



# Country Briefing & Treasury Practices

Mexico  
July 2010



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# Executive Summary

Today, Mexico's economy is wide open to foreign investment. Controls over deficit spending and a moderation in foreign debt are accomplishments that are building the confidence of foreign investors. The banking sector is relatively healthy. The working population is young and growing.

Since 1999, there have been no limits on foreign investment in the commercial banking sector. The insurance sector, however, remains closed as it is subject to an investment ceiling of 49%. As a result of the enactment of NAFTA, Mexico offers incentives to foreign companies that are looking to gain an strategic foothold on the North American continent.

Mexico enjoys free trade agreements with more than 40 countries. The most recent one was signed with Japan in September 2004 and makes Mexico the only country in the world to have free-trade agreements with the European Union, the United States and Japan. The free-trade agreement with the EU, in force since Oct. 1, 2000, makes it easier for the EU countries to improve their market share and increase their investments in the face of the impact of NAFTA and competition with Asian products.

The Mexican peso is a fully convertible, free-floating currency and there are no exchange controls. Local and foreign currency accounts are available to resident and non-resident entities.

Accounts held by resident and non-resident entities in Mexican pesos and US dollars may participate in cash concentration structures. It is possible (and is currently the practice of a variety of companies in different industries in Mexico) to include accounts held by different legal entities from the same group in a single cash concentration structure, although it is a more common market practice in Mexico to concentrate balances from accounts which are held by the same legal entity.

There are local and federal taxes. Local taxes are under the domain of each state, and federal taxes are applied nationwide. Federal taxes include corporate, withholding, and other taxes.

All payment instruments, excluding checks, have increased in both value and volume in Mexico over the last couple of years. There is a clear sign that companies are using less checks and more electronic payments, although the use of checks is still a common practice, particularly for companies that prefer the controls provided by check payments, as in more conservative types of companies in which the payment is not released unless an appropriate signature is provided.

Investment options and services available in Mexico consist of the stock market and money market. A combination of financial instruments issued by the government, banks, and private companies can offer attractive yields.

Scotiabank Global Transaction Banking services in Mexico offers Cash Management, Trade Finance and Correspondent Banking solutions for companies with business interests in Mexico.

# I. Economic and Political Brief

## GDP

The impact of the U.S. recession on Mexico was greater than expected in 2009. In addition, the swine flu outbreak also served to weaken the service sector even more. Signs of growth, however, can be seen for 2010. With the impact of the recovery of the industrial sector in the U.S., the Mexican economy is expected to grow 4.2% this year and generate 470,000 jobs. The industrial market sector will make up a good part of this expected growth since it is closely tied to the same sector in the U.S. However, while there is no progress in the structural reforms anticipated in Mexico, including fiscal, energy and labor reforms, the Mexican economy will remain vulnerable to the world economic situation, and especially the U.S.

## INFLATION AND THE EXCHANGE RATE

Given the economy's recovery as a result of fiscal measures adopted to maintain order in public finances, the rate of inflation is expected to ebb significantly in 2010 to an end-of-year rate of 5.50%. Beyond that, inflation should begin to assume a downward trajectory in 2011. The exchange rate will fundamentally depend upon changes in the perception of global markets. A moderation in the decline in the value of the peso can be expected at some point during the year once the developed economies begin to withdraw monetary and fiscal stimuli which will, as a result, limit flows available to developing countries such as ours.

## PUBLIC FINANCES

Although actions are being taken to limit the growth of the deficit, the root of the problem has not been corrected due to structural weaknesses in the government's income. A more profound reform in public finances that would significantly expand the tax base, providing more sustainable resources to the public sector which could be used as a tool for development, is still lacking. This reform is currently on the agenda of the Congress for this year. The public deficit is estimated to be at 2.8% of GDP in 2010.

## BALANCE OF PAYMENTS

Regarding the current account, the recession and decline in the exchange rate have corrected previously high imbalances and, in 2010 it is estimated that the deficit will be moderate at 1.2% of GDP which will not pose a financial risk. Regarding the capital account, a slight improvement in the flow of foreign direct investment is expected, along with a shortage in the flow of financial capital to Mexico.

## POLITICAL ENVIRONMENT

The ruling PAN party, (conservative right), lost ground in the recent mid-term elections. The PAN lost seats in the lower house of Congress, while the PRI, (center right), now holds the majority at 47%. The PVEM (green party), together with the PRI, represent the majority opposition. The PAN recuperated a 29% share in Congress and the PRD (left, center party) now holds 14%.

With these results, President Felipe Calderon can no longer ban budget spending. In addition, the mid-term election results have complicated plans for structural fiscal reforms planned by the Executive Branch. The mid-term elections suggest that the race for the Presidency in 2012 is an open question and will probably depend on the economic recovery in the next two years.

The year 2010 will be politically difficult, given that there will be elections in various states where 10 new governors will be appointed. Given this environment and electoral pressures, it is difficult to envision significant successes in structural reforms, and as such, the "status quo" is expected to continue. However, if some of the important reforms are implemented, the micro-economic environment could change significantly.

Moody's:	Baa1/Stable
S&P:	BBB+/Negative
Fitch Ratings:	BBB+/Negative



Source: Scotiabank Economic Study Group & Bloomberg, July, 2009

## COUNTRY INDICATORS

### Macroeconomics Chart: 2007 - 2011

ECONOMIC ACTIVITY (Real Annual Growth)	2007	2008	2009	2010 /p	2011 /p
Gross Domestic Product (GDP)	3.34%	1.48%	-6.53%	4.22%	3.47%
Total Consumption	3.87%	1.74%	-5.00%	3.37%	3.43%
Private Consumption	3.99%	1.87%	-6.10%	3.74%	3.75%
Public Consumption	3.12%	0.86%	2.23%	1.12%	1.44%
Total Investment	6.95%	4.38%	-10.09%	3.92%	2.80%
<b>INFLATION</b>					
Consumer Price Index December - December	3.76%	6.53%	3.57%	5.50%	4.58%
Underlying December - December	4.14%	5.73%	4.46%	4.74%	4.49%
Consumer Price Index Average	3.97%	5.12%	5.30%	5.16%	4.50%
<b>NOMINAL EXCHANGE RATE</b>					
Period End (\$ = Dollar)	10.87	13.54	13.06	13.20	13.69
Average (in Dollars)	10.93	11.14	13.55	13.05	13.41
Annual Average Devaluation	0.3%	1.9%	21.7%	-3.7%	2.8%
End of Period, Annual Devaluation	-0.1%	24.6%	-3.5%	1.1%	3.7%
Average Undervaluation /1	-9.4%	-8.9%	5.1%	-2.0%	-1.1%
<b>INTEREST RATE</b>					
Nominal 28 - Day Mexican Treasury Bill Rate (December)	7.44%	8.02%	4.50%	6.01%	7.57%
Nominal 28 - Day Mexican Treasury Bill Rate (Annual Average)	7.19%	7.67%	5.40%	4.97%	7.24%
Real 28 - Day Mexican Treasury Bill Rate (Annual Average)	3.73%	1.52%	2.00%	-0.25%	2.93%
28 - day TIE Rate (Annual average)	7.66%	8.28%	5.93%	5.35%	7.55%
<b>FINANCIAL SECTOR (Real Annual Growth, End of Period)</b>					
Financial Services GDP, Real Estate Sector	6.6%	7.4%	-4.8%	4.1%	3.9%
Financial Savings	6.3%	10.3%	2.6%	6.4%	-4.7%
Bank Funds	9.0%	11.7%	-0.4%	3.2%	-1.3%
Commercial Bank Financing	16.6%	4.7%	9.8%	3.2%	6.9%
<b>PUBLIC FINANCES (as a %of GDP)</b>					
Economic Balance	0.0%	-0.1%	-2.3%	-2.7%	-3.2%
Primary Excess Funds	2.2%	1.8%	-0.1%	0.3%	0.1%
Public Sector Financial Requirements /2	-1.8%	-2.8%	-5.9%	-6.0%	-6.5%
Net Foreign Public Debt (% of GDP)	3.4%	2.2%	10.5%	11.0%	11.5%
<b>FOREIGN SECTOR</b>					
Current Account (md)	-8,399.2	-15,889.0	-5,237.9	-13,026.1	-22,071.1
(% of GDP)	-0.82	-1.45	-0.60	-1.28	-2.08
Commercial Balance (md)	-10,073.7	-17,260.7	-4,677.5	-11,568.2	-19,585.0
Capital Account (md)	19,687.6	24,547.9	14,525.9	19,384.6	26,697.2
Total Foreign Debt (md)	124,432.5	125,233.1	159,197.4	165,000.0	170,000.0
Balance of International Reserves (md)	77,991.0	85,441.0	90,837.8	99,543.8	105,806.9
<b>INTERNATIONAL ECONOMY</b>					
U.S. GDP	2.1%	0.4%	-2.4%	3.8%	2.6%
Annual Inflation	4.1%	0.1%	2.7%	1.7%	3.0%
Treasury Bills Three - Month Average	4.5%	1.4%	0.1%	0.8%	2.5%
Labor Rate Three - Month Average	5.3%	2.9%	0.7%	0.7%	2.5%
Mexican Crude Oil Average	61.6	84.4	57.6	70.0	60.0

/1 Negative sign for over valuation  
 /2 Not including non-recurring income  
 /p Projected as of the indicated date

Updated data can be found at [www.scotiabank.com.mx](http://www.scotiabank.com.mx)

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## II. Foreign Relations / Trade

Mexico has historically sought to maintain its interests abroad and has followed the principles of nonintervention and self-determination. In its efforts to revitalize its economy and open up to international competition, Mexico has searched for closer relations with the U.S., Eastern Europe, and the Pacific Basin. Former President Vicente Fox and the current President Felipe Calderon have actively promoted international human rights and democracy and looked to increase Mexico's participation in international affairs.

Mexico actively participates in several international organizations; it has been elected to a place on the UN Security Council for the period 2009 to 2010. Mexico is a strong supporter of the United Nations and the Organization of American States and also pursues its interests through a number of ad hoc international bodies.

Mexico's principal imports are: agricultural products, machinery, and automotive parts for assembly and steel products. The main export products are chemicals, coffee, cotton, fruit and vegetables, oil and gas.

The key countries for exports and imports are:

EXPORTS	%	IMPORTS	%
USA	80.5%	USA	48.0%
CANADA	3.6%	CHINA	13.9%
GERMANY	1.4%	JAPAN	4.9%
SPAIN	1.0%	KOREA	4.7%

Source: Secretaría de Economía (Mexican Economic Ministry)

Mexico is highly dependent on exports to the U.S., which represent more than a quarter of the country's GDP.

EXPORTS		IMPORTS	
Oil:	17.40%	Intermediate goods:	71.80%
Non-Oil:	82.60%	Consumer goods:	15.50%
Manufacturing:	79.10%	Capital goods:	12.70%
Agriculture:	2.90%		
Mining:	0.60%		

Source: <http://www.focus-economics.com>

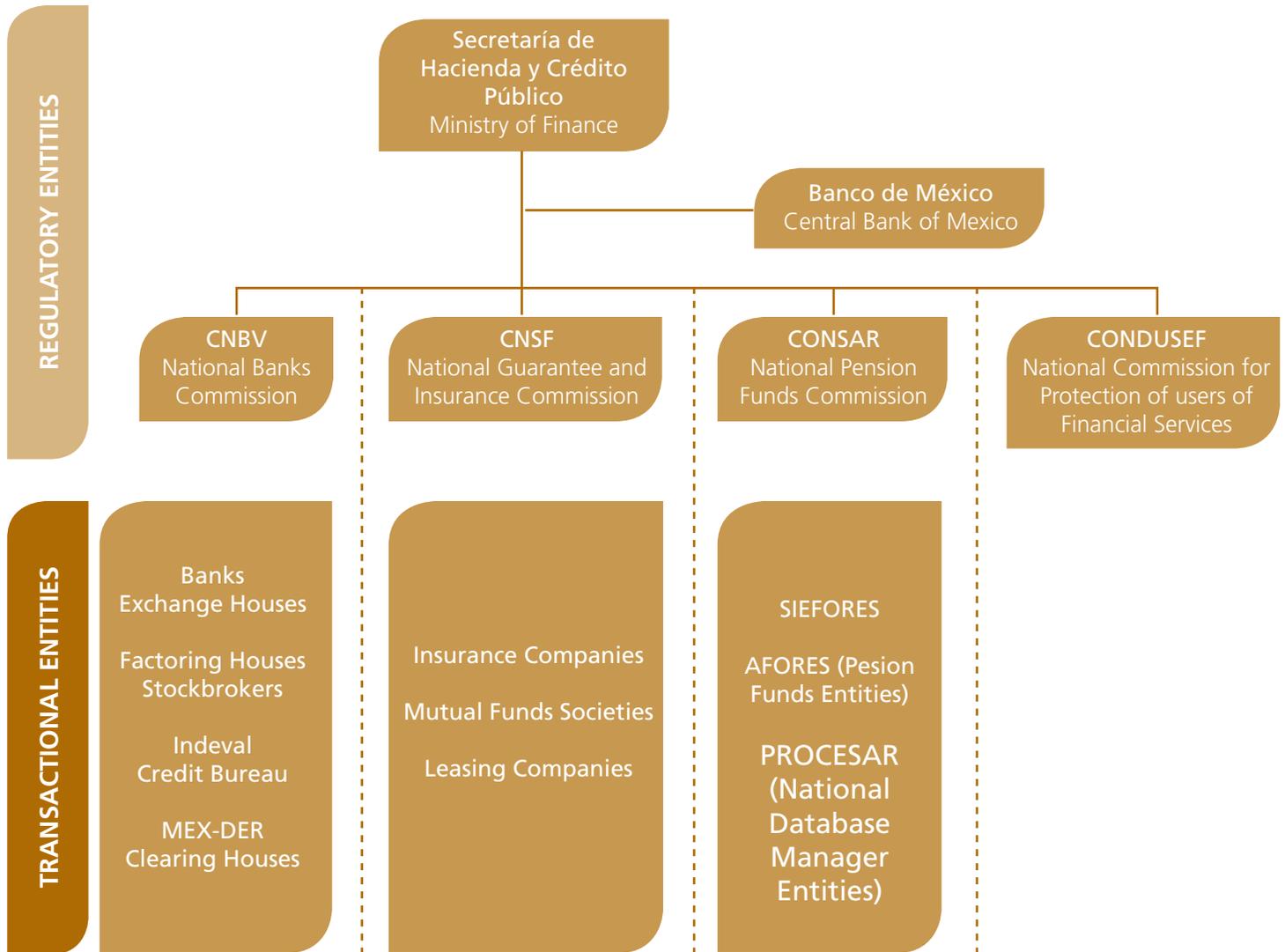
The main Mexican entities, which help to control and facilitate foreign trade, are:

- *Secretaría de Economía*: Ministry of the Economy.
- SEMARNAT: Ministry of Environment and Natural Resources.
- BANCOMEXT: Bank for Foreign Trade (Export Credit Agency).
- ANIERM: National Association of Importers and Exporters of the Mexican Republic.
- PROMEXICO: Mexican Government institution in charge of strengthening Mexico's participation in the international economy.
- COMCE: Mexican Enterprise Council of Foreign Trade, Investment and Technology.

The Ministry of Economy is the main regulatory entity for trade finance transactions. In Mexico, an import license is required for 145 of the 1,200 items subject to general tariffs. In the case of temporary imports of intermediate goods for export industries and raw materials, import licenses are exempt.

# III. Mexican Financial System

## MEXICAN FINANCIAL SYSTEM



Source: <http://www.apartados.hacienda.gob.mx/casfim/index.html>

Mexico has a very stable and well-capitalized banking system, consisting of a central bank and six types of banking institutions: public development banks, public credit institutions, private commercial banks, private investments banks, savings and loan associations, and mortgage banks. Other components of the financial system include securities market institutions, development trust funds, insurance companies, credit unions, factoring companies, mutual funds and bonded warehouses.

As a result of a period of privatization and consolidation in the early 2000s, the banks are primarily large, foreign-owned entities. There are currently 27 financial groups, 31 multiple banks, 6 development banks, 36 financial companies with limited operations, and 73 representative offices of foreign banks.

The banking system falls under the control and regulatory supervision of the Ministry of Finance and Public Credit (Secretaria de Hacienda y Credito Publico) which is primarily responsible for the day-to-day supervision of banks operating in Mexico and shares regulatory duties over the banking sector.

The central bank of Mexico is known as Banco de Mexico (Banxico). It is responsible for the control of monetary policy and is the overall regulator of both financial services and payment systems. It is similar to the Federal Reserve in the United States as it is the lender of last resort to financial institutions and the provider of treasury services to the federal government.

## IV. Liquidity

### ACCOUNT TYPES

The Mexican peso (MXP) is a fully convertible, free-floating currency and there are no exchange controls. Local and foreign currency accounts are available to resident and non-resident entities. All non-resident entities are required to register any foreign currency accounts held in Mexico with the banking authorities. Whether held by residents or non-residents, local currency accounts are not convertible into foreign currency. However, there are generally no lifting fees<sup>1</sup> on transfers between resident and non-resident accounts.

Banks are allowed to pay interest on any account, but in practice, they rarely pay interest on current (demand deposit) accounts, and if they do, the interest payment is generally much lower than the interest paid by an investment instrument.

### Short Term Borrowing

There is a wide range of short-term borrowing options available in Mexican financial markets. Interest rates are based on interbanking money market rates, but additional fees or restrictions may be imposed.

### OVERDRAFTS

Overdrafts are available to both resident and non-resident entities, but can be an expensive financing tool, as interest may be charged at more than twice the rate on the reference rate: CETE (Certificados de Tesorería de la Federación) "treasury bills." It also depends on each Banking relationship and the particular client's credit profile and their bank's appetite for providing the credit line.

### BANK LINES OF CREDIT/LOANS

Credit lines are available to both resident and non-resident entities for working capital and long-term purposes. The most common type of working capital loans are revolving short-term loans of 28 days or more (Credito Revolvente).

<sup>1</sup> In international banking, a lifting fee is often charged when money is moved from a resident account (one held by a domestic entity) to a non-resident account (one held by a non-local entity). The general rationale is that when money is in a resident account, it is under the control of the local monetary authority and thus part of the country's money supply. When moved to a non-resident account, it leaves the control of local authorities (effectively crossing the country's border) and a fee may be charged for that transaction.

## BANKERS ACCEPTANCES (BA)

In Mexico, this type of instrument is rarely used for short-term funds. Rates are based on the CETES (treasury bills) or TIE (Mexican benchmark interbank money market) rate.

## COMMERCIAL PAPER (CP)

Commercial paper is mostly issued by large companies and non-financial institutions with very strong credit ratings. TIE or CETES are used as reference rates with tenors for up to 360 days. These are normally offered at a discount through dealers and provide a quick source of low-cost and short-term financing for large and active companies in the market.

## SUPPLIER CREDIT

Depending on the relationship between companies and their suppliers, supplier credit may vary from 30-90 days after delivery. There are some highly specialized relationships in which a “supplier-managed” replenishment program is established, in which the supplier maintains and tracks the inventory of materials it provides to a customer, and as the inventory is used, the supplier bills the customer for the items and replenishes the supply.

## TRADE BILLS - DISCOUNTED

Banks will often discount trade bills for up to 90 days with recourse, but this form of financing is most commonly used by small exporters. The most popular terms are 45 days.

## INTER-COMPANY BORROWING

Parent companies commonly finance their subsidiaries by extending supplier credit. Additionally, foreign owned subsidiaries in Mexico may also obtain access to USD funding through inter-company loans.

The use of a cash concentration product (ZBA) facilitates this process, as funding is sent via the parent to be disbursed through a “core account” (master account) which may establish limits on the funds it provides to the related accounts.

## FACTORING

Factoring involves the sale of receivables to a company that specializes in financing and managing receivables. This is another alternative for obtaining liquidity.

## V. Cash Concentration/ZBA (Zero Balance Accounts)

Banking solutions in Mexico continues to support the trend towards centralized treasury operations. The zero-balance account (ZBA) structure is increasingly being used by resident and non-resident entities holding accounts in MXN and USD as a cash-concentration strategy. Accounts in different legal entities may form part of the ZBA structure. All these transactions can be considered intercompany loans. This is why it is a more common market practice to include accounts held by the same legal entities.

Companies find it useful to consolidate all their cash management operations (collections, investments, payments) and use a ZBA structure to assist them in managing their local balances and funds disbursements through an automated process, either at a bank or several banks. If companies maintain accounts at 2 or 3 banks, they may concentrate their funds into their main “ZBA” bank, which typically acts as the disbursement bank, as well.

Surplus balances can be invested in higher-yield investment instruments to maximize interest. In addition, the ZBA structure reduces resources required to monitor and transfer funds to cover disbursements.

Through the ZBA concentration structure, corporate treasury operations can effectively manage the cash position of their Mexican affiliates. Corporate treasury can also reduce the costs of multiple wire transfers to local affiliates in Mexico by having to fund only one core account.

Notional pooling is not allowed in Mexico, although some financial institutions offer specific complementary products, allowing clients to calculate positive and negative balances.

## VI. Investment Instruments

The following are typical investment options and services available in Mexico:

- Investment advice for treasury instruments (Money Market accounts and Mutual Funds)
- Capital markets portfolio management
- Liquidity and stock buy-back programs for companies listed on the Mexican stock market
- Investment in international markets
- Dedicated institutional investor services
- Savings account consulting and management
- Pension and retirement funds management
- Stock-option plans for executives of publicly traded companies
- Trust fund investment consulting
- Risk management advisory services using derivatives
- Professional investment banking consulting
- Public equity placements
- Public and private debt placements
- Mergers and acquisitions advisory services
- Funding for working capital, expansion in national and international markets
- Foreign currency exchange services
- Stock market, economic and political analysis

Other investment options include instruments issued by companies from different economic sectors (industry, commercial, services) and some Mexican public entities like state and municipal governments.

These instruments include:

- Commercial paper
- Promissory notes
- Medium- and long-term debt
- Asset-backed securities

## MONEY MARKET

The money market is made up of a combination of financial instruments issued by the government, banks, and public companies that offer attractive yields. In these type of investment instruments, a company can choose the term and the type of paper (subject to availability).

## GOVERNMENT BONDS

Instruments issued by the Mexican Federal Government through SHCP (Secretaría de Hacienda y Crédito Público) and auctioned by Banco de México, include:

- CETES: Mexican Treasury Bills
- Bonds: Mexican Government Development Bonds
- Udibonos: Mexican Government Development Bonds denominated in investment units
- UMS: Coupon bonds issued by the Federal Government quoted in US dollars
- Pics: Highway indemnity notes issued in investment units
- BPAs: Federal Government Coupon bonds issued by IPAB & Banco de México in Cetes
- BREMs: Federal Government Coupon bonds issued by Banco de México

## BANK INSTRUMENTS:

Instruments issued by or guaranteed by Mexican banks or other Mexican financial institutions.

- PRLVs: zero-coupon notes
- Udipagare: zero-coupon notes indexed to investment units
- CDs: Certificates of Deposit
- BAs: Bankers' Acceptances
- Term Deposits

## VII. Tax System

In Mexico, the tax regime is classified as follows:

- a) Taxes
- b) Social Security Payments
- c) Rights and Benefits contributions

Taxes must be paid by individuals and juridical persons (companies) that are fiscal residents in Mexico, meaning that they are established in Mexico and their main source of total income (+50%) comes from the Mexican territory or when their main business center is established in Mexico.

There are local and federal taxes. Local taxes are on the domain of each state, and federal taxes are applied over the country. Federal taxes can be divided into:

- I. Corporate Taxes
- II. Withholding Tax
- III. Other Taxes

### I. CORPORATE TAXES

In Mexico, taxes are paid in monthly advanced installments and annual payments. The calendar year is from Jan. 1st to Dec. 31st for annual payments and they must be paid during the month of March following the fiscal year. The monthly provisional payments, in which anticipated monthly tax payments are made with regards to the definitive tax payment, must be done every 17th day of the following month after which a tax declaration was presented.

The taxes that residents must prepare are:

#### A. INCOME TAX (ISR: Impuesto sobre la Renta)

This tax must be paid on income earned in Mexico, subtracting some tax-free income and allowed expenses, according to the law. The rate is 30%. Fiscal loses can be counterbalanced for a 10-year period.

## B. CORPORATE TAX SINGLE RATE (IETU: Impuesto Empresarial a Tasa Única)

This is a complementary tax from the above-mentioned tax. This tax must be paid according to the real income earned and paid expenses with some exceptions in the Income Tax in terms of its calculation. The rate is 17.5% as of 2010.

The amount of this tax must be compared with the Income Tax, and the higher amount of both is the one paid.

## II. WITHHOLDING TAX

Some items like interest and dividends are subject to withholding tax, which can be deducted from the annual payment.

	<b>Withholding Tax Residents in Mexico</b>	<b>Residents Abroad</b>
Interests	0.85% annual over main capital or investment that generates the interest.	4.9%, 10% or 28% over interests (according to the country tax regime from where the resident came from).
Dividends	Does not apply.	Does not apply.
Stock	Exempt as long as the law's requirements are met.	Exempt as long as the law's requirements are met.
Technical assistance	Does not apply.	25% or the rate established on the double tax Country Agreement.

### III. OTHER TAXES

#### VALUE-ADDED TAX (IVA: *Impuesto al Valor Agregado*):

This tax must be paid on the consumption of products or services obtained in Mexico or through imports or exports.

The rate is 16% nationwide or 11% in the border zones. In some cases, a rate of 0% may be applied or the tax does not apply.

#### CASH DEPOSIT TAX (IDE: *Impuesto sobre Depósitos en Efectivo*):

The Cash Deposit Tax (IDE) has a rate of 3%, which is applied to cash deposits exceeding the monthly amount of \$15,000 in one or many accounts of the same beneficiary, and is collected by financial institutions on the last day of the month. However, the tax is collected on time deposits exceeding the amount of \$15,000 when made with a financial institution.

In case a company buys a cashier check at a bank branch with cash, the tax will be calculated on the value of this document and charged at the moment it is purchased.

Amounts deposited in the name of individuals and entities through electronic and account transfers, securities or any other document or system within the system of financial institutions are not considered cash deposits.

#### SPECIAL TAX FOR PRODUCTION & SERVICES (IEPS: *Impuesto Especial sobre Producción y Servicios*)

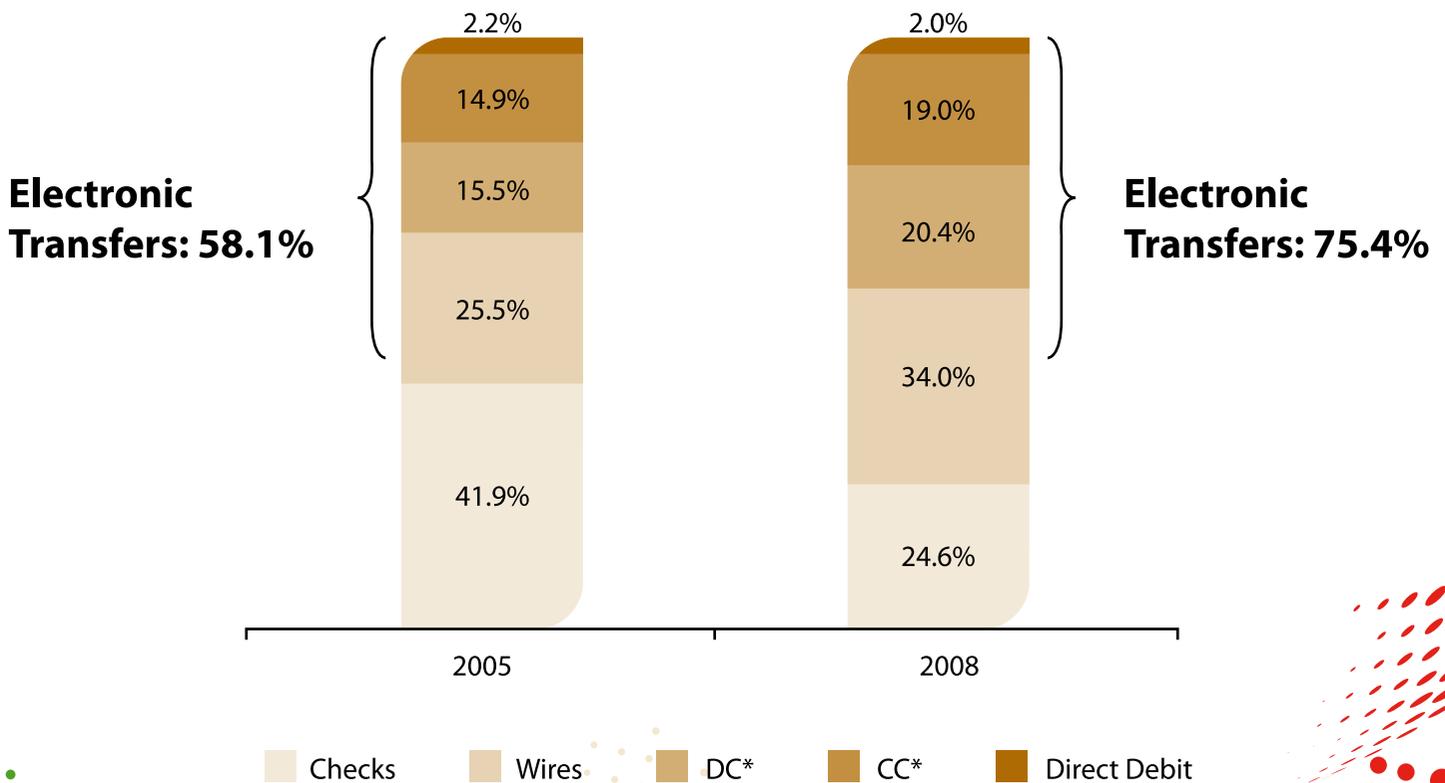
This tax is related to some kinds of services and production by sectors or imports. The rate can be 25% up to 160% on a case-by-case basis.

# VIII. Overview of the Payment Systems in Mexico

All payment instruments, excluding checks, grew in Mexico in 2008 by both value and volume. This is a clear sign that companies are using less checks and more electronic payments. However the use of checks is still a common practice, particularly for companies that prefer the controls that checks provide as in more conservative types of companies in which the payment is not released until there is a signature. It is common practice to have dual authorizations on both checks and electronic payments, and many companies have implemented check protection features (positive pay).

Checks still represent an important proportion of payment volumes overall and cash is still the main method of payment for low-value payments. In terms of value, same-day high-value credit transfers account for the largest proportion of payments, while credit and debit cards represent the highest percentage in terms of volume.

**TRANSACTION PAYMENT TRENDS**



Payroll payments are processed mostly with payroll cards, although some companies still pay in cash on site. There are different payroll cards available, including a debit card commonly referred to as a “store value card” (Monedero) in which the employee does not have to open a bank account. It has the benefit of being able to withdraw funds with no cost at the bank issuing the card, as well as at point-of-sale terminals. Funds may also be withdrawn at other banks’ ATMs for an extra fee. Other payroll products include opening checking accounts. Banks offer different packages, which may include checkbooks; Internet access; preferred rates on loans, mortgages and cars; and also special interest rates on investments.

Tax payments are mostly processed via credit transfers, particularly pensions, taxes and social security.

Electronic Payment systems in Mexico are classified into two groups:

### HIGH VALUE

High-value payments are made on the same day. They were originally developed to liquidate operations in the financial markets, obligations in other payments systems, and to finance the liquidity obligations of financial intermediaries. Thus, the payment amounts processed can be quite high.

- **High-value payment systems in Mexico are:**
- **SPEI:** The main channel through which banks process high-value, same-day transactions between themselves and their clients.
- **SIDV:** A system for liquidating purchase and sale transactions on different investment instruments through the Mexican stock exchange.
- **SIAC:** Operates in the current accounts that the banks have in the Central Bank. This is the channel through which the Central Bank (Banco de México) provides liquidity to the banks. It still functions as a payments system.

Note: Banco de México operates the SIAC and SPEI systems, while INDEVAL operates the SIDV system.

## LOW VALUE (SICAM)

This is a deferred payments system where settlement takes place on a next-day basis. Companies utilize this payment system for commercial payments, payroll and other non-urgent payments or those, which can be programmed. The average payment amount is usually low.

Checks, electronic transfers, payroll, direct debits, and bankcards are the type of payments included in this channel. Since June 2003, all checks are truncated and their images exchanged by CECOBAN's (SICAM's operator) Images Exchange Clearinghouse, before being processed.

The "Cámara de Compensación Electrónica" processes the compensation of these payments, except for credit cards.

"CECOBAN" operates the registry system and check compensation, electronic transfer of funds and direct debits, and the Central Bank liquidates them through the SIAC system.

There are two types of bankcards: debit and credit. Both of them are used as a payment method in businesses, which have point-of-sale (POS) terminals, and additionally to consult balances and withdraw cash at ATMs.

There are two card processors: PROSA and E-Global, both of which are connected to each other. The compensation of operations is done via PROSA and the actual liquidation of the transaction is done through a commercial bank.

## INTERBANK CROSS-BORDER PAYMENTS

Interbank cross-border payments can be made via SIAC's participation in the multilateral clearing system of the Latin American Integration Association, which includes participants from Argentina, Bolivia, Brazil, Chile, Colombia, the Dominican Republic, Ecuador, Paraguay, Peru, Uruguay and Venezuela. Mexico has clearing arrangements with Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

## CROSS-BORDER PAYMENTS

Most cross-border payments are sent via the SWIFT network and settlement takes place via accounts at correspondent banks. USD-denominated credit transfers from the USA to Mexico can also be made via the US FedACH's Directo a Mexico service, with funds available the next day.

### Incoming and Outgoing Payment/ Wire Transfers

For many years in general terms, banks in Mexico have absorbed fees charged by foreign correspondent banks in the processing of hard currency incoming and outgoing payments which are conducted via foreign correspondent Banks. It should be stated that the accepted practice of most Correspondent Banks is the deduction of these charges from the transfer proceeds such that the beneficiary receives an amount net of the charge. It is equally important to note generally talking Mexican bank's standard charge which represents the cost of the outgoing payment transfer will continue and the aforementioned service charge is not levied by the Mexican bank but rather at the Correspondent Bank level. This practice is commonly known as "bene deduct".

## IX. Electronic Banking

Using Electronic Banking in Mexico is the most common way for processing payments and reviewing collections and general information on-line.

Usually the Electronic Banking Platforms are web-based and offer seamless access to an expanding array of corporate banking services through a single application, allowing customers to be more efficient, flexible and in control of their banking transactions.

Since April 2007, the Internet Banking systems in Mexico requires a second authentication device for all the monetary transactions. This regulation has the purpose of increasing the safety and security in the use of Internet banking in Mexico.

The electronic banking system requires real time data on information that is updated every 24-hours for payments and authorizations, payments that can be exported and/or imported manually or with ERP interfaces that can meet customers' needs.

Today, Electronic Banking applications are a complementary channel for large companies and an added Host-to-Host solution for collections and reconciliation purposes. This new method of Cash Management includes centralization, encryption, multiple-level authorizations and local and regional shared service centers, in addition to a complex solutions list.

The centralization and sophistication of Cash Management solutions represent an opportunity for the Mexican market, and with this change, corporations are reducing the number of Electronic Banking Systems and increasing the interfaces between the ERPs and Banks for payroll services, collections and reconciliation.

Regarding consumer uses of electronic banking, it has increased by 200% during the last 5 years, becoming the second payment method after credit cards and cash.

# X. Cash Management Services by Sector

(Classified under the criterion of Scotiabank)

## PYME sector (SME-Small & Medium Enterprises)

The typical criteria used in Mexico to define a small- or medium-size company (typically referred to as “PYME” which in Spanish is “Pequeña y Mediana Empresa”) is the following:

1. Number of employees: < 50 employees
2. Annual sales: < MXP 50 million
3. Financial requirements: < MXP 5 million

Note: The above information may vary from bank to bank, although it is believed that the above data is the standard in the banking industry.

The main advantage of “PYME” companies is their dynamics, as they are able to make quick decisions and actions. Typically, the owner of the company is involved in and in charge of the business and looks for quality in customer service.

At the banking service level, “PYME” companies are served by bank branches and specialized account managers in this segment with products tailored towards meeting the specific needs of these companies.

A “PYME” requires banking services that are easy to obtain and operate, and that help the company optimize its management at a reasonable cost with secure means of access.

The financial services typically used by “PYMEs” are:

- a) Checking accounts
- b) Internet banking
- c) Payroll
- d) Point of sale terminals
- e) Financing

## COMMERCIAL BANKING

Segmentation is based upon the following criteria:

1. Annual sales: > MXP 50 million and < MXP 1,000 million
2. Financial requirements: > MXP 5 million

Note: These criteria may vary from bank to bank.

The companies that are included in the criteria described above are served by Relationship Managers specialized in this segment, in which the financial and service needs of companies are more complex, and sometimes require special developments or “tailor-made solutions” with a higher degree of specialization.

The main financial services that are required by these types of companies in the Commercial Banking area are:

- a) Checking accounts
- b) Investments
- c) Internet banking
- d) Payroll
- e) Large payments to providers
- f) Collections
- g) Financing (working capital, import/export)
- h) Foreign exchange transactions

## CORPORATE SECTOR

These clients are typically identified by the following criteria:

1. Annual sales: > MXP 1 billion
2. Subsidiaries of multinational companies
3. Other companies that may not meet above criteria, but that represent high potential growth

Note: These criteria may vary from bank to bank.

Large companies make payments to vendors/suppliers mostly electronically, although they may still issue checks for small nonrecurring payments.

The cash management services that large companies require overall are:

- a) Checking accounts and Zero Balance accounts
- b) Internet Banking and Host-to-Host connectivity
- c) Robust supplier payment platforms with flexibility to process same-day and programmed payments, and also providing detailed information on payments
- d) On-line billing
- e) Collections products, including direct debit and also collections through branches
- f) Payroll products, as indicated above, including stored value card and different ascending products (with checkbook, internet banking, etc.)
- g) Integration of different file formats (SAP, EDI) with the internet banking platform
- h) Foreign exchange transactions
- i) Financing (working capital, import/export)

## FEDERAL GOVERNMENT DEPARTMENTS AND DEPENDENCIES

Clients in this sector require a high degree of specialization and “tailor-made” solutions in most cases, in order to manage their cash flow.

These clients generally process many transactions and require different channels to receive their deposits and process their payments. Such channels include bank branches, the Internet, ATMs, special armored vehicles that move cash (in Spanish it is known as “traslado de valores”), as well as point-of-sale terminals.

The most important sources of deposits are:

1. Federal tax payments
2. Social security payments to employees and employers

The social security payments are done by the IMSS: Instituto Mexicano Del Seguro Social (Mexican Social Security Institution) through the “SUA”: Sistema Único de Autodeterminación. IMSS is the largest social security institution in Latin America. Its function is to take care of individual and collective well-being in Mexico and it is a critical part of the wealth redistribution system in the country.

To receive these important cash deposits, clients require special checking accounts based on interest arrangements to compensate lower or no cash management fees through account balances.

## STATE AND MUNICIPAL GOVERNMENTS

These sectors are currently under development, as they are exploring the making of their internal systems (ERPs) automatic.

These clients require access channels mainly to collect taxes. They establish contracts with banks and convenience stores in order to have more collection options in addition to their offices where they receive payments.

Taxes that are collected are from individuals and companies, and they include:

- a) "Tenencia": Automobile ownership taxes
- b) "Predial": Real estate taxes
- c) Penalties and surcharges
- d) License fees
- e) 2% payroll tax
- f) Water bills which make up the largest part of collections

These clients perform many transactions, particularly payments to beneficiaries in programs, which the federal government establishes.

The cash management products that these clients use include the following:

- a) Checking accounts with special check books
- b) Zero balance account structures
- c) Host-to-Host Connectivity
- d) Collections (with receipts, direct debit, referenced, and without receipts)
- e) Electronic account statements
- f) Stored Value Cards
- g) Electronic payments
- h) ATMs
- i) Payroll
- j) Internet banking

# XI. Scotiabank Mexico - Global Transaction Banking

Scotiabank Mexico is a member of the Scotiabank Group and is one of the largest banks in Mexico with over 623 branches and over 1,453 ATMs throughout the country. It offers an extensive range of cash management, business and wholesale banking services to individuals, commercial and corporate clients throughout the country.

Scotiabank is one of the top 10 best performing banks in the world, according to Oliver Wyman's 2009 annual shareholder performance index rating, and is the 8th largest bank in North America by market capitalization (March 2009).



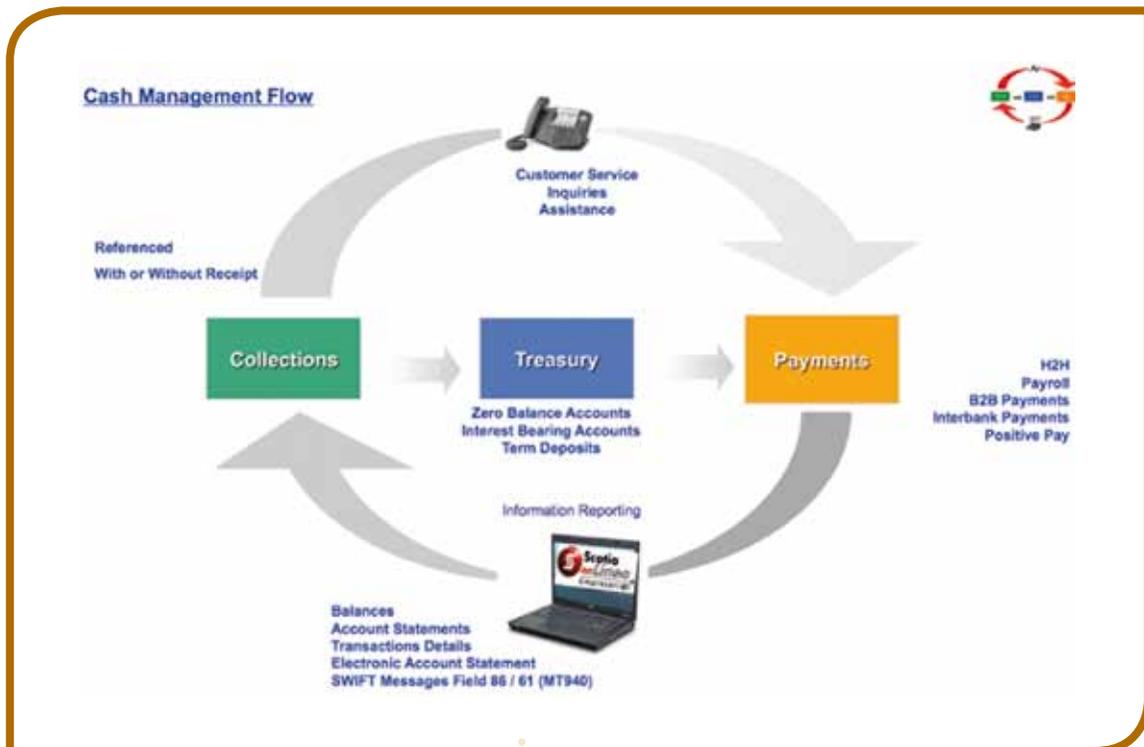
Other recent awards include:

- Recognized in 2009, in the Top 50 of the World's Safest Banks by Global Finance magazine
- In 2009, Scotiabank Mexico was ranked among the 50 Best Companies to Work for in Mexico by The Great Place to Work Institute for the sixth year in a row
- In 2009, Grupo Scotiabank Mexico was recognized as one of the 35 Best Companies to Work for Women in Mexico by The Great Place to Work Institute

As part of the Scotiabank Group (Canada), Scotiabank offers access to international markets thanks to its direct presence in over 50 countries and broad coverage with more than 2,000 bank branches, affiliates and affiliated companies in North, Central and South America, the Caribbean, Europe and Asia, as well as a vast network of correspondent banks.

## CASH MANAGEMENT PRODUCTS

Based on the traditional cash flow of each company, Scotiabank Mexico develops a group of products focused on typical needs and with sufficient flexibility to personalize them for each customer. This flexibility allows us to generate the right solution combining the proper set of products and services for our clients.



## Scotia Collections

Scotiabank Mexico offers flexible collections that provide companies with an efficient service that is timely, with accurate information, automatic controls, and different options to carry out collections. Scotia Collections meets the need for collections information, focus, and operations management with 5 types of services:

- Scotia Collections with / without Receipt (con/sin recibo)
- Scotia Direct Debit Collections (domiciliada)
- Scotia Collection Interact Online (Cobranza Lite)
- Scotia Collection via Referenced Deposit (Depósito Referenciado)

## Merchant Card Services

Provides state-of-the-art point-of-sale systems to reduce cash handling risk, and automated deposit of VISA, MasterCard and AMEX sales with next-business-day availability of funds.

## Scotia Payments

Our clients can send us a single file of all disbursements with payments settled by direct deposit to any Mexican Financial Institution or suppliers and can pick up cashier's checks at any Scotiabank branch that offers the following types of Payments:

- Supplier payments
- Federal tax payments
- SUA payments

### **(Scotia Protection) Check Protection and Positive Pay**

Minimizes the risk of check fraud, forgery, alteration and theft through online protection with check verification, reconciliation and cancellation of items issued throughout the country:

- Providing an electronic file specifying details about outstanding, paid, settled and protected checks
- Specifying check parameters and protected fields
- Facilitating online transmission of issued check fields
- Reducing reconciliation time
- Check Stop payments are registered immediately and applied in the event they are reported as lost or stolen

### **Bill Presentment**

Offers suppliers an easy way to obtain payment remittance information, details of new and outstanding invoices and perform online inquiries 365 days a year.

### **Scotia Treasury (ZBA)**

Helps our clients optimize and control their financial resources through Zero Balance Account structures with disbursement and collections. It is not necessary to transfer resources to/from branches or different accounts, as funds are received on-line through "collections accounts" and credited to the concentration account. Additionally, payments are automatically funded from the concentration account into the "payables accounts," and the establishment of daily and/or budgetary limits helps our clients control cash expenditures. We have seen how our ZBA products are a useful tool for planning, expense-controls, payment, and funds-concentration for our clients who need to budget projects and expenses, etc.

## Scotia Nomina (Payroll)

This is the ideal tool for performing in a secure and convenient way all of your transactions for payroll payments, savings and pension funds, as well as travel expenses and other payments for your employees.

Scotiabank has four different payroll products in the market, from a stored-value card for hourly/high turnover employees, to a Scotia Premium account with many benefits, including protection services in your home.



## Scotia Card Monedero

The key characteristic of the Scotiabank Mexico's Electronic Wallet is the exclusive ability of customers to register, replace and cancel any kind of card according to the needs of the customer's personnel rotation. It also eliminates unnecessary visits to bank branches.

Transactions may be carried out in large numbers by sending electronic files, or, individually and on-line, where you can also check the card transactions and directly settle any possible inquiries from your employees.

Let Scotiabank draw on our network of branches and offices around the globe to provide you with comprehensive, integrated trade finance and correspondent banking services.

## TRADE FINANCE

With over 150 years of experience in international trade finance, we can be your end-to-end supply chain financing partner, helping to facilitate international trade, minimizing trade risk or protecting import and export flows. We can provide seamless domestic and cross-border solutions including specialized vendor programs, cross-border buyer credits and subsidiary financing.

As part of Scotiabank Group (Canada), Scotiabank offers access to international markets thanks to its direct presence in over 50 countries and broad coverage with more than 2,000 bank branches, affiliates and affiliated companies in North, Central and South America, the Caribbean, Europe and Asia, as well as a vast network of correspondent banks worldwide.

Our international offices together with our North American specialists, can introduce you to a wide variety of solutions for: Importing and Exporting.

### **Importing:**

We can work with you to reduce the risk of not receiving the exact goods you have ordered and paid for. Our import services are designed to minimize the uncertainties and risks associated with cross-border trade and help you to maintain tighter control through:

- **Import Letters of Credit:** enable you to define the exact conditions under which your supplier will be paid: Specify shipping and payment dates, and request third party inspections to ensure that the goods you receive are the ones you ordered. For greater convenience, you can prepare and submit Letters of Credit 24 hours a day, 7 days a week securely through our web-based TRADEEXPRESS elite service.
- **Open Account:** If you have an established relationship with your suppliers and wish to reduce the total processing time and costs associated with letters of credit and documentary collections, consider using our open account payment service.

Scotiabank's electronic TRADEXPRESS elite service is ideal for any size importer/exporter who is looking to manage their transactions over the Internet. TRADEXPRESS elite offers fully automatic, secure processing of the following:

- Import and Export Letters of Credit
- Purchase Order processing and automatic Letter of Credit (LC) preparation
- Automated Open Account processing
- Standby Letters of Credit/Letters of Guarantee
- Transferable Letters of Credit
- Letters of Direction
- Discrepancy notification (import and export LCs)
- DocPrep interface allowing download of data from related LCs to TRADEXPRESS ExportDoc
- Direct Collections
- Comprehensive reporting - over 50 reports are available online - from transaction histories to outstanding LCs, with amounts and charges sorted by category

### **Exporting:**

Whether you are a new or established exporter, we can help you arrange financing for your export sales:

- Export Letters of Credit
- Foreign Documentary Collections
- TRADEXPRESS ExportDoc Service
- Cross-Border Letters of Credit
- Direct Collections
- Structured Trade and Foreign Buyer's Credits
- Vendor Programs
- Subsidiary Financing

EDC Agreement-as is.

ACE Program

The ACE Program is a joint effort between Scotiabank and EDC to provide competitive long-term credit facilities to import capital goods, spare parts, and services from Canada.

## CORRESPONDENT BANKING

Among other solutions, this unit has developed a specific business model to assist companies referred by correspondent banks in the opening of checking accounts for resident and non-resident companies in Mexico. These accounts have the capability of receiving and sending payments.

Companies from different industries (from financial services to automotive) can benefit from this model. Scotiabank has the expertise to serve companies from any part in the world, as our existing clients come from Canada, the USA, Spain, France, Italy and Germany, among other countries.

Our correspondent-banking network is integrated by more than 500 banks, allowing us to receive ongoing business referrals which are referred to Scotiabank by one of them.

Requirements for Non-resident accounts:

1. The company must be referred by one of our correspondent banks.
2. The documents required for the account opening are quite normal and easy to gather for an international company, which runs a business in Mexico. The main requirements are:
  - a. Copy of proof of address
  - b. Copy of the company's legal documents (articles of incorporation, board resolution) duly stamped with an "apostille" and notarized
  - c. Legal representatives' official IDs
  - d. Copy of tax payment for the last year
  - e. The filling out of internal forms for Scotiabank's compliance purposes
  - f. Introduction letter from Correspondent Bank

Main features Scotiabank offers:

1. Accounts are available in Mexican Pesos and US Dollars and do not bear interest
2. The means of access is exclusively online (no check books provided)
3. Straightforward implementation of the interactive access system
4. With our online banking access "Scotia en Linea" (also available in English) you can manage your company's accounts within the privacy of your home or office, 24/7, 365 days a year for balance inquiry and transfers programming
5. Bilingual support from our specialists 9:00-7:00 pm CT (central time), 5 days a week
6. Wide variety of Cash Management solutions, to meet company's needs and optimize your treasury processes

Our Correspondent Banking team has received several recognitions for excellent service in assisting the needs of foreign banks and institutions doing business in Mexico.

## Related Links of Interest

### **Managing in Mexico at Scotiabank**

[http://www.Scotiabank.com/gtb/cda/content/0,1679,CCDgtb\\_CID1892\\_LIDen\\_SID84\\_YID20,00.html](http://www.Scotiabank.com/gtb/cda/content/0,1679,CCDgtb_CID1892_LIDen_SID84_YID20,00.html)

### **Scotiabank México (Home page)**

[http://www.Scotiabank.com.mx/Pages/ScotiabankPortal\\_ing.aspx](http://www.Scotiabank.com.mx/Pages/ScotiabankPortal_ing.aspx)

### **On-line Rates of Mexico Market at Scotiabank**

[http://www.Scotiabank.com.mx/Pages/ScotiabankPortal\\_ing.aspx](http://www.Scotiabank.com.mx/Pages/ScotiabankPortal_ing.aspx)

### **Economic Studies articles/analysis of Scotiabank Mexico**

<http://www.scotiabank.com.mx/Finanzas/economia/estudioeconomicos/Quienes/Pages/%c2%bfQuienesSomos2.aspx>

### **The Ministry of Finance of Mexico (Home page)**

<http://www.shcp.gob.mx/Paginas/default.aspx>

### **Central Bank of Mexico (Home page)**

<http://www.banxico.org.mx/>

### **The Mexico Ministry of the Economy (Home page)**

<http://www.economia.gob.mx/?NLanguage=en&P=2>

### **Doing Business en Mexico (World Bank and IFC)**

<http://www.doingbusiness.org/Mexico>

### **ICC International Chamber of Commerce (Home page)**

<http://www.iccwbo.org/>

### **BANCOMEXT (Home page)**

<http://www.iccwbo.org/>

# Glossary

**Attributable Income:** Income that results from the business activity carried out by the Mexican permanent establishment; income from goods and personal and real property sold in Mexico by the home office or by any permanent establishments in other countries; and income obtained by the headquarters or any establishments abroad, in the proportion that the permanent establishment has participated in the expenses incurred to obtain the income.

**Bankers' Acceptances (BAs):** A time draft on which the "drawer" bank has provided its acceptance, and often used to finance the import, export or domestic shipment of goods. May also be used along with Letters of Credit (L/Cs) requiring a time draft drawn on a bank.

**Cash Concentration (ZBA):** The concentration of funds from collections accounts into a core account, as well as the funding of payables accounts from the core account. Provides the benefit of automating and consolidating funds at a master account level.

**CECOBAN (Centro de Computo Bancario):** Owned by a consortium of around 28 banks and 24 regional branches. Clearing channel that supports the processes of check compensation and funds transfers (debit and credit), and typically used for low value, high volume transactions. The equivalent of ACH in the USA.

**Commercial Paper (CP)** Mostly issued by large companies and non-banking financial institutions with strong credit quality and ratings, using TIE or CETEs as the reference rates. Tenor is up to 360 days, and it is normally offered at a discount through dealers. It provides a quick source of low-cost short-term financing for large companies, which are active in the market.

**Factoring:** Factoring involves the outright sale of receivables to a "factor" a company that specializes in the financing and management of receivables. In most financing arrangements, the buyer of the receivables has no recourse to the seller.

**Fixed base:** Applies from 1992. A fixed base is equivalent to a permanent establishment and is subject to the same tax treatment but refers to income earned from fees and independent professional services provided in Mexico by non-residents.

**Corporate Single Tax Rate (IETU):** Impuesto empresarial de tasa fija) for its acronym in Spanish. This tax must be paid by companies and persons living in national territory. as foreigners with permanent business activities in Mexico. The tax will be paid according to the income obtained, no matter the place where the income was generated (specifically for: selling fix assets, independent services and temporary rent of assets).

**Lifting fees:** Tax that companies may be required to pay when moving funds out of a country. These fees are charged when funds are transferred from a resident (known as domestic) account to a non-resident (or foreign account).

**North American Free Trade Agreement (NAFTA):** Also known as "TLCAN" (Tratado de Libre Comercio de América del Norte), is an agreement that was signed by the governments of the United States, Canada, and Mexico creating a trilateral trade bloc in North America. The agreement came into force on January 1, 1994.

**Notional Pooling:** Any excess funds in the accounts of a company or its subsidiaries that are used to offset any deficits in other accounts of the parent or subsidiaries. This type of pooling arrangement is offered for a variety of currencies and is commonly known as notional pooling because no actual funds are transferred. This service is NOT available in Mexico, although some banks may offer specific tools to monitor balances.

**SICAM (Sistema de Cámaras):** Net settlement system that clears paper-based and electronic payments, including checks, non-urgent electronic credit transfers and direct debits. Owned by the central bank, but operated by CECOBAN.

**SPEI (Sistema de Pagos Electrónicos Interbancarios):** The main channel through which banks process high value, same day transactions between themselves and their clients.

**Supplier-managed replenishment program:** In this type of program, the supplier maintains and tracks the inventory of materials it provides to its customers, and as the inventory is used, the supplier bills the customers for the items and replenishes the supply.

**Time draft:** A time draft is a draft payable on a specified future date that must be accepted by the importer before the collecting bank may release documents.



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# Conclusion

During the last ten years, commercial banking and cash/treasury management in Mexico have undergone substantial changes. While the economy is still largely cash-based on the consumer side, on the commercial side, businesses have embraced both technology and electronic transactions. The Mexican financial sector has implemented significant new systems for managing transactions and financial information, and large companies have availed themselves of modern technology in the treasury area. One area of future concern is the slow progress of anti-money laundering efforts in Mexico, but at least progress is being made. Overall, for today's treasury professional, the Mexican banking market may offer a few new challenges, but many familiar products and services will be readily available.

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