

# Mexican Central Bank's Measures to Promote Liquidity in the Financial Market in the context of the COVID-19 Pandemic

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In order to promote liquidity and the orderly functioning of the Mexican financial system in the context of the complex economic situation resulting from the COVID-19 pandemic, on April 21, 2020, the Mexican Central Bank (*Banco de México*) (“**Banxico**”) issued a press release through which it announced: **(i)** cuts to the same-day Interbank Equilibrium Interest Rate (TIIE in Spanish) in the amount of 50 basis points, to the amount of 6%; and **(ii)** the implementation of additional measures, which amount to over 750 billion pesos in support and which comprise the following (the “**Additional Measures**”):

1. Increasing liquidity during operating hours to facilitate the optimal functioning of financial markets and payment systems.
2. The expansion of securities eligible for the Additional Ordinary Liquidity Facility (*Facilidad de Liquidez Adicional Ordinaria* in Spanish) (“**FLAO**”), foreign exchange hedging operations and dollar-based credit operations.
3. Expansion of counterparties eligible for FLAO.
4. A front office for repo transactions of long-term government securities.
5. A temporary Collateral Exchange Window.
6. Facilities for repo transactions of corporate securities.
7. Granting resources to banking institutions to channel credit to micro, small and medium-sized enterprises and individuals affected by the pandemic.
8. Financing facilities for commercial banks backed by credits to corporations, in order to finance micro, small and medium-sized enterprises.
9. Swap of government securities.
10. Exchange rate hedges payable in US dollars with foreign-based counterparties to allow continued transactions during hours when domestic markets are closed.

To further analyze the Additional Measures which Banxico will implement, we have grouped such Additional Measures into four categories as follows:

### **I. Measures to increase liquidity in the financial market.**

Additional Measures 1 to 3 seek to increase liquidity in the financial market and in the payments system through two channels: (i) through ordinary means, such as increasing the overdraft limits of the SIAC accounts which banks and stockbrokers may use, based on the capital of each such entity; and (ii) through additional ordinary means, by granting additional ordinary liquidity facilities (FLAO), which include increasing: (a) the range of debt-based securities, allowing certain securities considered eligible, either for repo transactions or as collateral for loans, currency hedging transactions settled in pesos and dollar-based credit auctions, to obtain a credit rating of “A” at the national level, instead of “AA” as currently established by Banxico Circulars 8/2009, 3/2017 and 10/2015; and (b) counterparties eligible for FLAO, since development banks will now be able to enter into secured loans and repo transactions.

## **II. Repo, swap and securities exchange transactions carried out by and between financial institutions and Banxico.**

Additional Measures 4 to 6 and 9 mentioned above have an impact on repo, swap and securities exchange transactions as carried out by financial institutions with Banxico.

As pertains to repo transactions, Banxico approved extending their term and will also allow banks and stockbrokers to carry out repo transactions with corporate securities (short-term stock certificates and long-term bonds) issued by private entities whose registered address is located in Mexico.

Additionally, Banxico will allow financial institutions to execute swaps of government securities, wherein Banxico will receive long-term securities and deliver short-term securities in exchange, with terms of up to 3 years.

Finally, as pertains to the exchange of securities, financial institutions shall be entitled to exchange low-yield debt-based securities for government securities with higher yields with Banxico, subject to the obligation to return them at the end of the corresponding term. It is worth noting that this Additional Measure is not currently regulated under any Banxico Circular.

## **III. Financing to support SMEs and individuals affected by the COVID-19 pandemic.**

Additional Measures 7 and 8 relate to providing financing arrangements for micro, small and medium-sized enterprises (“SMEs”) and individuals affected by the COVID-19 pandemic.

For such purposes, the aforementioned Additional Measures consist of Banxico: (i) issuing a financing program of up to 250 billion pesos directed at SMEs and individuals, to be implemented through banks (both those engaged in commercial as well as development banking); and (ii) directly financing commercial banks through loans of up to 100 billion pesos each, backed by loans from companies whose credit rating is equal to or higher than “A”. Commercial banks must use any such direct financing as granted by Banxico exclusively to grant loans to SMEs. Loans extended under such direct financing arrangement will be subject to 18 to 24-month terms and accrue interest at same-day THIE rates.

## **IV. Settlement of dollar-based exchange rate hedging operations in with extended hours.**

Additional Measure no. 10 is related to the settlement of dollar-based foreign exchange hedging operations outside Mexican market hours, which will be allowed until such date as is determined for such purposes by the Exchange Commission.

This Additional Measure shall be applicable only to Banxico, which shall thereby be entitled to arrange and settle exchange rate hedging operations for differences in dollars with financial institutions not domiciled in the country, outside Mexican market hours thus eliminating the need for such financial institutions to have accounts in pesos.

The purpose of this tenth and last Additional Measure is to set orderly operating conditions in the peso-dollar exchange market, particularly in Asian and European sessions.

Additional Measures 1 to 9 will remain in force from April 21 to September 30, 2020, while the term of Additional Measure no. 10 is still to be determined by the Exchange Commission.

It is important to note that the Additional Measures will require amendments to the Banxico Circulars, as amended, and, in some cases, Banxico will have to issue entirely new regulations to govern their implementation.

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