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THE MEXICAN BANKING SYSTEM

ROBERTO MOLINA PASQUEL

INTRODUCTION

Banking law¹ has been included in the curriculum of Mexican law schools for only fifteen years; yet the history of banking in Mexico begins with the colonial era. At that time there were no Mexican banks in the modern sense even though the Spaniards had established a "Bank for Mines and Mining." In the first period of independence, when the Ordinances of Bilboa² were still in force, numerous banking projects were commenced. Early in this period charters for banks were granted within the terms of a rather under-developed commercial legal system. These operated with only relative success until the promulgation of the Commercial Code of 1884.³

During the period of the French invasion and the difficulties attendant on internal wars, all development in Mexico was temporarily halted. It was at this time, roughly between 1857 and 1867, that several states in the north issued banking charters without consulting the Secretary of Finance. Consequently, it was necessary to adopt uniform federal legislation for the control of banks. This legislation, enacted in 1873, was strengthened by the Commercial Code of 1884.⁴

The section of this code dealing with banking set forth the conditions for the chartering of the only type of bank recognized by it. This bank could be called a national bank or a "bank of issue". Its function was to raise money from the public against the issuance of bank certificates payable in cash to bearer on demand; cash at this time was understood as the monetary equivalent of the paper in circulation. These banks were obligated in turn to maintain a monetary reserve equal to thirty per cent of the amount of notes outstanding and to deposit with the federal treasury thirty-

1. The General Law of Institutions of Credit, part of the public law, supplies the conditions under which banks can be chartered, the rules for the operation thereof, and the general regulations controlling the nature of different types of banking activity, while the Commercial Law deals with the specific nature and character of the legal institutions involved. Thus, the subject is one of mixed private-public law.

2. The Ordinances of Bilboa were a codification of the customary law of the Spanish Peninsula, having been compiled in the early 18th century. The main feature of the Ordinances was the so-called *Consulate*, a customarily mercantile code of the type prevailing through Europe from the late middle ages.

3. Don Teodosio Lares was then Secretary of State in a strongly centralist government. The duration of this Code was very limited due to the fact that it was thrown out by the Federalists, when they returned to power, shortly after promulgation along with almost all of the other legislation of the centralist government.

4. The Code naturally included many other chapters regarding insurance, maritime shipping, occupations and general mercantile procedures, in addition to its banking chapter.

three per cent of that amount either in hard money or in government securities.

At this time a conflict arose within the banking and financial circles between those favoring the federal government's desire to establish one single bank with a nation-wide monopoly of banking and those backing the liberal tendency which preferred a free, competitive banking system. The Government never succeeded in completely suppressing competition. The national bank, with French capital, was supposed to have a monopoly, but there were several other banks in the country, namely a British and a Spanish bank in Mexico City, two others in Chihuahua, and another in Yucatan. A compromise was finally reached when the General Statute of Credit Institutions was enacted in 1897.

Under this statute three types of banks were introduced—the national bank of issue, the mortgage bank, and the bank of agriculture and industry. The two latter types of banks engaged mainly in large loans to the big land owners, and as a result, the entire banking system collapsed in 1908. The directors, who were at the same time owners of both the banks and the mortgaged farms, had permitted indefinite renewal of loans with the result that their portfolios became completely frozen. Since the loans had been made for the purposes of financing consumption rather than production, interim measures remained without success. This serious crisis was terminated by the more violent one culminating in the Mexican Revolution of 1910.

The new Constitution of 1917 established a banking system somewhat similar to the federal reserve system of the United States. The Bank of Mexico became the sole bank of issue. For the other types of banks, a law was enacted in 1924 regulating conditions for chartering. This radical reform was made possible by the collapse of the old banking system. The loans could not be collected from farms that had been distributed among the peasants who had formerly worked them. Many of the banks had been forced by one revolutionary group or another to make loans which the new government declined to recognize.

In 1925 the Bank of Mexico was opened and a new era in Mexican banking history was inaugurated. This bank was small with a capital of only twenty-five million pesos and although it had the function of being the only bank of issue, it was operated according to commercial standards. The bank was seriously affected by the international financial crisis of the late 1920's. This crisis showed the need for further overhauling of the banking system. To accomplish this the notes of the Bank of Mexico were made the only legal tender in 1931, and in 1932 the General Act of Credit Institution was passed. It might be added that this was the first act permitting trust companies. The statutes of 1941, now in force, establishes five principal types of private banks and two secondary ones.

GOVERNMENT BANKING

At the outset the present Mexican banking system can be divided into two parts, with the first and simpler part made up of the government banks. In a developing economy, such as the Mexican, the government banks have to assume all economic functions which private banks are unable or unwilling to perform. It is obvious, therefore, that governmental banking activity will be more complex than that which was envisioned as its principal function in past decades, namely as a central bank of issue. The Bank of Mexico still stands at the head of the government banking system as the classic central bank. Its most important function is still the monopoly of issuing the currency. Its other functions can be grouped under the general heading of the regulation of monetary circulation and the rediscounting of the portfolios of private banks. As an administrative agency, it controls and regulates the kind of investment permitted commercial and industrial banks and the rate of interest for loans; it also has general supervision of all banking activity and functions as a reserve bank.

It is hard to state which is the most important of the other types of national banks. Perhaps this place is shared by the National Agricultural Banks and the National Investment Bank. The former have as their principal purpose the financing of the small farmer and of the *ejidatario*.⁵ These banks are essentially non-profit institutions, as their purpose is to improve agricultural production. In recent years, the agricultural banks have been permitted to finance private agricultural activities, always subject to strict control to avoid a repetition of the mistakes that resulted in the 1908 banking crisis.

The National Investment Bank⁶ functions like the Reconstruction Finance Corporation and other similar agencies in the United States which pursued strenuous government investment policies in order to overcome a depression or other abnormal economic conditions. Primarily, the National Investment Bank is designed to finance new enterprises which are either too large or too risky for the private banks. More than anything else, this bank has been responsible for the growth of basic industries in Mexico such as steel, cement, and electric power.

Finally, the other national government bank is the National Mortgage Bank which is engaged in financing public works such as highways and irrigation projects.⁷

5. *Ejidatario* is a member of an *ejido* who holds a rather interesting type of joint ownership of land belonging to the nation but is given in perpetuity to the collective. It is an indigenous Mexican solution to the problem caused by the breakup of the large haciendas as a result of the Revolution.

6. *Nacional Financiera, S.A.*

7. This short description is not intended to discuss all of the government banks. There are several others of minor importance whose omission does, however, not affect the over-all picture.

PRIVATE BANKING

There are two main methods of classifying private banks. The first is to divide banks into those which engage in active operations and those which engage in passive operations. A bank is deemed to be in active operation if it lends or discounts or in any other way handles money of its customers; operations are classified as passive if their main functions consist in raising funds by public subscription or by inviting deposits, such as through the sale of bonds or other types of shares and the establishment of checking or savings accounts. The banks may also be classified on the basis of the type of credit which they may extend, the principal dividing line being that between short-term and long-term credits.

Recently another method of classification of banks has been advanced. This method divides banks into two fundamental types. The first consists of banks whose principal function is to engage in monetary transactions, while the second includes banks which mainly render services to the customer.

Using these several distinctions, our private banking system can be divided into five principal categories. The first and most important group of banks, as well as that most familiar to the public, is represented by the deposit or commercial bank. Its primary operation consists of the acceptance of checking accounts against which the normal short-term withdrawals by check are made. These commercial banks are required to maintain a deposit in legal tender with the Bank of Mexico ranging from 35 to 65 per cent of the bank's deposits, according to requirements established from time to time by the Bank of Mexico.

In addition to checking activities, these banks are permitted to make short-term loans running from 45 to 180 days, but never renewable for more than one year. They may also discount bills of exchange in ordinary commerce if the bills mature within the same time limits. They are a most important instrument in international trade in that they may also handle open and irrevocable letters of credit.

These banks, as all other private banks, are chartered by the Secretary of Finance. Their importance is evident from the fact that at the present time approximately ninety per cent of the entire assets of the banking industry in Mexico are held by the commercial banks.

The second type of bank is the investment bank, which works closely with industry. These banks raise money by the sale of securities called general bonds or financial bonds which mature in five, ten, or fifteen years. Being long-term credit banks, the law prevents them from making loans of less than 180 days duration. Their normal activity consists of the sale of an issue of bonds equal in amount and time to the loan made to a particular industry. The bank then collects money from the borrower and pays off

the holder of the bonds. Its profit is the difference between the two rates of interest, the one payable by the borrower and the other paid to the bondholder. Since there is, even in the financing of the expansion of established industries, a certain amount of risk, these loans are secured by a mortgage or trust of the entire business of the borrower including its tangible and intangible assets. The investment bank is also permitted to act as a trustee for the holders of securities and to underwrite the issuance of securities by the corporation should they wish to undertake this operation directly.

The third type of bank is engaged in the making of loans for construction within the urban areas. These banks are called mortgage banks. It will be recalled that the older type of mortgage bank (1897) loaned money on farms or residence buildings, but rarely for investment purposes. Mostly these moneys were used for trips to Europe or other kinds of recreation. As a result, at the date of maturity there was no other way of securing repayment except through the sale of the mortgaged property. The bank then became the interim owner of large farming properties and the capital so invested could only be recovered if the bank were able to sell the property to another productive farmer.

Under the new system, which is to be credited for the enormous growth of the cities in Mexico, particularly the capital, the loan must be made for productive purposes so that the income derived from the construction covers the necessary payments. The maximum period for this type of loan is ten years with a ten per cent per annum interest rate, payable monthly. The bank may not lend beyond fifty per cent of the appraised value of the property.

In order to raise its funds, the bank sells bonds, the *cedulas hipotecarias*. These *cedulas* are in fact mortgage bonds, the most popular banking paper in Mexico especially favored by women. They bear interest at eight per cent per annum payable every month. The bonds themselves are amortized by a system of drawings every three months. Such bonds are retired without premium. Normally the banks are willing to exchange such a retired bond for a new interest bearing bond. What has contributed most to the popularity of the *cedula* is the fact that the bond carries a double guarantee, first the mortgage on the property itself, and second, the added joint liability of the bank. It should be pointed out that in the entire history of this particular kind of bond, no payment has ever been defaulted.

The fourth category of banks is the capitalization bank. This is really a combination of a savings and investment bank with a few features characteristic of insurance as well as a touch of lottery. The main purpose of this bank is to create capital through savings. Since the role of savings

in a developing economy must be pressed vigorously on a public still unfamiliar with its many advantages and shy of banking establishments in general, it was found that a small lottery flavor would make the venture more inviting. The active operation of this type of bank consists in the sale of capitalization titles, a secured certificate with some of the characteristics of a share of stock. The purchaser buys titles in monthly installments. The typical one has a face value of 1,000 pesos, maturing in ten years. The purchase price is payable in monthly installments of 8 pesos. The total price of 960 pesos for the 1000 pesos certificate equals the capital at 4.5 per cent interest less selling expenses. They are sold like insurance policies through agents working for substantial commissions. When they were first issued, the face amount was paid only on the death of the owner. This feature, however, has now been eliminated and the only means of recovering the entire face value before maturity is through a monthly drawing. With the capital raised by the sale of these certificates, the banks are permitted to engage in both short-term and long-term loans, the rates being kept to a carefully fixed percentage of their assets.

The fifth and final type of banking institution in Mexico is still in the process of formation. It has been created to alleviate a drastic housing shortage. A literal translation of the name of this type of institution would be a savings bank for home construction. This translation is given so that the reader will not confuse it with the savings and loan associations familiar to Americans, a type of institution unknown in Mexico. These savings banks for home construction have been created to take care of the needs of the middle and lower middle classes. This group has not been favored by the subsidized low cost public housing reserved for workers and is, at the same time, not sufficiently strong to provide the fifty to seventy-five per cent of the cost of a home normally required to be available for this kind of banking projects. The bank operates in the following fashion. If the home owner is able to secure the first twenty-five per cent of the cost of the home in installments, and the level is reached, then the bank will grant a loan of seventy-five per cent, or the balance remaining. The bank, in effect, discounts the paper of the construction company and takes over the obligations which it held, freeing the company for other construction activities. The additional twenty-five per cent over the normal fifty per cent allowed on ordinary houses and buildings is considered financially sound in view of the fact that these small homes are more readily marketable and are not subject to a decline in price. The rather strong inflationary trend in Mexico has contributed drastically to a need for this type of construction loan. No building project is able to stand the declining buying power of the peso, most particularly when that project is to be financed by savings accumulated over a period of time by members of an economically weak group.

As this new type of institution emerges, one can see a parallel with the government financial activities in the same field in the United States. In Mexico, it is now possible for members of the middle class to buy a home for an amount equal to what was previously paid in the form of rent. The banks are secured by being able to discount their local contracts, when necessary, with the National Mortgage Bank.⁸

It should be made very clear that the five types of banking institutions outlined above are mutually exclusive. Thus a charter cannot be granted to the same corporation to operate simultaneously as a commercial bank and a mortgage bank, nor can a bank be authorized to do business as a capitalization and savings and home construction bank. Only two categories, savings and trust, can be granted within one charter or combined with other types of banks. Thus commercial banks have as a rule a savings department, and home investment or mortgage banks have a trust department.

The savings banks or departments are permitted to receive sums up to sixty thousand pesos bearing an interest of no more than 4.5 per cent per annum. All deposits must be made on special forms and only small amounts are permitted to be withdrawn at sight. Other withdrawals, depending upon amount, must be made on prior notice which runs from eight to sixty days. A savings institution is permitted to invest its capital or assets in medium term loans on which the charge is normally ten to twelve per cent interest. Savings accounts are favored in the tax laws, being exempt from estate taxes up to a certain amount and enjoying other minor privileges.

TRUST DEPARTMENTS

The operation of a trust company or a fiduciary department in the Mexican banking system results from the adoption, in 1924, of a law permitting this type of banking. The model for the enactment was the institution developed in the United States, and the purpose for transplanting it to Mexico was to establish a reliable method for channeling savings into productive activities, especially activities devoted to the development of the Mexican economy. In the period from 1924 to 1946 this type of banking did not prosper. The failure was probably due to a lack of understanding of the nature of the trust which resulted in an unfriendly attitude on the part of the banking community. In the last ten years, however, the banking *fideicomiso*, adapted to peculiar needs of Mexican banking, has become a workable institution which mainly follows patterns developed by American trust companies.

8. The profit to the bank consists of the difference between the rate of interest which has to be paid to the National Mortgage Bank on the discounted portfolio of construction loans.

These fiduciary departments are, in fact, credit institutions and not banking institutions since they offer services to the public rather than money. They are the only entities with a monopoly on the role of trustee in all fiduciary contracts as well as all of the other activities connected with a trust company. In Mexico they have handled taxes and other public funds earmarked for the repayment of the many types of government bonds. They have also been instrumental in guaranteeing the financial soundness of other types of securities issued by private entities. Of late the fiduciary department has become very important as the perfect means for the administration of guardianships and other types of fiduciary estates, either created *inter vivos* or *causa mortis*. The fiduciary departments handle other types of fiduciary relationships created by operation of law as well. It may be added that these departments derive their profits from fees rather than a difference in interest rates since they are being paid for services and not lending money.

CONCLUSION

This outline of the Mexican banking system, brief as it is, will clearly show the increasing rate of its progress which has been due primarily to the demands of international trade and the demands of a public constantly more inclined to the use of banking facilities. No doubt, much of this progress must be credited to new ideas accompanying international trade. It is also equally clear that the future will carry this trend further toward a better coordinated banking system for the Western Hemisphere.