

MARKET STUDY AND RECOMMENDATIONS REGARDING COMPETITION CONDITIONS
IN THE FINANCIAL SECTOR AND ITS MARKETS
Top-Line Summary

Mexico City, 10 July 2014

1. Introduction

The financial system is the sum of the entities and markets that attract savings from society, and administers and channels them toward financing productive or personal projects. It is made up of numerous institutions—known as financial intermediaries—such as banks, non-banking intermediaries (that undertake complementary activities in parallel with banks)¹, insurers, stock exchanges, investment- and pension-fund managers as well as sundry other institutions that carry out complementary activities on behalf of those financial services. That said, because of their public-facing nature, banks are the best known of such entities and therefore indispensable to the existence and proper functioning of a modern financial system.

The financial system is exceedingly relevant to a nation's economy, not merely for its direct contribution to production, investment and employment, but also because of the impact it wields in terms of consumer wellbeing and other economic sectors' efficiency. A competitive financial system exerts a positive impact on a country's GDP and promotes rapid economic growth. As such Mexico's Federal Commission for Economic Competition (*Comisión Federal de Competencia Económica*; acronym in Spanish: COFECE) stresses the importance of healthy in-sector competition as a motor of economic growth in Mexico.

The Mexican financial system exhibits strengths, such as low debt-delinquency rates and adequate capitalization indexes among all banking institutions, which provide stability to its financial markets. That said, both the system's penetration levels and the general populace's use of the services it offers are limited.

In this context, the financial reform enacted in January 2014 seeks to strengthen this sector's performance, through four-pronged approach: 1) by fomenting credit through Development Banks; 2) by increasing competition; 3) by expanding private financial institution credit and 4) by ensuring financial sector solidity and prudence.

¹ E.g.: grassroots financial organizations, savings and loan institutions and credit unions, among others.

As part of the second thrust of the financial reform, Mexico's congress mandated that COFECE conduct an investigation regarding competition conditions within the financial system and its markets.

Within the framework of powers that Mexico's Federal Law for Economic Competition (*Ley Federal de Competencia Económica*; acronym in Spanish: LFCE) grants COFECE, LFCE article 24, section XVIII *bis* 2, effective as of the decree, grants the Commission power to undertake research work on sectorial economic competition, as required, in order to liberalize, deregulate or modify current norms when it detects damaging risks to the competition process, or openness therein, or when it identifies price levels that may indicate a competition problem, actions that lead to significant price increases, or when notified of such issues by other authorities. Specifically, when it carries out such study, the Commission realizes a diagnostic exercise on the causes why a market may be functioning inadequately in terms of efficiency, competition and consumer welfare.

Therefore, the Commission undertook a study on the financial system and its markets to fulfill Mexico's congress mandate under the terms of LFCE described above. Ultimately, COFECE provided recommendations to financial authorities that aim to improve competition conditions within the system and its markets.

The present study seeks only to make a sector diagnostic and formulate recommendations. Therefore, it does not interfere with the powers that LFCE and the Commission charter grant COFECE to investigate anti-competitive practices or competition barriers, openness or essential resources in order to avoid monopolistic practices, illicit concentrations or other impediments to efficient market functioning. As a consequence, all conducts opposing to the LFCE that the Commission may report at present or in the future will be subject to COFECE's due process and authority.

To do so, and in order to safeguard the integrity of present and future investigations, Cofece's present recommendations focus on **regulatory actions and sector policy** to improve financial system competition conditions.

2. Market Study Results

The market study that COFECE undertook considered various analytic elements such as sector structure and characteristics, regulation of entry and operations for the institutions that make up the system, behavior on the part of economic agents that participate within it, and law changes contemplated to modify the previously mentioned aspects in the financial reform, once implemented. Based on the study **and recommendations on competition conditions in the financial sector and its markets**, COFECE concluded that there are major areas of opportunity as regard sector regulation or policy designed to foment competition and open markets along five fundamental lines:

- **Avoiding displacements or impeded access for financial market competitors.** Recommendations designed to further encourage actors to share and grant their competitors access to networks and infrastructure, as well as offer all sector participants access to the same information.
- **Reducing the risk of coordinated anti-competitive effects among competitors. Some conditions of** the Mexican financial sector allow for economic actors to coordinate efforts in ways that lead to anti-competitive effects. Present recommendations aim to inhibit such conduct as a means of reducing prices and improving service quality.
- **Reducing competitive barriers for actors already within the sector for whom competition is difficult.** Recommendations fundamentally center on regulatory framework improvements that increase the overall number of market players.
- **Eliminating restrictions that cause markets to operate inefficiently.** These recommendations seek to improve information within financial markets to facilitate decision-making and fine-tune regulation/State intervention to achieve greater financial market efficiency.
- **Increasing effectiveness of investigating and sanctioning powers of the competition authority in regard to possible LFCE violations** by improving monitoring, information and market analysis so that COFECE can fulfill its constitutional mandate efficiently in relation to this economic sector.

The financial sector segments or services that were analyzed were the following:

- A set of **cross-category sector aspects** (issues related to regulation, payment systems, credit reporting agencies, trusts and State financial-sector interventions).
- **Credit** (consumer, payroll loans, personal loans, car loans, mortgages, business loans, credit to the states and municipal jurisdictions and credit cards).
- **Savings** (deposits in regulated institutions, retirement savings accounts and investment funds).
- **Stock market financing.**
- **Insurance.**

Thirty-six specific recommendations have been made:

Competitiveness element	Issue	Problem	Recommendation
Avoid displacement or impeded access to financial markets	Prudential regulation	The operative and supervisory burdens that various banking institutions share are not proportional to the risk they imply to overall system stability, which largely affects smaller institutions.	Make sure that operative and supervisory burdens are proportional to each type of institution and its risk profile, etc.
	Low-value payment systems (ATMs)	Large-bank ATM coverage is hard to replicate among other intermediaries and even among newly authorized commercial banks. The ATM system is also fragmented because accountholders largely use ATMs from their own banks because it becomes highly expensive to withdraw funds from another bank's ATM (a charge between twenty to thirty pesos).	Guarantee users non-discriminatory access to ATM infrastructure. To such an end, a fee schedule that reduces the user fee differential between different banks' ATMs is to be promoted.
	Electronic transfers, mobile payments, payment systems, regulated- and correspondent-entity deposits.	To participate in the Cecoban clearing and settlement house, one must be a shareholder or get access through a shareholder. This can represent a barrier to non-banking entities when it comes to direct debits and checks.	Review access to Cecoban clearing and settlement services in terms of entry and requirements to facilitate access to direct deposits and checks clearing and settling services on the part of a number of financial intermediaries.

(CONT'D) Avoid displacement or impeded access to financial markets	Mobile payments	Reduce the risk of discrimination with regard to mobile network access, given that one of the mobile payment networks is operated in conjunction with the predominant telephone company.	Establish a requirement that telecommunications operators provide mobile-phone transfer services by means of short messages for any financial processor or intermediary that so requests.
		Mobile payment platforms continue to operate in a closed fashion, i.e., they only work among client accounts at the same bank that offers the service.	Evaluate the effectiveness of regulation on transfer inoperability via mobile devices issued by Mexico's Central Bank at the end of 2013, two years after becoming effective and, as necessary, enacting pertinent corrections.
	Credit reporting agencies (acronym in Spanish: SICs)	One SIC, Buró de Crédito, is the property of and operates under the control of major banks that hold 70% of its shares and simultaneously grant more than 85% of housing, consumer and business credit. Under current regulation, the governing bodies of the abovementioned and the other SIC could be making decisions that favor shareholders and not necessarily the credit information system's efficient functioning.	Adjust the regulatory framework to establish that banks are under legal obligation to provide credit information to all authorized SICs, equally, and at accepted quality standards. In addition, revise and—should it be necessary—adjust volume discount policy in regards to the consultation services offered to users by SICs as a means of avoiding explicit discrimination of economic agents.
		Small banks face information limitations that impede effective competition in relation to specific products targeted at specific population segments. Legal uncertainty with regard to the possibility of anonymously reselling or using SIC data limits analysis of such information as well as the provision of value-added services.	Issue guidelines so that SICs—while respecting principles of information anonymity—offer their anonymous database to other SICs and to third parties that can create value-added services.

(CONT'D) Avoid displacement or impeded access to financial markets		People and firm information on loan servicing or utilities payment to government entities is not available to creditors. As a consequence the possibility that users enjoy a credit history that affords them credit is reduced.	Issue norms that secure database provision to any SIC with regard to payments made to government entities (Infonavit or Fovissste contributions, among other services).
	Business loans	In addition to efforts to facilitate guarantees on the part of solvent small and medium businesses, it is key that such businesses enjoy access to financing and investment capital.	Support development and, where necessary, regulation of electronic capital investment and productive-project-financing platforms that disclose small and medium business capital and financing needs and that receive project financing and co-investment offers from financial institutions.
	Investment funds	Investment funds enact price differentiation policies in commissions and multi-series fees, by distribution channel, whether internal or external, which carry potential anti-competitiveness risks.	Guarantee neutrality and non-discrimination in the promotion and billing of operation and distribution services among proprietary and third-party investment funds. Additionally, in two years evaluate the effects of secondary regulation associated to the new investment fund law on reasonability criteria and proprietary and third-party fund-placement composition, among other issues, and, as necessary, make needed adjustments.
	Insurance	The Mexican Association of Insuring Institutions (acronym in Spanish: AMIS) database of insurance customer risk histories is used in a very limited fashion to perform actuarial measurements. As such, these data do not necessarily impact policy prices and/or the development of new products that cover potential-client needs.	Create a risk bureau owned and operated with independence from insurers, to which they are obliged to provide information, and that serves as a mechanism for them to make more precise actuarial calculations with regard to potential clients.

Reduce the risks of coordinated anti-competitive actions on the part of competitors.	Systemic risk	The three-day period that financial legislation allows for the issuance of a resolution on accumulation via bank liquidation is insufficient if COFECE is to undertake an analysis of its market-structure and -operations implications, and can also limit the agency's corrective actions.	Modify the regulatory framework for financial entity resolution situations to allow pertinent authorities to make their own resolutions such that COFECE need not get involved while assuring that it can take necessary measures based on its mandate to eliminate anti-competitive practices and barriers to competition.
	Low-value payment systems (credit and debit cards)	It is possible that cardholders face difficulties when transferring outstanding balances to a new bank that offers improved terms (a mere 5% of credit card customers switched from issuing institutions between 2011 and 2012). It is also not clear that banks use interest rates to compete for customers.	Financial reform calls for conditions that favor portability. As such, the rules that govern credit portability, in relation to how well they support switching creditors and reducing credit card non-monetary cancellation costs, must be evaluated in two years.
	Transparency	Users may face difficulty when choosing financial products since it is not easy to access information or compare available services. Examples include car loans, retirement insurance, and annual profitability outcomes for savings and investments at institutions that are not mainline retail banks.	Expand services at Mexico's National Commission for the Protection of Financial Services Consumers (acronym in Spanish: Condusef) to incorporate values expressed in pesos in addition to percentages when comparing banking services commissions and requirements; establish platforms for on-line credit and insurance comparisons; consolidate comparative information that includes all financial intermediaries on a single platform; among other services.

(CONT'D) Reduce the risks of coordinated anti-competitive actions on the part of competitors.	Consumer and housing credit	Debt-holders enjoy little mobility when it comes to switching between consumer and mortgage creditors. They can find themselves locked into unfavorable contractual obligations that feature high interest rates or commissions or inflexible payment terms and forms.	Support the development and, where necessary, the regulation of electronic consumer and housing credit platforms where a) consumers present their financing needs and authorize consultation of their credit histories at SICs; and 2) financial intermediaries make financing offers.
	Payroll loans	There is no client mobility between payroll loan providers, which tends to limit competition in this credit sector.	Issue the secondary regulation originally considered as part of financial reform that allows for effective payroll loan portability.
	Mortgages	Transferring mortgage guarantees between lenders is burdensome and retards refinancing.	Promote state-level, uniform civil reform to enact low-cost, homogenous mortgage- and mortgage-modification-related administrative tasks as well as tasks performed with public property registries.

(CONT'D) Reduce the risks of coordinated anti-competitive actions on the part of competitors.	With regard to points-of-contact	The fact that financial system competitors share multiple points of contact (some legally mandated) weakens competition by facilitating information-exchange and strategy collusion.	Review all points-of-contact between competitors and retain only those that are indispensable to financial system operation.
	Insurance	Evidence points to possible overpricing in the credit-related insurance industry, especially when comparing auto and housing loan-insurance policy prices for products that are not linked to a credit for purchase and those that are.	Review regulations to establish mechanisms that oblige financial intermediaries to provide credit solicitors (largely requesting auto and housing loans) an alternative for acquiring economical insurance that meets minimum requirements for third-party acceptance as a guarantee.
		There is scant flexibility and dynamism in the individually-written or personalized insurance sector.	Drive development of standardized insurance policies focused on basic coverage (via adhesion contracts) by obliging financial intermediaries to offer them.

Reduce barriers to competition	Business incorporation and operation requirements	Numerous requirements are established for the incorporation and operation of financial intermediaries that lend too much discretion to regulatory authorities.	Carry out a revision of financial intermediary incorporation and operation requirements and licensing processes in accordance with standards established by Mexico's Federal Commission for Regulatory Improvement (acronym in Spanish: COFEMER) to simplify and improve market-accessibility conditions.
	Trusts	There are barriers that prevent economic actors that do not belong to the financial system from providing fiduciary services.	Evaluate the risks and benefits of allowing other economic actors to serve as fiduciaries of trusts that are non-financial (hereditary or family).
	Low-value payment systems (credit and debit cards)	There have been no new market entries on the part of bank- and non-bank-based organizations interested in competing for credit and debit card segments not currently served by traditional banks. One limiting factor could be access to the card payment systems.	Over the course of two years, evaluate the effectiveness of eliminating restrictions on card issuing and acquiring services (regulations on interbank facilitation organizations) and make pertinent corrections as necessary.

Eliminate efficiency restrictions	Low-value payment systems (credit and debit cards)	Card acceptance in commercial establishments is low, as is the frequency with which consumers that have cards use them. Additionally, interchange fee differences between different business categories do not appear to be related to businesses' willingness to accept cards and cardholders' willingness to use them.	Regulate credit and debit card interchange fees to optimize the use and coverage of payment cards. A reduction to average interchange fee would be a boost to consumer welfare.
	Remittances	Programs that publicize conditions under which remittance services can be provided—for example, information regarding impediments to tied sales at locations where products are sold, the prohibition against payment retention, or the absence of reasons to pay commissions above and beyond those that the service initially set—must be reinforced.	Establish regulations for publishing and ranking the prices and quality of remittance services, besides Profeco's (Spanish acronym for: Federal Consumers Protection Office) advisory tools.
	Trusts	Trustee-reported information on trusts is limited and framed by a mere two variables (total assets and commissions by financial institution). This information is not sufficient for evaluating trust activities.	Establish a requirement among trustees to provide regulators with performance-measuring information such as the number of trusts, value and commissions by trust type and financial institution.
	Development banks	Development bank financing and ongoing government supports in certain sectors affects efficiency and creates risks to competition.	Review and, where necessary, modify development bank intervention entry and withdrawal criteria, to avoid unnecessary distortion when it comes to competition in supported sectors.

<p>(CONT'D) Eliminate efficiency restrictions</p>		<p>Unlike private financial institutions, Mexico's Infonavit and Fovissste development banks directly bear housing account origination and opening costs at the same time they automatically discount worker credit installments. As well, they transfer loan portfolios to private financial institutions through direct allocation contracts.</p> <p>Not least of all, the credit conditions they offer are more burdensome than those of financial intermediaries within the ranges in which they compete, such that their advantages are not reflected in lower costs to debt-holders.</p>	<p>Focus Infonavit and Fovissste on activities that offer competitive advantages (origination and loan servicing), by means of open portfolio tendering among private financial intermediaries or by allowing workers to transfer their housing accounts to the financial intermediary of their choice.</p>
		<p>Financial intermediaries do not offer certain financial services to particular population sectors in a sufficient amount, which negatively affects competition conditions.</p>	<p>Where an opportunity to strengthen competition or boost private financial intermediary participation is identified, the development bank or other government programs should get involved. One example would be to open a distribution channel to the public for Cetesdirecto accounts, which would establish a trustworthy reference with regard to the savings yields offered by banks.</p>

(CONT'D) Eliminate efficiency restrictions		Some administration boards and decision-making bodies at development bank institutions are made up of members who hold interests within the sectors they support.	Review election requirements for development entities' administration-board- and technical-committee-members, to identify conflicts of interest that affect decision-making neutrality.
	Personal credit	In the case of financial institutions linked to commercial enterprises or other lines of business, there is little clarity with regard to the retail price of the acquired good or financial service, which generates unequal competition risks that favor integrated economic actors.	Establish the obligation for commercial enterprises to publish their goods/services purchase prices, with or without financing, and make transparent the financial institution that will support the goods/services purchase.
	Mortgages	Some of the activities that national housing institutions undertake are not governed by principles generally accepted at private financial institutions and can distort mortgage-market competition conditions (e.g., interest rates based on x-times minimum wage).	Establish that national housing institutions act according to principles generally accepted for financial institutions in all matters surrounding credit provision.

(CONT'D) Eliminate efficiency restrictions	Retirement savings systems	Service providers of retirement savings accounts principally compete through promoting their services (40% of <i>afore</i> -style retirement fund expenses are dedicated to that end, with only 4% devoted to investment). Promotional outlay ups system operational costs and offers no clear benefit to users. Thus one-half of all workers who switched retirement funds in 2013 did so to an administrator that offered inferior net performance.	Implement measures to align system incentives towards better worker retirement pensions, e.g., that limit promotional costs via an absolute and relative spending maximum and establish that the commission on the balance be separated into two components: account management and funds management.
	Insurance	Analysis of insurance provision structures in the ranching and farming sectors must be deepened.	Realize an integrated evaluation of agricultural insurance supply and demand conditions—which should consider the role of Agroasemex, Mexico's state agricultural insurance agency as a development agent as well as a reinsurance institution.

Increase power to sanction possible LFCE violations	Concurrent powers	There are a number of regulatory activities that create areas of opportunity that would allow COFECE to more effectively fulfill its mandate that are not currently being leveraged (when regulatory authorities are aware of anti-competitive activities).	Establish a cooperation mechanism between sector regulators and COFECE to generate information related to economic activity on the part of regulated parties so that COFECE may access information it needs to perform ongoing monitoring of sector competition conditions.
	Trusts	Information on transactions involving trusts is considered a banking industry secret, which limits COFECE's access to information that indicates the presence of anti-competitive risks.	Establish a requirement that credit institutions provide COFECE with information and documentation relative to the operations and services they provide, including trusts.