Serfin Scheme May Be Inadequate: Can Mexico Afford to Subsidize itsBanking Sector?

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Mexico's $1 billion bailout plan for Banca Serfin is the government's most important banking initiative since creation of the UDI investment unit scheme earlier this year. The rescue confirms the government's new policy of cleaning the books of troubled financial institutions with injections of private capital. But there are worries about whether the Banco de Mexico has enough funds to see through its unspoken commitment to prevent banking failures by subsidizing the sector.

"We've yet to see if the central bank has the resources it needs to see this program through in a consistent manner," says Consuelo Blanco, a banking analyst at Vector brokerage.

The process is expected to move on in coming days with a similar deal for Inverlat, a smaller bank. But some analysts warned that the recent recapitalization of Serfin, Mexico's third largest bank and by far the most important of the stricken banks, could be unable to restore the institution to full health on its own. Further measures may be forthcoming.

The Serfin deal conformed to the model set by the previous recapitalization of Grupo Financiero Probursa, in which the central bank prepared the way for a fresh injection of private capital by purchasing poor quality debt at discount prices. In both cases, the government's Fund for the Protection of Savings, Fobaproa, bought poor quality loans with a nominal value of twice the funds put up by private sources to recapitalize the institution.

At the end of the first quarter of 1995, Serfin's past due loans amounted to 12.7% of its total portfolio, according to official figures widely regarded as excessively conservative. Now, under the agreement between the government and Serfin shareholders, the central bank will pay a to-be-determined market price to buy Serfin loans with a nominal value of 3.4 billion pesos, while shareholders will put up 1.24 billion pesos, and parent Grupo Financiero Serfin will provide a further 1.85 billion pesos, 920 million pesos of which will come from a new issue of five year debentures.

The deal differs from the Probursa agreement in that while Probursa was sold to a new majority owner, Banco Bilbao Vizcaya, Serfin will retain ownership. And the nominal value of 4.3 billion pesos of the loans taken off Serfin's books represents only 4.68% percent of the bank's total loan portfolio at the end of the first quarter, while the 4.7 billion pesos of loans to be bought from Probursa is closer to 40% of total loans. Furthermore, Serfin will be liable for 20% of any losses incurred by the loans purchased by Fobaproa.

"By itself, this package is not enough. Sooner or later, fresh funds will have to be injected into the bank," argued a senior economist who requested anonymity, pointing out that up to 20% of the bank's previous loan portfolio could turn bad as Mexico's economic recession and sky-high interest rates continue to bite.

Serfin, the largest Mexican financial institution to have ADRs on the New York Stock Exchange, followed a markedly less conservative loan policy than its main rivals in recent years, while Banamex and Bancomer cut back loan growth in an attempt to control the quality of their portfolios. Other Mexican banks which now stand in need of capitalization include Bancern, Grupo Financiero Bital and Inverlat.

The government emergency plan initially sought to recapitalize banks by providing funds from the emergency capitalization fund known as Procapte, but the scheme has been seen as less than perfect, since bad, often irrecuperable debt remained on the banks' books and the central bank was left holding large amounts of bank debt which would be convertible into equity after a five year period.

"The problem was that Procapte involvement was not widely understood," said Blanco. "Banks which entered into the scheme acquired a sort of stigma, which damaged confidence."

"The only way current stockholders can maintain their control of the banks is if they inject fresh capital, otherwise their stake will be diluted in favor of Fobaproa," said Eduardo Fernandez, president of the National Banking and Securities Commission.

The current model is expected to be more permanent. And the markets remain sanguine enough. Perceptions of Mexican risk had diminished enough on June 13 for 28 day Cetes rates to move under the 50% mark, to 47%, in line with the recent reduction in monthly inflation to 4.18% for May.

Extra assurance is likely to come from a imminently expected plan to convert loans for the country's toll road program into UDIs. Serfin, with over 3 billion pesos of mostly non-performing road loans on its books at the close of 1994, would especially benefit from such a plan. However, this is unlikely to greatly affect bondholders in Mexican roads securitized on world markets, since tough international regulations ensured that such projects would have enough revenues to pay off interest due, a condition all too rarely met elsewhere in the sector.

Nevertheless, "with good management, the resources the central bank is injecting will be enough for Serfin, and the banking sector generally, to emerge from the current crisis," said Blanco. "The important numbers will come out in the third quarter, as the central bank buys up loans as it has promised and the banks try to improve their operations."

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