MEXICO

SECURITIES

SUMMARY

The implementation of the North American Free Trade Agreement (NAFTA) opened the Mexican securities market to U.S. and Canadian firms. Under NAFTA's national treatment guarantee, U.S. securities firms and investment funds, acting through local subsidiaries, have the right to engage in the full range of activities permitted in Mexico. U.S. and Canadian firms will be subject to market share limitations during NAFTA's 1994-99 transition period.

Mexico has one securities exchange, the Bolsa Mexicana de Valores (Bolsa). The exchange has three sections: the main section, a section for medium-sized Mexican companies (MMEX), and a section for trading securities issued in overseas markets (the International Quotations System). A new exchange, the Mexican Derivatives Exchange (MEXDER), has been approved although trading has not yet begun. As of September 1998, there were 33 brokerage houses operating in Mexico. There are five foreign brokerage firms operating in Mexico. Three of the five are subsidiaries of U.S. firms. Of the five representative offices in operation, three represent U.S. firms.

Trading in money market operations continues to dominate the securities market, accounting for over 95 percent of the trading activity. Money market trading is concentrated in government instruments. As of September 1998, a total of 787.9 billion pesos (US$77.9 billion) in government securities was outstanding.

The securities industry is regulated by the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores, or CNBV), the Ministry of Finance, and the Bank of Mexico (BOM). The Bolsa and the Mexican Association of Trading Intermediaries exercise limited self-regulatory functions.

Foreign investment plays an important role in the Mexican securities market. As of December 1997, foreign investment accounted for 31 percent of the Bolsa's market capitalization. Foreigners held 11 percent of the government securities held outside of the BOM in December 1997. Foreign entities may freely invest in government securities. Foreign investors may also purchase non-voting shares through mutual funds, trusts, offshore funds, and American Depositary Receipts. They also have the right to directly buy limited or non-voting shares as well as free subscription shares, "B" shares, which carry voting rights. Finally, foreigners may purchase "A" shares (normally reserved for Mexican citizens) indirectly through a neutral fund operated by the Mexican development bank Nafinsa. Foreigners invest in the fund, which in turn holds title to the actual shares.

DESCRIPTION OF THE MARKET

Domestic Securities Market

Mexico has one established securities exchange, the Bolsa Mexicana de Valores (Bolsa). Stocks, warrants, fixed-income securities, government securities, and metals contracts are traded on the exchange.

The securities market is regulated by the CNBV, a semi-autonomous agency of the Ministry of Finance. The National Securities Commission was merged with the National Banking Commission in April 1995. Under recently proposed legislation, the CNBV would be transferred from the Ministry of Finance to the BOM and given greater autonomy. The Ministry of Finance and the BOM also have regulatory authority under the current regulatory scheme. The Bolsa and Mexican Association of Trading Intermediaries act as self-regulating organizations. A new Code of Ethics for the Mexican Securities Industry was passed in 1997 and the Bolsa is currently creating a new disciplinary committee.

As of September 1998, 33 brokerage houses were in operation. Twenty-two brokerage houses belong to financial groups and eleven operate independently. Thirteen of the brokerage houses have U.S. subsidiaries. Brokerage commissions are not regulated. Brokerage houses conduct most of the trading, but banks' money market and foreign exchange desks are active in buying and selling securities. Three rating agencies are authorized to operate in Mexico. Two of the agencies, Standard and Poor's and Duff and Phelps, are U.S. firms.

Stock Market

The Bolsa has three sections: the main section, the mid-cap section (MMEX), and the International Quotations System. As of December 1997, the Bolsa had a market capitalization of 1.26 trillion pesos (US$154.8 billion). One hundred ninety-eight issuers were listed on the stock market with 155 quoted on the main section in 263 stock series. The average daily trading in 1997 was 1.5 billion pesos (US$189.6 million). Total trading volume for the year came to 24.7 billion shares.

The MMEX was originally launched in July 1993. In December 1997, there were 39 issuers and 59 series listed on the MMEX. The annual value traded on the MMEX in 1997 was 2.5 billion pesos (US$316.1 million) with a total of 635.6 million shares changing hands. In November 1996, the first MMEX issuer moved from the mid-cap section to the main section. A second issuer followed in March 1997.

In July 1997, the Bolsa opened a new section, the International Quotations System (Sistema Internacional de Cotizaciones, or SIC), for listing and trading shares of foreign companies that are already quoted on other CNBV-authorized markets. Shares of four foreign issuers are currently being traded on the SIC.

Stocks are sold for cash and payment takes place within 48 hours (T+2). Short sales were introduced in 1991 on stocks with high marketability. The volume of short sales has been relatively low. In 1997, the volume of short sales was 37.5 million shares traded, a 62 percent drop from 1996. The introduction of a new securities lending system may soon spark growth.

Money Market

Money market operations dominate trading on the Bolsa, accounting for 97 percent of the value of the securities traded in 1997. The principal money market instrument is the Mexican treasury bill, the Cete (Certificado de la Tesoreria de la Federación). In December 1997 Cetes represented almost 51 percent of outstanding public sector debt instruments. Cetes are discount bills with a par value of 10 pesos and are available in maturities of 28, 91, 182, and 357 days. Cetes are auctioned weekly by the BOM, usually in a multiple-rate auction. The majority of Cetes are purchased by institutional investors such as banks, brokerage houses, and pension funds. Cetes are sold in the secondary market directly or through repurchase operations. In December 1997, foreigners held roughly 8 percent of the outstanding Cetes.

Tesobonos (Bonos de la Tesoreria de la Federación) are treasury bills denominated in U.S. dollars and payable in pesos at the current market exchange rate. The Mexican government paid off all outstanding Tesobonos in February 1996.

The most important private money market instruments are certificates of deposit and banking notes with yield payable at maturity, bankers' acceptances, and commercial paper. Banking instruments are traded over-the-counter as well as on the Bolsa.

Capital Market

The BOM auctions two principal long-term government securities: Bondes (Bonos de Desarollo) and Ajustabonos. Bondes are development bonds with roughly three-year maturities. They have a face value of 100 pesos and are sold at a discount. They pay interest every 28 days and are indexed to the three-month Cete yield. Ajustabonos are three- and five-year bonds whose interest payments and redemption at maturity are indexed to inflation in order to guarantee a real return. Ajustabonos pay interest quarterly based on a 100 peso par value adjusted for inflation.

Mexico's privatized pension funds, Afores, are the major buyers of Mexican long-term government securities. In December 1997, Bondes and Ajustabonos represented approximately 30 percent of outstanding public sector debt instruments.

The government introduced a new instrument, Udibonos, in May 1996. Three- and five-year Udibonos are offered twice a month in the BOM's primary auction. Udibonos are denominated in units of investment (Udis). Udis are an accounting unit that is adjusted to changes in the Mexican National Consumer Price Index.

Mutual Funds

Foreign banks and securities firms may offer and manage mutual funds through their Mexican subsidiaries under NAFTA. Foreigners may also own mutual fund management companies that are not affiliated with banks or securities firms. The CNBV regulates the mutual fund industry.

At the end of 1997, 284 mutual funds were operating as equity funds, debt funds, and capital investment funds in Mexico. Total assets reached approximately 71 billion pesos (US$8.7 billion) in December 1997. Foreign investment accounted for 3 percent of the mutual funds' total assets. Foreign investment in Mexican mutual funds grew 50 percent in nominal terms and 30 percent in real terms in 1997.

Pension Funds

In 1995 and 1996, the Mexican government passed pension privatization legislation. The reforms established individualized pension funds and tied pension benefits to individual contributions. The new system became operational in 1997. Under the system, funds are managed privately and workers may select their fund managers (Afores). Workers may choose to remain in the old system of defined benefits or move to the new system. Workers opting for the new system will have up to four years to choose an Afore. By November 1997, over 80 percent of the Mexican workers covered by the Mexican Social Security System had opted for the new system and selected an Afore.

Financial intermediaries from NAFTA countries which participate as fund managers are accorded national treatment. Of the 17 Afores authorized since February 1997, eight have foreign participants (including four U.S. companies) and two are wholly owned by U.S. companies.

Foreign Investment

Mexican financial markets continue to become more international in scope. At the end of 1997, foreign investment in the stock market totaled US$48.9 billion or 31 percent of the Bolsa's capitalization.

Foreign investment in Mexican companies' voting stock is limited to minority positions in certain sectors, including most financial companies. Foreigners may purchase free subscription shares ("B" shares) directly. "B" shares carry voting rights. They may also freely purchase limited or nonvoting shares. In order to purchase interests in "A" shares which carry voting rights and are normally reserved for Mexican investors, foreigners may invest in the shares via Nafinsa's neutral fund. Finally, foreigners may invest through offshore funds or through American Depositary Receipts (ADRs). ADRs are certificates that represent a set number of shares and are traded in U.S. markets.

As of December 1997, 47 percent of foreign stock investment was in ADRs, 40 percent in free subscription shares, 10 percent in Nafinsa's neutral fund, and 3 percent in the Mexico Fund, a closed-end fund incorporated in Maryland. Foreigners also made minor investments in stock listed on the MMEX and in warrants.

Derivatives Market

The Mexican Derivatives Exchange (MEXDER) was approved on May 13, 1998 but has not yet begun trading. MEXDER will be completely self-regulating. Brokerage houses, credit institutions, authorized exchange houses, and non-financial companies or partnerships will be able to trade on the new exchange. (Brokerage houses and banks operating on the MEXDER can do so only through subsidiaries specially constituted to participate in this market.) The exchange will initially trade dollar futures, futures based on the IPC stock index, and bond futures. Trading will be conducted by open outcry. After approximately one year, an electronic market will commence operations. Interest in MEXDER is high. The exchange initially offered 165 seats but the overwhelming response made it necessary to increase the number of seats to 192. The exchange currently has a waiting list for seats.

There is not a clear division of responsibility regarding the regulation of futures and options. The BOM drafts regulations for peso and interest rate futures and in many cases the CNBV carries out the supervisory function. The BOM would be the regulator of over-the-counter forwards and options. However, the BOM is also the regulator for some exchange-traded futures and options.

U.S. PRESENCE IN THE MARKET

Of the 33 brokerage houses currently operating in Mexico, five are subsidiaries of foreign firms. Three of the five foreign brokerage houses are U.S. firms. U.S. brokerage houses hold 7 percent of Mexican brokerage houses' total capital. The top three Mexican brokerage houses handled 24 percent of the total trading in 1997. Three of the five operational representative offices are of U.S. origin. Direct branching is not permitted.

Mexican residents may issue equity and debt securities in overseas markets. Mexican companies have been extremely active in foreign financial markets in recent years. Overseas issues are subject to prior approval by Mexican regulatory authorities for prudential reasons. The United States is the most important overseas market for Mexican issuers and U.S. firms are actively involved in underwriting Mexican offshore securities issues.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

The implementation of NAFTA in 1994 permitted U.S. and Canadian securities firms to enter the Mexican market for the first time through subsidiaries. Under NAFTA's national treatment guarantee, U.S. firms' subsidiaries can engage in the full range of securities activities open to Mexican firms and are subject to the same rules and regulations. Non-NAFTA country firms may enter the Mexican market under NAFTA's provisions via their U.S. or Canadian subsidiaries. This allows them to circumvent the fact that Mexico's GATS offer of December 1997 is less liberal than treatment accorded under NAFTA.

Under NAFTA, U.S. and Canadian subsidiaries have individual and aggregate market shares limits during NAFTA's 1994-99 transition period. The individual market share limit caps the authorized capital of a single securities firm at 4 percent of the global capital of all Mexican and foreign securities firms. Roughly speaking, global capital is paid-in capital and capital reserves adjusted by earnings and changes in asset valuation.

NAFTA originally set an aggregate capital limit of 10 percent of the global capital of all Mexican and foreign securities firms in 1994. The limit is currently 18 percent of global capital and will increase to 20 percent in 1999. The limit will be completely eliminated in the year 2000. However, between 2000-04, Mexico may freeze for up to three years the global capital of U.S. and Canadian firms if it represents 30 percent of aggregate capital. Except for these capital limits, NAFTA members face no national treatment barriers in Mexico's securities sector.

In 1995, the Mexican government liberalized regulations governing investment in financial institutions. Foreigners may invest directly in Mexican brokerage firms through Series "B" shares. Series "B" shares may represent up to 49 percent of a brokerage's capital. The limit was 30 percent prior to 1995. In addition, the 1995 reforms permitted foreign institutions to acquire Mexican financial institutions and convert them into affiliates without being subject to capital limits, subject to CNBV approval. Since the reforms, two foreign financial institutions have purchased Mexican financial institutions. There have been no further developments since 1995.

Exchange Rates Used:

1997 period average	7.91 pesos/US$
1997 end-of-period	8.14 pesos/US$
September 1998 end-of-period	10.11 pesos/US$