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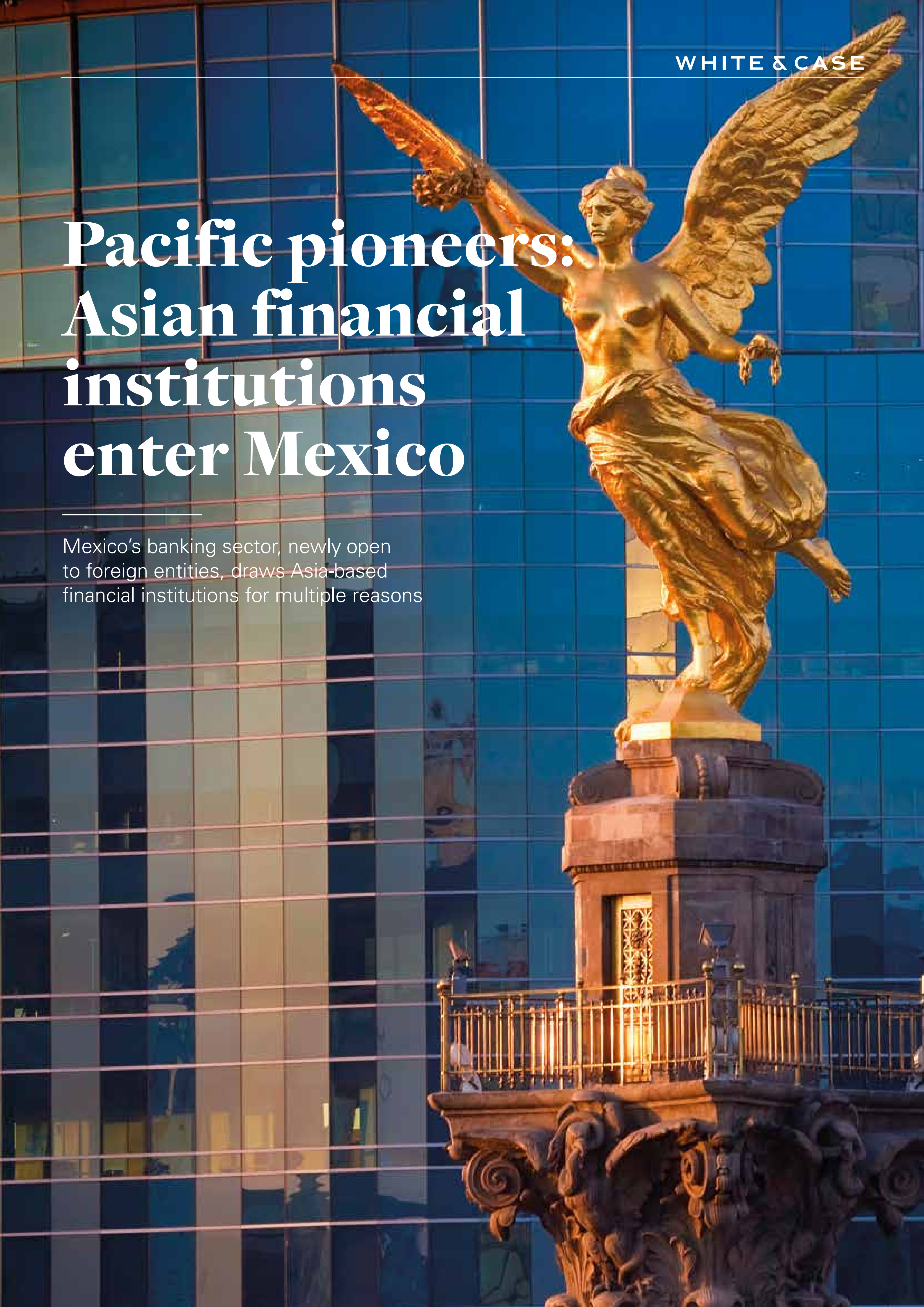


Pacific pioneers: Asian financial institutions enter Mexico

Mexico's banking sector, newly open to foreign entities, draws Asia-based financial institutions for multiple reasons

Pacific pioneers: Asian financial institutions enter Mexico

Asian banks are crossing the Pacific as some of the primary pathfinders in Mexico's newly open financial services markets

By Francisco Garcia-Naranjo, Francis Zou, Mariel Martínez Zárate

For most of Mexico's history, foreign state-owned entities were not permitted to participate in the capital ownership of a Mexican bank. This meant that Mexico's heavily regulated financial services industry was effectively closed to all banks whose owners or investors included foreign sovereign entities.

This changed in 2014, when Mexican legislative reforms began allowing these banks to establish subsidiary operations in Mexico in limited circumstances.

Almost immediately, Asian banks began crossing the Pacific as some of the primary pathfinders in Mexico's newly open financial services markets.

The trends that initially drew Chinese, South Korean and other Asian financial institutions to set up their own banking institutions in Mexico continue in the current investment climate. These include opportunities to provide financing support for Asia-based multinational manufacturers and other Asia-based corporations in Mexico.

Depending on political and trade developments over the next few years, the growth potential for Asian financial institutions in Mexico could continue to increase even further.

"Asian banks were among the first to take advantage of new opportunities for foreign financial institutions in Mexico.

Chinese paper parasols decorate the space above the street in Mexico City's Chinatown

Mexico City skyline

> “
> **Subsidiaries of foreign investment funds, including foreign sovereign investment funds, may now own a bank in Mexico.**

LEGISLATIVE REFORMS OPEN MEXICO'S FINANCIAL SECTOR TO FOREIGN INSTITUTIONS

In 2014, the Mexican government announced comprehensive reforms of the regulations governing financial institutions. Mexico amended, supplemented and repealed various legal provisions, including amending 34 legal statutes to foster greater competition in the financial and banking system by creating incentives to increase lending, as well as a new mandate for development banks. These reforms sought to strengthen both the stability of financial institutions and the powers of financial authorities in regulatory, monitoring and enforcement matters.

The reforms included amendments clarifying how foreign state-owned entities can legally participate in Mexican financial institutions. They set out the rules that require prior approval from Mexico's national banking and securities commission—the Comisión Nacional Bancaria y de Valores (CNBV)—before foreign governments may invest in Mexican commercial banks, as a temporary prudential measure, in cases where foreign entities receive financial support or are rescued. The reforms made it clear that this type of intervention should be only through official entities that do not exercise direct authority or control over the Mexican bank. Thus, foreign government participation in a Mexican financial institution must be indirect, without direct control. The reforms also regulated in more detail the procedures for exchanging information with foreign authorities and verification visits.

As a result of the reforms, it became possible for a foreign institution to participate in a Mexican bank as long as the investing entity

Foreign bank subsidiaries in Mexico

6 of the **40**

foreign banks that currently have direct subsidiaries in Mexico are headquartered in Asia:

Asia

- **3** Japan
- **2** China
- **1** South Korea

Americas

- **12** United States
- **1** Panama
- **4** Brazil
- **1** Canada

Europe

- **5** United Kingdom
- **3** Netherlands
- **3** France
- **1** Germany
- **3** Spain
- **1** Andorra

Source: Capital IQ

does not exercise authority over the bank. Subsidiaries of foreign investment funds, including foreign sovereign investment funds, may now own a bank in Mexico.

PAN-PACIFIC PATHFINDERS: ASIAN BANKS, MEXICO AND THE US

Asian banks were among the first to take advantage of these newly available opportunities for foreign financial institutions in Mexico. They included several banks owned and controlled, including indirectly, by Asian government agencies that established subsidiaries supervised by sovereign wealth fund investment managers.

For example, a subsidiary of the Industrial and Commercial Bank of China (ICBC)—the world's largest bank by total assets—received the first-ever license allowing a foreign sovereign to own a controlling indirect participation in a Mexican banking institution in 2015. Bank of China—the world's fourth-largest bank and the oldest bank in China—followed soon thereafter.

In 2015, Shinhan Bank became the first Korean bank to operate a Mexican subsidiary. Two years later, KEB Hana Bank—the largest financial institution in South Korea—obtained a license to establish a banking subsidiary in Mexico.

Six of the 40 foreign financial institutions that currently have direct subsidiaries in Mexico are Asian headquartered banks, according to Capital IQ.

Strong and increasing Mexican-Asian commercial ties

Mexico's banking sector attracts Asian financial institutions for multiple reasons.

First, Asia-based banks are well suited to support Asian companies globally, due to cultural and language links and those companies' comfort with their existing banking relationships.

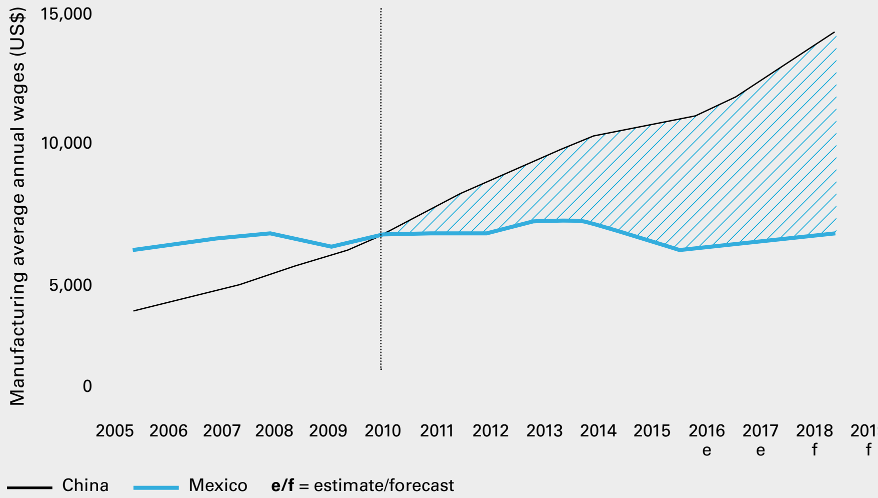
A recent, growing trend has seen Asian manufacturers establishing manufacturing operations in Mexico. Manufacturing in and exporting from Mexico offers competitive advantages, including proximity to the United States—the world's largest consumer market—which

Mexico: One of the best countries for economic risk in Latin America

	Regional rank	Global rank	Short-term economic risk score
Chile	1	32	70.2
Mexico	**2**	**34**	**70.0**
Peru	3	36	69.2
Colombia	4	54	63.8
Uruguay	5	55	63.5
Panama	6	59	62.7
Guatemala	7	62	61.5
Brazil	8	68	58.8

Source: *BMI Mexico Country Risk Report Q3 2018*

Lower manufacturing wages than China



Source: *BMI Mexico Country Risk Report* Q3 2018

Dragon on window in Mexico City during Chinese New Year


MEDICINA
TRADICIONAL
Y

currently is accessible from Mexico through the North American Free Trade Agreement (NAFTA). Mexico also participates in a high number of other free trade agreements, by some estimates more than any other country in the world. As Asian multinational companies expand their manufacturing operations in Mexico, many of their Asia-based suppliers and financers are focusing interest on Mexico, too.

During the past few years, a series of legislative and economic reforms have further improved the commercial environment in Mexico, which now ranks among the best countries for economic risk in Latin America.

According to a Boston Consulting Group study, Mexico's average direct manufacturing costs have been at least 4 percentage points cheaper than China's since 2004. Labor costs in China have risen significantly, while productivity gains in Mexico have offset almost all of the country's wage increases.

Mexico's manufactured goods exports, which accounted for more than 80 percent of its total goods exports in 2017, "have experienced a robust growth in recent years and are likely to perform well over the long term," according to *BMI Research's Mexico Country Risk Report*, Q3 2018.

Furthermore, foreign direct investment flows to Mexico from Asian countries are strong and growing. According to *fDi Intelligence*, from January 2011 to June 2018, Asian companies carried out 597 projects in Mexico worth more than US$42 billion. The top investing countries by number of projects were Japan (US$18.2 billion), South Korea (US$10.6 billion), China (US$5.2 billion) and Hong Kong (US$5.3 billion). The top sectors for Asian foreign direct investment in Mexico by number of projects included automotive components, metals and industrial machinery, and equipment & tools.

These direct investment ties go both ways. From January 2011 to June 2018, Mexican companies carried out 40 FDI projects worth US$1.98 billion in Asian countries, according to *fDi Intelligence*. The top target countries by number of projects included China, the Philippines, India and South Korea.

Trade ties between Mexico and Asia continue to expand. From 2013 to 2017, Mexico's exports to Asia grew at a compound annual growth rate of 4.67 percent, while its imports from Asia grew at a compound annual growth rate of 5.33 percent, according to the International Trade Centre. In particular, China, which imported US$6.7 billion worth of Mexican-made products in 2017, is now Mexico's fourth-largest trading partner by exports, according to several estimates.

7

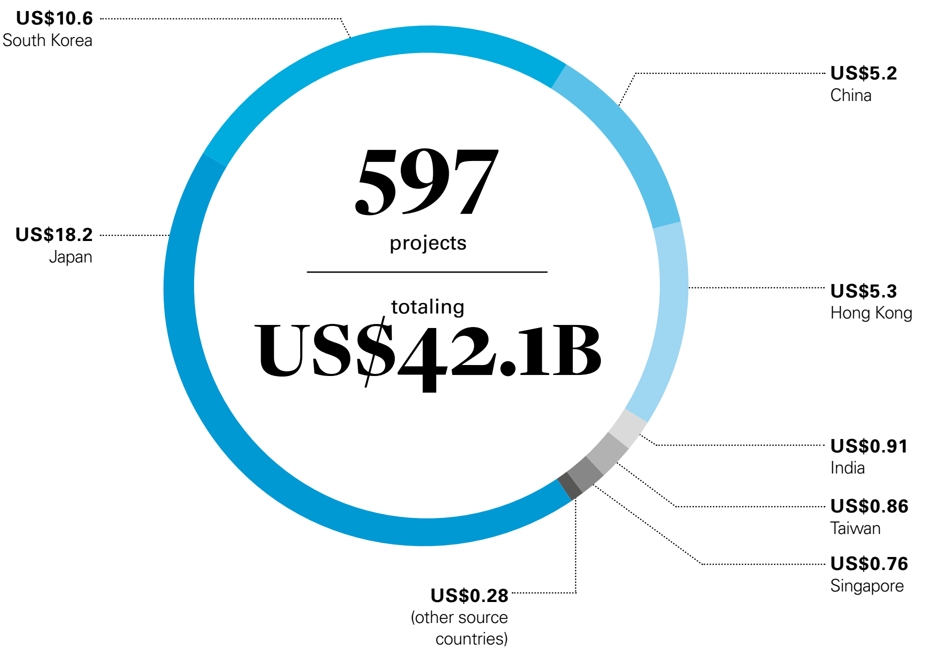
major Asian automobile manufacturers currently have direct subsidiaries in Mexico

Source: Capital IQ

Finally, Mexico is an appealing destination for Asian capital seeking M&A investments. From 2009 through Q1 2018, Asian companies carried out 39 acquisitions in Mexico worth approximately US$4.76 billion. The top target sectors by value in Mexico for Asian companies during this period were energy, mining and utilities, industrials and chemicals, TMT and transportation.

Foreign direct investment from Asia to Mexico (January 2011 – June 2018)

Capital investment (US$ billion)



Top 5 foreign direct investment sectors from Asia to Mexico by # of projects

206 projects
Automotive components

70 projects
Metals

42 projects
Industrial machinery, equipment & tools

36 projects
Plastics

34 projects
Automotive OEM

Source: *fDi Intelligence* (Asia to Mexico, January 2011 to June 2018)

Torre Latinoamericana in Mexico City

Korean Won

Linking the flow of Asian capital into Mexico's economy has the potential to be a powerful combination: larger than the economic might of the United States, the world's largest economy.

Potential for further growth, despite current uncertainties

Upheavals and events could possibly derail these trends going forward. Notably, the impact of the current US presidential administration on Asia-Mexico investment flows and existing trade routes remains uncertain. For example, after the current US administration threatened potential economic retaliation, several Asia-headquartered corporations announced plans to shift some of their production from Mexico to the US or to abandon planned further expansion of their operations in Mexico.

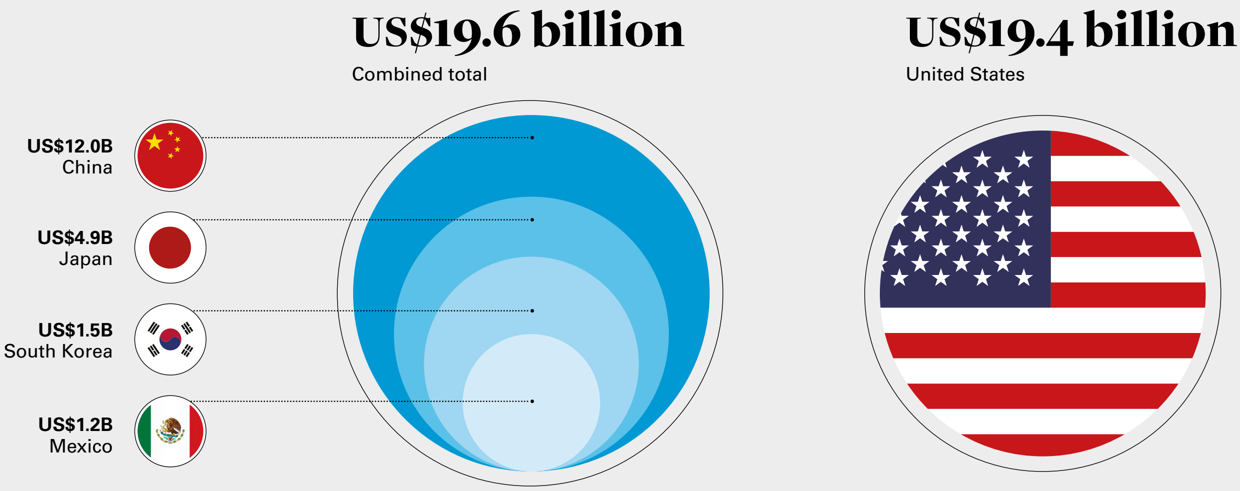
Still, disruptions like the current US administration's threats to renegotiate NAFTA could result in China emerging as an even more significant trading partner for Mexico. Soon after the November 2016 US presidential election, top diplomats from China and Mexico announced they had met to commit to deepening their trade and investment ties. Similarly, after the current US administration announced its intent to abandon the Trans-Pacific Partnership multi-nation trade agreement, Mexico and South Korea pledged to move forward with creating their own free trade agreement.

At the same time, banking connections between Mexico and Asia have broad potential for growth. Mexico's commercial relationships with Asian countries, which are fast developing, could continue to strengthen, result in a steady flow of Asian investments into various sectors of Mexico's economy, and prompt even more banks to enter Mexico.

Forecasts by *BMI Research's Mexico Country Risk Report*, Q3 2018 predict that Mexico's "growing manufacturing sector, solid private consumer and favorable demographics" will make it "well placed to see steady economic expansion over the coming decade."

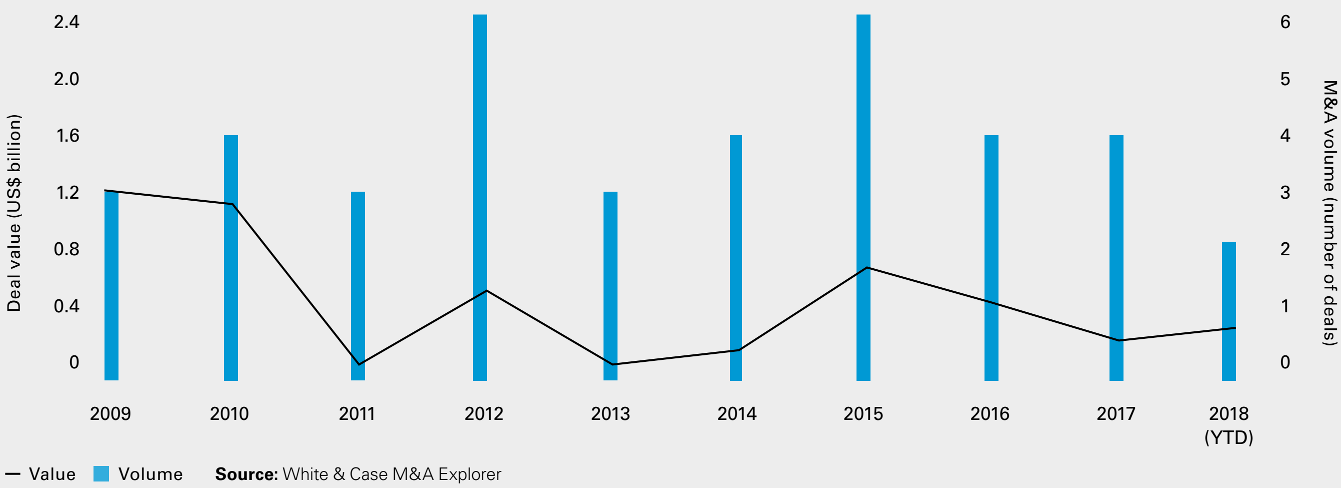
Combined economic might: Mexico with China, Japan & South Korea

GDP, current prices



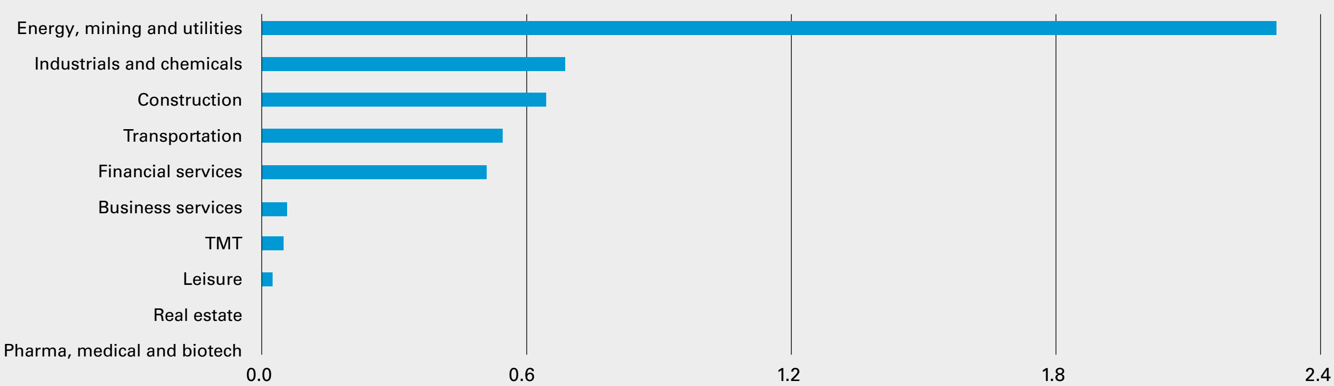
Source: International Monetary Fund's World Economic Outlook Database, April 2018

Asian companies in Mexico: M&A activity 2009 – Q1 2018



Source: White & Case M&A Explorer

Asian M&A in Mexico: Top sectors by value 2009 – Q1 2018



Source: White & Case M&A Explorer

Mexico's Central Bank,
old town Mexico City

> **Mexico 'benefits from a competitive manufacturing sector with strong trade linkages to the US, low labor costs, favorable demographics and the 2013/14 economic reforms, all of which will help to drive increasing investment.'**
>
> *BMI Mexico Country Risk Report Q3 2018*

CHALLENGES AND CREATIVITY: ESTABLISHING A FOREIGN-OWNED BANK SUBSIDIARY IN MEXICO

Obtaining the authorization to establish or acquire a bank in Mexico requires creativity, a deep understanding of Mexican regulatory authorities' procedures and a patient investment approach.

Asian financial institutions that include foreign state-owned entities as owners or investors and that would like to take advantage of the new opportunities to expand into Mexico are more likely to find long-term success by preparing to surmount a series of challenges with creativity and insight into Mexican regulators' priorities.

Set up initial informal meetings with Mexican authorities

To establish a bank in Mexico, the first step for an Asian financial institution is to seek authorization from CNBV, which requires both prior approval of CNBV's Board of Governance and a favorable opinion of Mexico's Central Bank.

Before officially submitting an application for authorization of a foreign-owned financial institution, it can be highly productive to explain the proposed project to the relevant Mexican regulatory authorities and seek their informal feedback. Best practices generally involve working with Mexican regulators to convince them that the new project is supported by reputable investors, has minimal potential liabilities and will likely make a positive net contribution to the Mexican economy.

PRACTICAL TIP: HAVE YOUR US BANK PERSONNEL LAUNCH YOUR BANK IN MEXICO

Asia-based financial institutions should consider having employees located in New York—or other US offices—lead the efforts to set up and run operations for a new bank subsidiary in Mexico.

US bank personnel of an Asia-based financial institution can draw from several similarities to launch a Mexican subsidiary, including:

Regulatory experience

Many Asian banks that establish operations in Mexico had previously undertaken a relatively similar process to first enter the US financial markets. Employees who are already experienced in navigating regulatory pitfalls and complying with capital requirements and other legal issues in the US can often apply that experience while adapting it to enter Mexican markets.

Time zone proximity

Responding rapidly to requests for information from Mexican authorities and conducting telephone meetings, when necessary, with Mexico is more efficient for individuals who work in North American time zones.

Overlapping customer base

An Asian bank's Mexican subsidiary very likely will serve many of the same customers as its US subsidiary. Corporate clients that conduct manufacturing operations in Mexico are likely to provide related warranty operations, marketing and other services in the US and Canada. Seamless banking service for customers who straddle borders can help maintain strong relationships with those customers.

The path to approval can be complicated if the proposed bank is controlled directly or indirectly by a foreign government—or serves as a vehicle where foreign governments invest reserves—as the filing will likely require significant additional documentation.

Mexican regulatory authorities have discretionary authority to request a variety of information from applicants. Regulators have broad latitude to approve or deny a proposal and theoretically can change the approval process at any time. So it's important to know how to navigate these requests and be proactive. Instead of simply waiting for comments, a bank seeking a new license can work actively with Mexican regulators to clear a mutually agreed-upon path for approval.

Request a license to establish or acquire a bank in Mexico

An official filing of a new application with CNBV starts the clock ticking. According to statutory requirements, Mexican authorities have 180 calendar days to determine the result of an application. This can include additional requests for the Asian financial institution to submit or revise further materials.

After both CNBV's Board of Governance and Mexico's Central Bank have resolved to approve an Asian bank's application, CNBV will send an official notice authorizing the organization and operation of the new bank.

Within 90 calendar days of receiving the official notice from CNBV, the bank must formally incorporate the Mexican financial institution before a Mexican notary public, and file the deed of incorporation with CNBV for its approval, before proceeding to registration with Mexico's Public Registry of Commerce.

Prepare for immediate regulatory scrutiny of banking operations

After obtaining CNBV's approval of the deed of incorporation, the new bank will have only 180 calendar days to commence operations in Mexico and prepare for an inspection by CNBV.

Setting up bank operations in Mexico can involve significant efforts, compliance with a series of often complex and dynamic requirements, and substantial investments of time and money. So, it is prudent to begin preparing for these tasks far in advance.

In addition to submitting regulatory filings, the new Mexican bank will have to deal with a set of immediate challenges in order to be ready to commence operations within the legal timeframe. This will include adjusting complex IT infrastructure systems to Mexican requirements, in addition to executing a lease agreement for new offices, opening new bank accounts, hiring employees and special advisors (such as for labor and tax law compliance) and handling other start-up issues.

Finally, the new Mexican bank will likely receive sustained regulatory scrutiny, particularly during its first few years of operations, in addition to the ongoing efforts the new bank will face in order to comply with all applicable laws and regulations and inspections from the relevant banking authorities.

Authorities may visit the bank's operations frequently, test its processes and the feasibility of its IT infrastructure, interview its people and possibly impose fines for violations. During this period, legal counsel can be particularly helpful in knowing when and how to comply with regulatory requests. Often, the most effective approach can be to propose creative solutions to the Mexican authorities or craft persuasive arguments based on careful analysis of a particular project and its likely impact. Prepare in advance to be flexible and adapt.

Plaza de la Constitución,
Mexico City

CHECKLIST: HOW TO SET UP AND OPERATE AN ASIAN BANK IN MEXICO

Establishing a bank in Mexico can be time-consuming and present varying detailed challenges, depending on a bank's individual circumstances. Overall, a patient, flexible approach and creative problem-solving are most likely to bring effective results.
In general, Asian banks find it most useful to follow these steps:

1. **Conduct initial informal advance meetings with Mexican authorities**
Since the filling will require detailed information and analyses from the applicants, working from the beginning of the project with the relevant authorities to seek their advance feedback can help make the application significantly more efficient.

2. **Start planning how to establish operations in Mexico**
It's a good idea to begin the planning process even before submitting an application with the Comisión Nacional Bancaria y de Valores (CNBV), Mexico's national banking and securities commission, since the new bank will have only 180 calendar days to commence operations in Mexico and prepare for an inspection by CNBV after obtaining approval of its deed of incorporation.

3. **File an application with CNBV**
CNBV, with a favorable opinion of Mexico's Central Bank, must approve the application and can request additional information during the authorization process.

4. **Incorporate a Mexican financial institution**
The deed of incorporation, executed with a Mexican notary public, must be filed with CNBV for approval within 90 days after receiving CNBV's official approval.

5. **Commence banking operations within 180 days**
This includes compliance with a series of difficult issues, including adjusting complex IT infrastructure systems to Mexican requirements, among other start-up challenges.

6. **Prepare for Mexican regulators' scrutiny**
It's important to bear in mind that the new bank will face ongoing compliance with the applicable laws and regulations and inspections from the relevant banking authorities.

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