Operating in Mexico: Effectively Managing Banking and Businesses Challenges

Maria Molinuevo
May 7, 2009
Country overview

- **Second-largest economy** in the Latin America Region. Economy is tightly correlated with the U.S. manufacturing sector.
- **Population**: 111 Million (2008) - most populous city in the country is the capital, Mexico City
- **Area**: 377,899 sq km
- **Currency**: Mexican Peso (MXN)
- **FX Regime**: Independently floating
- **Government**: Democratic Republic
- **GDP**: USD 1,486 billion (2008 est.)
- **GDP per head**: USD 14,921 (2009 est.)
- **Trading Partner**:
  - Exports: US; Canada; Germany
  - Imports: US, China, South Korea

Mexico’s GDP Growth vs. Countries in the Latin America Region (2008)

Data source: CIA World Fact Book

Mexico - Historical Real GDP Annual Growth

Data source: INEGI / Banxico
Mexico’s trade finance market

Current trade flows

<table>
<thead>
<tr>
<th>Year</th>
<th>Mexico Exports to the U.S. (% of total Mexico exports)</th>
<th>U.S. Imports from Mexico (% of total U.S. imports)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>85.7</td>
<td>10.0</td>
</tr>
<tr>
<td>2006</td>
<td>84.7</td>
<td>10.4</td>
</tr>
<tr>
<td>2007</td>
<td>82.1</td>
<td>10.6</td>
</tr>
<tr>
<td>2008</td>
<td>80.1</td>
<td>10.1</td>
</tr>
</tbody>
</table>

Source: US Census and INEGI.
Mexico’s financial framework

Banco de Mexico
(Central Bank)

- Promotes the healthy development of the Mexican Financial System.
- Governs banking business
- Local Retail & Commercial Banks
- Foreign Banks & Rep Offices
- Supervises financial institutions and markets

Hacienda (SHCP)
(Ministry of Economics)

- Federal Agency - major authority within Mexican Financial System
- Manages the monetary and credit policy of the country.
- Operational responsibilities for all fiscal affairs.
- Allocates public investment, collects taxes, and regulates foreign exchange
- Governs exchanges, Credit Unions, non-bank financial intermediaries, investment companies, insurance & values and development banks.

Comision Nacional Bancaria y de Valores

- Commission’s objective to regulate, inspect, watch and supervise the financial organizations.
- Banking industry’s lobbying organization making policy recommendations

Liberalized FX laws

- Residents are allowed to hold local currency accounts and USD accounts in country and to hold accounts in foreign countries.
- Non residents are allowed to hold MXN Pesos accounts in Mexico. There are restrictions on non-residents establishing USDs in Mexico.
- Residents may settle freely transactions with other domestic companies in foreign currencies

Law Concerning the Restriction of Interest Rates

- Resident and non-residents accounts can be interest bearing. All residents and non-residents are subject to ISR (Impuesto Sobre la Renta) for all IBA accounts.
....and electronic clearing systems

- **Real Time Gross Settlement System (SPEI)**
  - Same-day, urgent electronic clearing

- **CECOBAN**
  - Mass-payments electronic clearing (T+1 settlement):
    - TEFs - Transferencias Electonicas de Fondos
    - DOMIs-Domiciliaciones.
  - Paper based (checks) clearing

- **SWIFT**
  - Used to settle domestic USDs
  - No local USD clearing in Mexico

<table>
<thead>
<tr>
<th>2008 Clearing Statistics</th>
<th>Volume (in MM)</th>
<th>% Share</th>
<th>Value (MXN MM)</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Checks</td>
<td>62,238,000</td>
<td>97.76%</td>
<td>802,284</td>
<td>4.22%</td>
</tr>
<tr>
<td>Electronic Mass Pmts - Cecoban</td>
<td>5,493,148</td>
<td>1.48%</td>
<td>5,033,223</td>
<td>26.49%</td>
</tr>
<tr>
<td>Same Day Clearing - SPEI</td>
<td>2,811,910</td>
<td>0.76%</td>
<td>13,165,767</td>
<td>69.29%</td>
</tr>
</tbody>
</table>

Source: Banco de México
The Mexican banking industry has changed dramatically in the past two decades.

Banking industry in Mexico since 1992

- **1982:** Debt crisis leads to devaluation of Peso and nationalization of banking system.
- **1988:** The Pacto leads to relative price adjustments & structural reform, while inadequate to attract foreign capital and investment.
- **1991:** Government privatizes all banks and lifts capital controls imposed after 1982 crisis.
- **1994:** Maxi-devaluation of Peso.
- **1997:** Banco Santander acquires Grupo Invermexico.
- **2000:** BBVA acquires Bancomer.
- **2001:** Citibank acquires Banamex.
- **2002:** HSBC acquires Bital.
- **1999:** Banco Santander acquires Serfin.

Source: Banco de México, World Bank
Mexico - banking environment current characteristics

Currency: Mexican Peso (MXN$)
- US$ account allowed in-country - residents only
- Demand Deposit Accounts (DDA) in MXN Peso and USD can be interest bearing
- DDAs can not be overdrawn by law - Arranged Over-drafts allowed

Tax Structure
- Withholding tax - ISR (Impuesto Sobre la Renta) on interest paid on DDAs:
  - Resident: 0.85% (annually) over average balance
  - Non-Resident: 4.9 to 40% on the interest paid - rate depends on various factors such as country of origin of account holder, tax treaties, etc.
- Cash Deposits totally over of $25,000 MXN (or USD equivalent) within a monthly period (30-days) are taxed at 2% (i.e. if client deposits $26,000 MXN, there will be a tax of 2% on the $1,000 that exceed the limit)
- In-Country Notional Netting or pooling of accounts not permitted, only ZBA where there is a physical movement of funds
- No withholding tax on cross border transactions

Payments
- Checks, and electronic payments (wires, local ACHs)
- Direct Deposit payments for payroll & Payroll Programs
- Same day and next day value (no matter about the amounts)

Collections
- Collections in cash and check
- Direct debit growing in use - but still not a significant volume (less 1%)
- Bank’s branches become payment/deposit collection centers
  - Standard remittance information-available electronically next day
- No traditional U.S. Lockbox service available
Electronic payments have made significant gains against checks as the primary methods of payment.

Amount (MX$ mm)

Source: Banco de México

Number of transactions

Source: Banco de México

1. SIAC, SPUEA, SPEI and Cecoban data in millions; checks data in billions
Moving towards electronic payments......

Source: Banxico, CNBV & Cecoban.
Recent changes in treasury practices in Mexico

- Mexico Central Bank is promoting the use of electronic transfers to reduce the use of checks
- An enhanced clearing system was released in March 2005 (SPEI), and without amount limit since March 2006
- A clear tendency to use Internet for financial operations
- Direct debits has been exponentially growing in use, with major promotion (still less than 1%)
- TEF and SPEI standardization (CLABE, reference numbers, etc.)
- Implementation of account statement as a fiscal document
- Implementation of electronic payment for local federal taxes
- Check Image Clearing
...and other initiatives under development in Mexico’s cash management practices

- Make the Public Sector payments through electronic means (including payroll)
- Checks:
  - Credit on T+2
  - Not endorsable
- Direct Debit:
  - Reduce from 90 to 30 days, the possibility of a reversal/rejection.
  - Incorporate all payments to government through Direct Debit solution.
- Government sponsored programs with incentives to clients/entities that migrate to electronic payments.

Banking through electronic means will drive to make a stronger “formal” economy.

Banking system in-line with the most advanced systems in the world.

Less reliance on antiquated methods of payment.

Providing flexibility and efficiency to corporate treasures.
# Nuances of Mexico’s unique market

<table>
<thead>
<tr>
<th>Checks</th>
<th>USA</th>
<th>Mexico</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Checks widely used by corporates and individuals</td>
<td>- Checks widely used for payments and collections.</td>
<td></td>
</tr>
<tr>
<td>- Double endorsements permitted</td>
<td>- Double endorsement highly regulated.</td>
<td></td>
</tr>
<tr>
<td>- Checks clearing schedules determined by location of drawer bank.</td>
<td>- All local MXN Peso &amp; USD checks clear next day.</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Electronic Transfers</th>
<th>USA</th>
<th>Mexico</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Payroll supported by Direct Deposits</td>
<td>- Payroll Programs supported by stored value cards &amp; ATMs</td>
<td></td>
</tr>
<tr>
<td>- ACH, CHIPS, Fedwire</td>
<td>- Domestic Same day MXN Peso wires settled through SPEI</td>
<td></td>
</tr>
<tr>
<td>- Accounts structures differ among banks</td>
<td>- Domestic USDs settled through correspondence banks in the US.</td>
<td></td>
</tr>
<tr>
<td>- Back valuation and use of funds is standard practice</td>
<td>- TEFs - Transferencias Electrónicas de Fondos - local form of ACHs credits with a T+1 settlement. MXN Peso only.</td>
<td></td>
</tr>
<tr>
<td>- Corporate Cards not a common payment method.</td>
<td>- Corporate Cards not a common payment method.</td>
<td></td>
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<table>
<thead>
<tr>
<th>Receivables</th>
<th>USA</th>
<th>Mexico</th>
</tr>
</thead>
<tbody>
<tr>
<td>- ACH network supports Direct Debit</td>
<td>- Domiciliaciones - local form of direct debits - still not widely used.</td>
<td></td>
</tr>
<tr>
<td>- Lock-box service supports paper receivables</td>
<td>- Lock-box does not exist due to lack of reliable postal service. A Reference Deposit Service - using bank branches and an OTC deposit is used instead.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liquidity</th>
<th>USA</th>
<th>Mexico</th>
</tr>
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<tbody>
<tr>
<td>- DDA is NIB, but automatic sweep can be used to pay interest</td>
<td>- Current account can also be interest bearing.</td>
<td></td>
</tr>
<tr>
<td>- Notional pooling allowed and widely used</td>
<td>- Only Physical sweeps (ZBA) allowed.</td>
<td></td>
</tr>
<tr>
<td>- Notional pooling not allowed.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Tips for MNCs in Mexico

Challenges

Funds management
- Paper-based collections
- Pooling and concentration structures
- Investments

Risk management
- Timely MIS to regional and global HQ
- Local regulations
- Country risk and counter party risk

Electronic Access
- Compatibility with global technology platforms and industry standards

Recommendations

- Streamline number of bank accounts
- Proactively move towards electronic collections
- Auto-sweep into bank deposits and mutual funds

- Standardized & timely MIS received electronically
- Engage service providers with proven track record
- Global counter parties to mitigate this risk

- Identify service providers that can help automate processes through ERP integration
- Outsource payments & reconciliation
J.P. Morgan in Mexico
More than 60 years ago, J.P. Morgan established its presence in Mexico

- Chase Manhattan Bank opens its representative office in Mexico
  - 1947
- J.P. Morgan, Chase Manhattan, Chemical and Manufacturers Hanover are the main architects of the Brady Program to restructure Mexico debt.
  - 1990
- Chemical Bank acquires Chase Manhattan Bank and merges the local entities in Mexico.
  - 1996
- J.P. Morgan creates the historic Aztec Bond, to raise $2.6 billion USD and restructure debt to foreign banks. The Aztec bond was the model for the Brady Bond.
  - 1988
- J.P. Morgan serves as the formal advisor to the Mexican government with the mission to reassess the international capital markets following the devaluation of the peso.
  - 1995
- J.P. Morgan leads Mexico’s debut euro-denominated bond, raising €400 million euro for seven years
  - 1999

- Today the J.P. Morgan franchise employs more than 300 staff in Mexico
- Best M&A house in Latin America (Latinfinance 2008)
- Unparalleled commitment to the region—more than 60 years of doing business in Mexico

J.P. Morgan
J.P. Morgan has a wide range of products to offer our corporate clients

### Basic capabilities

**Payments**
- Domestic wires (SPEI)
- Cross-border wire
- TEFs (local ACHs)
- Local Federal Taxes

**Receivables**
- Incoming wire
- Cash MXN$ OTC deposits

**FX**

### Innovative Solutions

**Receivables**
- Enhanced electronic collections system planned for 2011

**Other payment**
- Check books capabilities planned for 2010

**Inquiry**
- Electronic transactions information inquiry service

**FX**
- Active FX service fully integrated into the cash management solution (Real-time 24 hour FX service globally)

**USD payment**
- Same day-transfer

### Local Currency Payment & Collection

**Payments**
- Payments & Receivables
  - MXN Peso and USD payments and receivables.

**FX**

### Multi-Currency and FX Service

**Payments & Receivables**
- In-country sweep ZBA

### Liquidity and Account Services

**Basic account** - local MXN Peso and USD

**Cash Concentration**
- End-of-day, two way, and tiered ZBAs available.

### Trade & Global Logistics Service

**Trade**
- Supply Chain Finance

**Logistics**
- Integrated global logistics management solutions
  - Trade Management Consulting
  - Trade Managed Services

### Client Access

**JPM Access**
- Web-based integrated channel with high security
  - Payment
  - Message-based
  - Local ACH

**Investment**
- In-country sweep ZBA

**Investment**
- Interest bearing account.
- Money Market account by end of 2009

**PaySource**
- Host-to-Host connection that offers advanced Artificial Intelligence technology

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Case Study: Integrating Mexico into a region-wide treasury management solution

J.P. Morgan designs a program and solution to integrate Mexico into a large scale migration of cash management processes to achieve centralization of global standard disbursement processing through a Global Shared Service Center.

Solution: Integrate J.P. Morgan Mexico’s cash management capabilities under a global H2H payment platform, PaySource:
- Client extracts all locations’ payment data from SAP in an IDOC format which is then translated to EDIFACT in the Client’s EDI system.
- J.P. Morgan technology allows connection to Mexico’s local clearing systems
  - Information Reporting (balance, account movement)
  - Cross-border Payments
  - Domestic payment
  - Incoming (cross border/ domestic)
- J.P. Morgan Mexico provides additional services to the client to ensure a comprehensive solution
  - Liquidity solutions

Key Client Benefits:
- Improved cash and liquidity management
- Greater flexibility to meet changing needs
- Increased automation and control
- Improved information, reporting and analysis
- Rationalization of bank account structure
Why J.P. Morgan in Mexico...

**Proven and committed track record**
- Over 60 years of operation in Mexico
- #1 USD clearer in the world, #2 Euro clearer in the world\(^1\)

**Our strengths**
- 100% bilingual client service group
- Global/regional integrated solutions augments country-based expertise
- Regional and global staff to assist you when and where you need further support

**In-country footprint**
- Over 30 sales, product, operations and technology staff on the ground in Mexico to support your business
- Active member of in the Mexico Banking Association, where we actively contribute to various committees
- Focused strategy and commitment to further enhancing local product development in Mexico

\(^1\)J.P. Morgan AG is the second largest clearer of euros by value in RTGSplus
### Mexico: economic indicators

<table>
<thead>
<tr>
<th></th>
<th>Average</th>
<th></th>
<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>2002-06</td>
<td>2007</td>
<td>2008</td>
<td>2009f</td>
<td>2010f</td>
</tr>
<tr>
<td>Real GDP, % change</td>
<td>2.8</td>
<td>3.6</td>
<td>1.3</td>
<td>-4.0</td>
<td>3.4</td>
</tr>
<tr>
<td>Consumption¹</td>
<td>2.7</td>
<td>2.9</td>
<td>1.1</td>
<td>-2.4</td>
<td>1.3</td>
</tr>
<tr>
<td>Investment¹</td>
<td>0.3</td>
<td>1.3</td>
<td>1.2</td>
<td>-1.4</td>
<td>3.1</td>
</tr>
<tr>
<td>Net trade¹</td>
<td>-0.2</td>
<td>-0.6</td>
<td>-1.0</td>
<td>-0.2</td>
<td>-1.0</td>
</tr>
<tr>
<td>Consumer prices, %oya</td>
<td>4.4</td>
<td>4.0</td>
<td>5.1</td>
<td>5.1</td>
<td>3.3</td>
</tr>
<tr>
<td>% Dec/Dec</td>
<td>4.4</td>
<td>3.8</td>
<td>6.5</td>
<td>3.3</td>
<td>3.4</td>
</tr>
<tr>
<td>Producer prices, %oya</td>
<td>5.5</td>
<td>4.0</td>
<td>6.3</td>
<td>4.3</td>
<td>4.0</td>
</tr>
<tr>
<td>Government balance, % of GDP</td>
<td>-0.4</td>
<td>0.0</td>
<td>0.0</td>
<td>-2.5</td>
<td>-2.5</td>
</tr>
<tr>
<td>Merchandise trade balance (US$ bn)</td>
<td>-7.2</td>
<td>-10.1</td>
<td>-16.8</td>
<td>-24.1</td>
<td>-32.2</td>
</tr>
<tr>
<td>Exports</td>
<td>195.6</td>
<td>271.9</td>
<td>291.8</td>
<td>268.7</td>
<td>293.5</td>
</tr>
<tr>
<td>Imports</td>
<td>202.8</td>
<td>281.9</td>
<td>308.6</td>
<td>292.8</td>
<td>325.6</td>
</tr>
<tr>
<td>Current account balance</td>
<td>-7.0</td>
<td>-8.2</td>
<td>-15.5</td>
<td>-28.6</td>
<td>-35.6</td>
</tr>
<tr>
<td>% of GDP</td>
<td>-0.9</td>
<td>-0.8</td>
<td>-1.4</td>
<td>-3.4</td>
<td>-3.7</td>
</tr>
<tr>
<td>International reserves, (US$ bn)</td>
<td>64.8</td>
<td>87.1</td>
<td>91.1</td>
<td>88.1</td>
<td>95.1</td>
</tr>
<tr>
<td>Total external debt, (US$ bn)</td>
<td>166.6</td>
<td>193.3</td>
<td>198.3</td>
<td>188.3</td>
<td>192.3</td>
</tr>
<tr>
<td>Short term²</td>
<td>34.8</td>
<td>34.9</td>
<td>34.9</td>
<td>34.9</td>
<td>34.9</td>
</tr>
<tr>
<td>Total external debt, % of GDP</td>
<td>20.8</td>
<td>17.7</td>
<td>18.0</td>
<td>22.9</td>
<td>19.6</td>
</tr>
<tr>
<td>Total external debt, % of exports³</td>
<td>70.9</td>
<td>55.9</td>
<td>57.1</td>
<td>61.2</td>
<td>55.4</td>
</tr>
<tr>
<td>Interest payments, % of exports³</td>
<td>5.2</td>
<td>4.6</td>
<td>4.2</td>
<td>4.8</td>
<td>4.7</td>
</tr>
</tbody>
</table>

1. Contribution to growth of GDP.
2. Debt with original maturity of less than one year.
3. Exports of goods, services, and net transfers.

Source: J.P. Morgan.
Glossary of terms commonly used in Mexico

**Banxico:** “Banco de Mexico”, Mexico Central Bank.

**Cecoban:** “Centro de Cómputo Bancario”, Clearing System in Mexico for next day value payment (similar to ACH payments).

**SPEI:** “Sistema de Pagos Electrónicos Interbancarios”, a Clearing System for same day payments; controlled by Banxico.

**TEFs:** “Transferencias Electrónicas de Fondos” - local ACHs - only in MXN peso. T+1 settlement.

**DOMI:** Or “Domiciliacion” are local Direct Debit transactions.

**CLABE:** Country wide standard account structure - composed of 18 digits - to be used for all financial transactions,

**TIIE:** “Tasa de Interés Interbancaria de Equilibrio”, a representative interest rate in Mexico.

**CETES Rate:** “Certificados de la Tesorería”, representative rate for Mexican Treasury Certificates of Deposit - available in various term periods (i.e 28 days, 180 days, etc.)
Thank You

For more information, please contact:

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