team is separate from the Assessment Team, and provides an additional level of quality assurance for the report's findings and conclusions.

Annex 2: List of LCR standards under the Basel framework used for the assessment

Basel documents in scope of the assessment

(i) The Liquidity Coverage Ratio (January 2013), including the frequently asked questions on Basel III's January 2013 Liquidity Coverage Ratio (April 2014);

(ii) Liquidity Coverage Ratio disclosure standards (January 2014);

Basel documents reviewed for information purposes

(iii) Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools (January 2013) (part on liquidity risk monitoring tools);

(iv) Monitoring tools for intraday liquidity management (April 2013); and,

(iv) Principles for sound liquidity risk management and supervision (September 2008).

Annex 3: Local regulations issued by the Mexican authorities for implementing Basel LCR standards

Overview of issuance dates of important Mexican capital rules

Table 3

Domestic regulations	Name of the document, version and date
Implementation of the LCR	General Provisions on Liquidity Requirements for Commercial Banks, 19 December 2014
Banking Act	General Provisions Applicable to Credit Institutions, December 2, 2005, version of 8 December 2014

Hierarchy of Mexican laws and regulatory instruments

Table 4

Level of rules (in legal terms)	Type
Law	Issued by the Congress
General Provisions	Issued by Bank of Mexico and CNBV

Annex 4: Details of the RCAP assessment process

A. Off-site evaluation

(i) Completion of a self-assessment questionnaire by the Mexican authorities

(ii) Evaluation of the self-assessment by the RCAP Assessment Team

(iii) Independent comparison and evaluation of the domestic regulations issued by the Mexican authorities with corresponding Basel III standards issued by the BCBS

(iv) Identification of observations

(v) Refinement of the list of observations based on clarifications provided by the Mexican authorities

(vi) Assessment of materiality of deviations for all quantifiable deviations based on data and non-quantifiable deviations based on expert judgment

(vii) Forwarding of the list of observations to the Mexican authorities

B. On-site assessment

(viii) Discussion of individual observations with the Mexican authorities

(ix) Meeting with selected Mexican banks, accounting firms and a credit ratings agency

(x) Discussion with the Mexican authorities and revision of findings to reflect additional information received

(xi) Assignment of component grades and overall grade

(xii) Submission of the detailed findings to the Mexican authorities with grades

(xiii) Receipt of comments on the detailed findings from the Mexican authorities

C. Review and finalisation of the RCAP report

(xiv) Review of comments by the RCAP Assessment Team, finalisation of the draft report and forwarding to the Mexican authorities for comments

(xv) Review of the Mexican authorities' comments by the RCAP Assessment Team

(xvi) Review of the draft report by the RCAP Review Team

(xvii) Review of the draft report by the Peer Review Board

(xviii) Reporting of findings to SIG by the team leader

Annex 5: List of rectifications by the Mexican authorities

Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Basel paragraph	Reference to Mexican document and paragraph	Brief description of the forthcoming correction
10	General Provisions on Liquidity Requirements for Commercial Banks, transitional articles fourth provision	The Mexican regulation included an upper limit for the size of a new bank to be eligible for the phase-in for the LCR after the initial phase-in period is completed.
17	Article 12	The Mexican authorities have amended the regulations to specify that it is not possible for banks to operate more or less consistently slightly below the 100%. If banks fall below 100% in Scenario II on three or more occasions within six months, they would be classified in Scenario III.
24		If deemed urgent, the regulation could be amended within four weeks.
72	General Provisions on Liquidity Requirements for Commercial Banks, Article 10, fraction VI last paragraph	This fraction was included to make it clear that, in case there is ambiguity as to which outflow factor should be assigned to a given operation, the most conservative one should be used.
99	General Provisions on Liquidity Requirements for Commercial Banks, Annex 2, last paragraph before the table.	The Mexican authorities modified the regulation (General Provisions on Liquidity Requirements for Commercial Banks, Article 1 fraction XVI and Annex 2 last paragraph before the table) to explicitly exclude from operational deposits the deposits associated to correspondent banking.
116, 117, 123, 158, 159 (in conjunction with 69 and 142)	General Provisions on Liquidity Requirements for Commercial Banks, Annex 2 III.2 Annex 3 III.2 and Annex 4.	The Mexican authorities modified the regulation (General Provisions on Liquidity Requirements for Commercial Banks, Annex 4). First, a cap on inflows is introduced on derivatives operations up to the amount of outflows from derivatives operations, such that there can be no net inflows from derivatives. Second, two methodologies are included in Annex 4, the Basel methodology (considering inflows and outflows from derivatives within 30 days plus the look-back-approach, and the one considering inflows and outflows for the whole portfolio of derivatives, regardless of maturity, plus an add-on based on the CEM). Banks will apply the most conservative treatment between the two methodologies when computing their LCR. Finally, the modified CEM approach now uses the division over the square root of 12.
126	General Provisions on Liquidity Requirements for Commercial Banks,	The drafting in Annex 2, (items V.5.1 to V.5.11) has been amended to make it clear that it refers to the unused portion of all credit and liquidity facilities, not just to "unused" credit and liquidity facilities".

	Annex 2 (before the tables)	
98	General Provisions on Liquidity Requirements for Commercial Banks, Article 11, fraction II.	A requirement was included for banks to have a methodology to determine the amount of deposits they hold in other banks that should be classified as operational. Such a methodology must be consistent with the one used to determine the portion of deposits which others hold at the bank and which can be classified as operational for the purpose of determining outflows.
142, 151, 154	General Provisions on Liquidity Requirements for Commercial Banks, Article 11, fraction I	The regulation requires that all inflows from loans should only be based on fully performing loans. Defined as performing loans without past-due payments.

Annex 6: Assessment of the binding nature of regulatory documents

The following table summarises the assessment of the seven criteria used by the Assessment Team to determine the eligibility of Mexican regulatory documents. Based on this the Assessment Team concluded that the regulatory instruments issued and used by the Mexican authorities as set out in Annex 3 are eligible for the RCAP assessment.

Criterion	Assessment
(1) The instruments used are part of a well defined, clear and transparent hierarchy of legal and regulatory framework.	The Credit Institutions Law provides a comprehensive framework for the Banking Liquidity Regulation Committee to determine through general guidelines the limits and structure of liquidity requirements for Mexican banks. Furthermore, said law empowers BdM and CNBV to jointly issue LCR general provisions applicable to banks based on the guidelines determined by the Committee, as well as to supervise and enforce said provisions. The Credit Institutions Law includes powers for CNBV to impose corrective measures and fines against banks that are found not compliant with the LCR requirements established by the general provisions. Since both the Committee´s guidelines and BdM and CNBV´s joint LCR general provisions are not legislative in nature and are issued at the discretion of said authorities the framework allows flexibility for the authorities to react, if urgent, and amend the provisions without influence from Congress.
(2) They are public and easily accessible	BdM and CNBV jointly developed the LCR general provisions and submitted them to COFEMER for a review that follows a clearly defined process that includes public consultation. The proposed regulations and public comments are public and accessible on its website: http://207.248.177.30/regulaciones/scd_expediente_3.asp?ID=05/2353/311014 The LCR general provisions have been approved by COFEMER, published in the Federal Official Gazette and made available on both BdM and CNBV websites.
(3) They are properly communicated and viewed as binding by banks as well as by the supervisors.	LCR general provisions issued by BdM and CNBV are legally binding and violations thereof are directly enforceable and punishable with fines against banks. Furthermore, the CNBV has general supervisory powers to evaluate compliance with the requirements, which include the possibility to start investigations against non-compliant banks. The Mexican authorities have held several open meetings with banks and issued technical guidance to ensure familiarity and compliance with the requirements, as well as to inform banks of the dates and transition periods provided by the general provisions.
(4) They would generally be expected to be legally upheld if challenged and are supported by precedent.	Under the Credit Institutions Law, banks that are deemed not compliant with the Mexican LCR requirements will be subject to corrective measures and fines. Furthermore, the Mexican authorities have broad powers to take supervisory actions as well as remedial and enforcement actions to compel compliance with general provisions.
(5) Consequences of failure to comply are properly understood and carry the same practical effect as for the primary law or regulation.	Under the Credit Institutions Law, bank violations of the LCR general provisions will be subject to corrective measures and fines. However, the said legal framework does not give the authorities discretion to apply different measures to banks depending on the reasons why a bank does not meet a requirement. A breach of a requirement of certain magnitude must always trigger the same or equivalent corrective measures. Therefore, in order to provide some flexibility, LCR general provisions classify banks into five different categories of compliance, or "scenarios", based on predefined thresholds. It specifies that banks falling below Scenario II will be considered non-compliant and therefore subject to the measures and fines mentioned above.
(6) The regulatory provisions are expressed in clear language that complies with the Basel provisions in both substance and spirit.	The LCR general provisions were drafted in clear and concise language using the Basel standard as guidance in order to limit misinterpretation and aid enforcement. Additionally, the authorities issued guidelines to provide greater

	clarity and achieve harmonisation in the completion of the data template and LCR computation. Furthermore, the LCR general provisions empower the Mexican authorities to answer consultations regarding the scope of the regulation.
(7) The substance of the instrument is expected to remain in force for the foreseeable future	The LCR framework is legally issued and consists of binding laws, regulations and guidelines which are expected to remain in force for the foreseeable future Furthermore, there is a legal obligation for BdM and CNBV to issue this regulation, and such legal obligation can only be modified by the Congress.

Annex 7: Key liquidity indicators of the Mexican banking system

Size of banking sector (MXN millions). Data as of September 2014		
1. Total assets all banks operating in the jurisdiction	7,075,213	
2. Total assets of all major locally incorporated banks	7,075,213 (By law, all banks in the Mexican system have to be locally incorporated banks (subsidiaries), ie no branches are allowed.	
3. Total assets of locally incorporated banks to which liquidity standards under the Basel framework are applied	7,075,213 (By law, all banks in the Mexican system have to be locally incorporated banks (subsidiaries), ie no branches are allowed.	
Number of banks		
4. Number of banks operating in the jurisdiction	45	
5. Number of Global Systemically Important Banks (G-SIBs)	11 subsidiaries of GSIBs,	
6. Number of Domestic Systemically Important Banks (D-SIBs)	-	
7. Number of major locally incorporated banks	7	
8. Number of banks required to implement Basel III liquidity standards	45, with a gradual implementation	
9. Number of banks required to implement domestic liquidity standards	45, with a gradual implementation	
Implementation of liquidity standards under the Basel framework	Unweighted	Weighted
10. Total HQLA	938,493	901,520
11. Level 1 HQLA	797,565	797,565
12. Level 2A HQLA	70,880	60,248
13. Level 2B HQLA	70,048	43,707
14. ALA HQLA	0	0
15. Total cash outflows	5,963,554	1,210,144
16. Retail and small business stable deposits	853,271	42,664
17. Retail and small business less stable deposits	613,324	61,332
18. Wholesale operational deposits	536,146	125,569
19. Wholesale unsecured non-operational funding	764,181	397,453
20. Secured funding	1,996,874	59,807
21. Debt issued instruments	266,179	266,179
22. Other contractual outflows	407,984	202,101
23. Contingent funding obligations	525,595	55,039
22. Total cash inflows	987,133	353,651
23. Secured lending	481,814	12,380
24. Fully performing unsecured loans	406,281	242,233
25. Other cash inflows	99,038	99,038
26. Liquidity Coverage Ratio		105%

Annex 8: A summary of the materiality assessment

As a general principle, and mirroring the established RCAP assessment methodology for risk-based capital standards, the RCAP-LCR materiality assessment is based both on quantitative and qualitative information with the overlay of expert judgment. Where possible, teams also take into account the dynamic nature of liquidity risks and seek to assess the materiality of deviation at different points in time.

In line with underlying RCAP principles, the quantitative materiality assessment for the LCR is based on a determination of the cumulative impact of all identified deviations (both quantifiable deviations and non-quantifiable deviations). Where deviations are quantifiable, the Assessment Team will generally base the assessment on the highest impact that has been reported across three data points. The collection of data across different dates is agreed upon between the team leader and the assessed jurisdiction.

In the case of the Mexican LCR assessment, no quantifiable material deviations were identified taking into account the amendments made by the Mexican authorities during the course of the RCAP. The following table summarises the number of deviations according to their materiality.

Number of gaps / differences by component Table 5

Component	Non-material	Material	Potentially material
Scope of application	1	0	0
Transitional arrangements	1	0	0
Definition of HQLA (numerator)	5	0	0
Outflows (denominator)	1	0	0
Inflows (denominator)	1	0	0
LCR disclosure requirements	1	0	0

Note: materiality is defined based on quantitative benchmark thresholds (for the quantifiable gaps) and expert judgment (for the non-quantifiable gaps). See Section 2 with the detailed assessment findings for further information.

The following five internationally active Mexican banks were selected for materiality testing of the quantifiable deviations. Together these banks represent 71% of the total assets of the Mexican banking system (31 December 2013).

1	BBVA Bancomer
2	Banamex (Citi)
3	Santander
4	HSBC
5	Banorte

Annex 9: Mexico's implementation of liquidity monitoring tools

In addition to the minimum standard for the LCR, the Basel LCR framework also outlines the metrics to be used to monitor liquidity risks ("the monitoring tools"). The monitoring tools capture specific information related to a bank's cash flows, balance sheet structure, available unencumbered collateral and certain market indicators. The monitoring tools supplement the LCR standard and are a cornerstone for supervisors in assessing the liquidity risk of a bank. This annex provides a qualitative overview of the implementation of the monitoring tools in Mexico.

Method of implementing the Basel liquidity monitoring tools

The liquidity monitoring tools will be implemented in Mexico in the first quarter of 2015 through amendments to the Risk Management Framework – in particular to Article 81, which outlines the considerations that banks must observe when managing their liquidity risk and the specific risk management process banks that must follow. Further, the proposed amendments to Article 81 require banks to calculate and follow a number of specific indicators which are similar or identical to the Basel liquidity monitoring tools outlined in the LCR standard.

How are the tools used by supervisors?

Banks are required to calculate the monitoring tools as part of their liquidity risk management process and practices. Regular reporting of the monitoring tools to the supervisor is not required. However, authorities already collect the necessary information to compute most of the monitoring tools and, if needed, can also ask banks to report the indicators to them at any time.

If banks do not calculate the monitoring tools, the Mexican authorities have the power to require banks to calculate them. Failure to compute them, or if the Mexican authorities detect a risk by observing them, could trigger the use of other supervisory powers by CNBV to review the institution's internal controls.

Description of how the monitoring tools in the Mexican regulation will be implemented

I. Contractual maturity mismatch

The Mexican regulation requires banks to have an indicator showing future contractual cash in- and outflows. Like the Basel Contractual mismatch monitoring tool, this metric requires banks to calculate all future contractual cash in- and outflows, including those from contingent liabilities. Further, the Mexican regulation does not allow banks to make their own rollover assumptions. For asset and liabilities with an open maturity, these should be reported separately. Further, the indicator is required to calculate cash flows for at least the same asset and liability items as for their LCR reporting and for the following time buckets: daily, weekly, monthly, quarterly, semi-annual, annual, and beyond one year.

II. Concentration of funding

The Basel standard tool is meant to identify those sources of wholesale funding that are of such significance that withdrawal of this funding could trigger liquidity problems. For this purpose banks should follow funding concentration by counterparty and funding instrument as well as list assets and liabilities by significant currency.

The Mexican regulation requires banks to have an indicator showing for each of its 100 largest creditors or group of creditors that can be considered as the same creditor, the total amount each of such creditors has at the corresponding date, as well as the amount of funding from those liability products which represent more than 1% of the total liabilities of the commercial bank. Further, banks are required to break down the liabilities calculated for each creditor or instrument according to their remaining maturity and report them separately for the time horizons: up to and including one month; one to three months; three to six months; six to 12 months; and more than 12 months.

Finally, related to calculating this indicator, banks are also required to monitor, report and group assets and liabilities for each relevant currency. The Mexican regulation defines relevant currency as when that currency represents 5% or more of the institution's total liabilities.

The definition of this indicator follows the Basel definition of the concentration of funding in all relevant respects.

III. Available unencumbered assets

The Basel monitoring tool is meant to provide supervisors with data on the quantity and key characteristics, including currency denomination and location, of banks' available unencumbered assets that could potentially be used as collateral to raise additional HQLA.

The Mexican regulation requires banks to have an indicator showing the amount of available collateral the commercial bank can sell on the secondary market or to the Bank of Mexico in order to obtain financing. This should be done for each significant currency. Furthermore, banks are required to monitor the term for which assets are available, and their usability as collateral with the central bank.

IV. LCR by significant currency

While the LCR is required to be met in one single currency, the Basel liquidity standard states that banks and supervisors should also monitor the LCR in significant currencies. This will allow the bank and the supervisor to track potential currency mismatch issues that could arise.

The Mexican regulation requires banks to define and monitor their LCR for each relevant currency. In line with the Basel standard, a currency is defined as relevant if liability transactions denominated in that currency represent 5% or more of total liabilities of the institution. The definition of the LCR to be used by currency is the same as the one specified in the General Provisions on Liquidity Requirements, ie the LCR requirement regulation.

V. Market-related monitoring tools

For the market-related monitoring tools, the Basel standard does not set out any requirements for banks. Instead, these indicators are proposed as tools to be used by supervisors as early warning indicators in monitoring potential liquidity difficulties at banks. The standard does not identify one or more specific indicators. Instead, it recognises that there are many types of data available in the market and gives examples of (i) market-wide information; (ii) information on the financial sector; and (iii) bank-specific information that can be used for this purpose.

The Mexican regulation does not require the authorities to follow any specific market indicators when supervising banks. However, they have the option of asking banks to report any information that the banks are required to monitor (for example, as part of their liquidity risk management framework), which includes market-related information.

Instead there is a requirement for banks to identify and follow relevant market-related monitoring indicators for the purpose of putting in place their contingency funding plan. Banks are required to consider macroeconomic and market conditions. They are also required to benchmark funding costs and monitor funding costs spreads relative to their peers as well as credit quality indicators.

Annex 10: Mexico's implementation of the Basel Principles for sound liquidity risk management and supervision

This annex provides a qualitative description of the implementation of the Basel Principles for sound liquidity risk management and supervision in Mexico's regulation. The principles are not part of the formal RCAP assessment and no grade is assigned. This annex serves for information purposes only.

Principles 1–13 are implemented in Mexico's regulation through the General Provisions Applicable to Credit Institutions (the General Provisions). These principles are applicable to all credit institutions (commercial banks and state-owned banks). Notwithstanding, the LCR is only applicable to commercial banks. Principles 14–17, which give guidance for supervisors assessing liquidity risk management in banks, are implemented through the National Banking and Securities Commission Law and the Credit Institutions Law.

Fundamental principle for the management and supervision of liquidity risk – Principle 1

The first principle states the overall purpose: banks are responsible for having processes in place to actively monitor and manage liquidity risk.

The scope and overall aim of Mexico's liquidity regulation are laid down in the General Provisions. These include requirements for sound risk management overall as well as a specific requirements concerning liquidity risk. In particular, this regulation requires banks to observe the guidelines of the framework for comprehensive risk management set forth in the General Provisions, and to establish mechanisms that allow them to operate with liquidity risk levels suitable to the amount of their liquid assets in normal, adverse and extreme conditions.

Specifically, when managing liquidity risk, credit institutions must consider the risk on an individual and consolidated basis and, as a minimum, they must ensure that they are capable of complying with its obligations at all times, even in adverse conditions. Additionally, they must maintain an adequate level of liquid assets, sufficient to cover outflows even in stress situations that correspond to the institution's appropriate risk profile, as well as to assumptions about the duration and severity of financial stress and asset realisation values, taking into account possible unrealised losses.

Governance of liquidity risk management – Principles 2–4

These principles give guidance on the division of responsibility for liquidity risk management and controls within banks. The aim of these principles is to clearly articulate a liquidity risk management process through which the senior management and the board of directors actively participate for defining a liquidity risk tolerance that is appropriate for the business strategy of the organisation. For this purpose, the above mentioned process should incorporate liquidity costs, benefits and risks in the internal pricing, performance measurement and new product approval process for all significant business activities (both on- and off-balance sheet), thereby aligning the risk-taking incentives of individual business lines with the liquidity risk exposures their activities create for the bank as a whole.

Aligned with these principles, Mexico's regulation requires the senior management (including the risk committee and the general director) and the board of directors to be involved in the process to define, approve and monitor the liquidity risk tolerance of all credit institutions. The involvement of these governance bodies is required as part of the responsibilities the risk committee, the general director and board of directors must accept for liquidity risk management purposes according to the General Provisions.

In addition to the abovementioned functions, the liquidity risk management process (including the process to approve mergers, acquisitions and operations, services, products and new lines of business) must permit banks to allocate the liquidity costs, benefits and risks of the various business units appropriately, allowing them to take a holistic approach to liquidity risk measurement for the entire bank and to align the risk-taking incentives of individual business lines with the liquidity risk exposures that their activities create for the bank as a whole.

Measurement and management of liquidity risk – Principles 5–12

The aim of these Basel principles is that banks have a cushion of unencumbered, high-quality liquid assets to be held as insurance against a range of liquidity stress scenarios, including those that involve the loss or impairment of unsecured and typically available secured funding sources. For these purposes, banks are required to have a sound process and tools for identifying, measuring, monitoring and controlling liquidity risk and additionally to have a formal contingency funding plan (CFP) as a backstop measure for addressing liquidity shortfalls in emergency situations.

Mexican regulation requires credit institutions to comply with their obligations, while considering the possibility of adverse conditions, and to maintain a level of liquid assets that is sufficient to cover outflows, even in stress situations that correspond to the institution's appropriate risk profile, as well as to assumptions about the duration and severity of financial stress and asset realisation values, taking into account possible unrealised losses. For this purpose, credit institutions are required to have a process for identifying, measuring, monitoring and controlling liquidity risk. They are also required to monitor and control liquidity risk exposures and funding needs within and across legal entities, business lines and currencies, taking into account the legal, regulatory and operational limitations for the transfer of resources.

Mexico's regulations require that credit institutions differentiate between encumbered and unencumbered assets. They also require institutions to proactively manage their liquidity positions and their intraday risks to comply with payment and settlement obligations in a timely fashion, both in normal and stress conditions.

In addition, Mexican regulations require that credit institutions must have a documented contingency financing plan in their comprehensive risk management manuals that clearly establishes the strategies, policies and procedures to be followed in case of liquidity shortfalls or asset liquidation issues and to execute, at least once a year, stress tests that must meet the guidelines described in the General Provisions Applicable to Credit Institutions.

Public disclosure – Principle 13

Principle 13 requires regular public disclosure of liquidity-related information that enables market participants to make an informed judgment about the soundness of institutions' liquidity risk management frameworks and liquidity positions.

Under the risk management disclosure framework, Mexican regulations require that all credit institutions must disclose the key elements of their methodologies for the management of liquidity risk, including:

- Brief description of the methodology used to identify and quantify liquidity risk.
- Exposures and portfolios being assessed for liquidity risk.
- Brief explanation of how market participants should interpret the results of the risk figures that are disclosed.

The role of supervisors – Principles 14–17

Under these principles, the supervisor should regularly perform a comprehensive assessment of a bank's overall liquidity risk management framework and liquidity position to determine whether they deliver an adequate level of resilience to liquidity stress given the bank's role in the financial system. This comprehensive assessment should be supplemented by monitoring a combination of internal reports, prudential reports and market information. It should be noted that, in the case of deficiencies in a bank's liquidity risk management processes, the supervisor should intervene to require effective and timely remedial action by the bank.

Based on the National Banking and Securities Commission Law, the CNBV may make inspections to credit institutions in order to assess if their operations, organisation, processes and systems of internal control and risk management comply with the provisions regarding liquidity risk on a regularly basis.

For this purpose, CNBV assesses the risks to which the credit institutions are exposed, their control systems and the quality of management, to ensure that they maintain adequate liquidity. Additionally, the institutions must provide the Commission with the information it requires for its liquidity risk assessments.

Annex 11: Areas for further guidance from the Basel Committee

The Assessment Team listed the following issue for further guidance from the Basel Committee.

Treatment of inflows for operational deposits

The Basel standard applies a 0% inflow factor for operational deposits held at other banks, given that these deposits are required for operational reasons, and are therefore not available to the depositing bank to repay other outflows. The Basel standard, however, does not specify whether and how to determine the excess amounts of operational deposits held at other banks. The Mexican authorities have adopted the same rigid criteria as for outflows: to model and identify excess operational deposits (which would receive the favourable treatment). The regulation also gives the CNBV the power to reject an approach suggested by a bank and require them to use a more conservative treatment. Data on operational deposits that banks received from other banks (which determines outflows) suggest that such deposits have been volatile so far. By incentivising banks to model both operational deposits that they receive from other banks and those they themselves have deposited will help supervisors to assess the numbers provided by banks. Overall, the Assessment Team views this as a fair interpretation and implementation of the Basel standard. The team would ask the Basel Committee to confirm this interpretation.

Annex 12: List of issues for follow-up by future RCAP assessments teams

The Assessment Team identified the following issues listed below for follow-up and for future RCAP assessments of Mexico.

Definition of HQLA

The Basel standard states that where the sovereign has a non-0% risk weight, domestic sovereign debt issued in foreign currency is eligible as a Level 1 asset up to the amount of the bank's stressed net cash outflow in that specific currency. Holding of such bonds in excess of that amount would be treated as Level 2B assets. Under Mexican regulations, Mexican sovereign bonds denominated in foreign currencies (UMS) are included as Level 1 HQLA without any restriction. The team recommends a future follow-up assessment to determine the materiality of this deviation.

Objective of the LCR and use of HQLA

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.

Treatment of derivative inflows

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.

Annex 13: Areas where Mexican LCR rules are higher than the Basel minimum standards

In several places, the Mexican authorities have adopted a stricter approach than the minimum standards prescribed by Basel or have simplified or generalised an approach in a way that does not necessarily result in stricter requirements under all circumstances but never results in less rigorous requirements than the Basel standards. The following list provides an overview of these areas. The information in this annex has been provided by the Mexican authorities and has not been cross-checked or assessed by the RCAP Assessment Team. It should be noted that these areas have not been taken into account as mitigants for the overall assessment of compliance.

- The Mexican definition of small business customers is stricter than the one stated in the Basel standard. The Mexican limit is 400,000 UDIs (approximately MXN 2,113,000 or around USD 145,000, as of December 2014).[11]
- The Mexican treatment of derivatives is more conservative than the Basel standard, since banks are required to apply the more conservative of the two treatments, whether the one based on the whole portfolio of derivatives and the modified CEM, or the Basel approach based on inflows and outflows for 30 days plus the look-back approach.
- Mexican regulation applies the same treatment to unconditionally revocable "uncommitted" credit and committed credit facilities.

[11] Mexico's Investment Units (UDIs) are units based on price increases and are used to settle mortgage obligations or commercial acts. They are designed to retain purchasing power and not be subject to inflation. They were created in 1995 to protect banks and are focused mainly on mortgage loans. BdM publishes the value in pesos of the UDI in the Official Federal Gazette.

Annex 14: Implementation of LCR elements subject to prudential judgment or discretion in Mexico

The following tables provide information on elements of LCR implementation that are subject to prudential judgment and national discretion. The information provided helps the Basel Committee to identify implementation issues where clarifications and (additional) FAQs could improve the quality and consistency of implementation. It should also inform the preliminary design of any peer comparison of consistency across the membership that the Committee may decide to conduct, in similar fashion to the studies on risk-weighted asset variation for the capital standards.

Elements requiring judgment (non-comprehensive list) Table 6

Basel paragraph	Description	Implementation by the Mexican authorities
24(f)	Treatment of the concept of "large, deep and active markets"	There is no specific reference to this characteristic. However, Annex 1 comprises a list of specific eligible assets that meet this requirement.
50	Treatment of the concept of "reliable source of liquidity"	There is no specific reference to this characteristic. However, Annex 1 comprises a list of specific eligible assets that meet this requirement.
52	Treatment of the concept of "relevant period of significant liquidity stress"	Assets may not have posted a cumulative decline over 30 days that exceeds a specific percentage (depending on the asset type). The period of observation spans from 2005 to date, including the financial crisis of 2008–09.
74–84	Retail deposits are divided into "stable" and "less stable"	Retail deposits are classified as stable and less stable as in the Basel document. Stable deposits need to be transactional/operational deposits (as defined in the Mexican regulation, which is consistent with Basel document), and they must be guaranteed by the deposit insurance (IPAB). Only the insured amount receives the lower run-off factor. There are no additional categories of less stable deposits, with run-off rates higher than 10%.
83, 86	Treatment of the possibility of early withdrawal of funding with maturity above 30 days (para 83 – retail deposits; para 86 – wholesale funding)	In practical terms, there is no scope for early withdrawal of term deposits, since a specific case-by-case approval by the Bank of Mexico would be needed for early repayment of term deposits.
90–91	Definition of small business customers' exposure is based on nominal EUR amount (1 million)	Small business customers are based on the amount insured by the IPAB. The limit is 400,000 UDIs (the Mexican inflation-indexed investment unit).
94–103	Deposits subject to "operational" relationships	Mexican regulation imposes a requirement for operational deposits. This requirement is similar to the one imposed in the Basel standard. Banks need to have a methodology for the determination of operational deposits (both for inflows and outflows). These deposits need to be in an account specifically designated to clearing, custody, and cash management purposes.
131(f)	Definition of other financial institutions and	All financial institutions different from banks receive

	other legal entities	the most conservative treatment. Mexico does not have the situation of other jurisdictions where financial institutions which do not operate as banks or market infrastructures also have a banking license. As for other legal entities, any type of legal entity not referred to in the regulation would be treated as "other legal entity".

Elements left to national discretion (non-comprehensive list)

Table 7

Basel paragraph	Description	Implementation by the Mexican authorities
5	These two standards [the LCR and NSFR] comprise mainly specific parameters that are internationally "harmonised" with prescribed values. Certain parameters, however, contain elements of national discretion to reflect jurisdiction-specific conditions. In these cases, the parameters should be transparent and clearly outlined in the regulations of each jurisdiction to provide clarity both within the jurisdiction and internationally.	Elements of national discretion and their correspondent outflow or inflow rates are detailed in Annexes 2 and 3. Most of the cases for national discretion are limited to uncommitted credit and liquidity facilities, for which the Mexican regulation applies the same treatment as for committed facilities.
8	Use of phase-in options	Mexican regulation uses the phase-in proposed by the Basel Committee.
11	The Committee also reaffirms its view that, during periods of stress, it would be entirely appropriate for banks to use their stock of HQLA, thereby falling below the minimum. Supervisors will subsequently assess this situation and will give guidance on usability according to circumstances. Furthermore, individual countries that are receiving financial support for macroeconomic and structural reform purposes may choose a different implementation schedule for their national banking systems, consistent with the design of their broader economic restructuring programme.	Article 16 states that the Bank of Mexico and CNBV may exempt banks partially or totally in extraordinary stress situations, based on the Committee of Banking Liquidity Regulation.
50(b)	Eligibility of central bank reserves	Central bank reserves are eligible as Level 1 assets because banks can access liquidity automatically against their reserves.
50(c)	Marketable securities that are assigned a 0% risk weight under the Basel II Standardised Approach for credit risk	Mexican regulation uses the same 0% risk-weight measure.
53–54	Eligible Level 2B assets	The Mexican authorities decided to include the category of Level 2B assets as stated in the Basel standard, with the exception of the RCLF.

54a	Provision relating to the use of restricted contractual committed liquidity facilities (RCLF)[12]	NA
55(f)	Treatment for jurisdictions with insufficient HQLA (subject to separate peer review process)	NA
68	Treatment of Shariah-compliant banks	NA
78	Treatment of deposit insurance	The Mexican deposit insurance meets the requirements established in the Basel standard. Thus, insured deposits are treated in accordance with the Basel standard.
79(f)	Categories and run-off rates for less stable deposits	Mexican regulation adopts the minimum run-off factor of 10% for less stable retail deposits. There are no additional buckets for less stable retail deposits.
123	Market valuation changes on derivative transactions.	The Mexican overall treatment of derivatives is more conservative than the Basel standard. With respect to valuation changes, the Mexican regulation considers both an adjusted CEM method and the LBA. In the end, banks must apply the most conservative overall treatment for derivatives between the one proposed by the Basel standard and the one considering the whole portfolio of derivatives operations (not just those maturing within 30 days) and an add-on based on the adjusted CEM.
134–140	Run-off rates for other contingent funding liabilities.	Other contingent funding liabilities receive a run-off factor of 100%, as specified in Annex 2.
160	Weight assigned to other contractual inflows.	Other contractual inflows receive a 100% inflow factor, as specified in Annex 3.
164–165	Determination of scope of application of LCR (whether to apply beyond "internationally active banks" etc) and scope of consolidation of entities within a banking group	The LCR applies to the consolidated bank, although liquid assets held in subsidiaries or legal entities abroad can be included only up to the amount of net cash outflows of such entity. It applies to all banks operating in Mexico.
168–170	Differences in home/host liquidity requirements due to national discretions.	None at the time
Annex 2	Principles for assessing eligibility for alternative liquidity approaches (ALA).	NA

12 See www.bis.org/publ/bcbs274.htm.