

RESEARCH

Mexican Structured Finance: Steady Amid Turbulence

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(Editor's Note: In the commentary article, originally published Feb. 7, 2008, Banorte's collateralized loan obligation transaction securitization amount was misstated. A corrected version follows.)

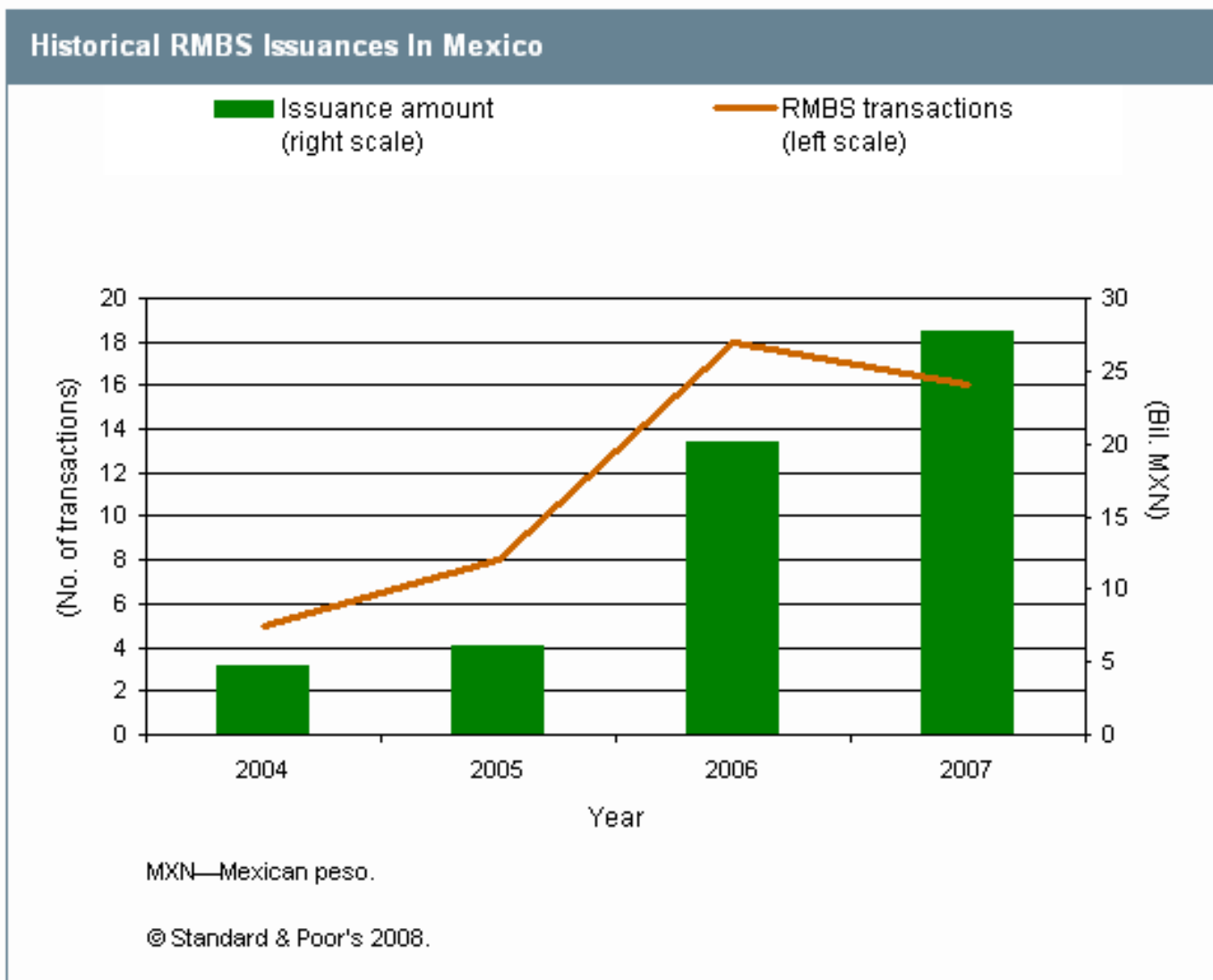
In 2008, Standard & Poor's Ratings Services expects Mexican structured finance to remain unscathed by the worldwide market disruption. We do expect issuance to ease up at times (as it did in August and September 2007) because of the global market's uncertainty and high volatility, but it will remain active because of issuers' ongoing funding needs. The performance of some asset-backed securities (ABS) portfolios may suffer a bit if global economic volatility and a possible recession in the U.S. influence the Mexican economy. But we expect Mexico's economy to remain stable, with no adverse effects on the performance of outstanding transactions and the credit risk of structured bonds.

Residential Mortgages Remain The Dominant Asset Type

Residential mortgage-backed securities (RMBS) continue to dominate the country's structured finance market. Currently, 50 outstanding public RMBS issuances are trading, almost all of them in the local markets. In 2007, RMBS accounted for 35% (or US\$2.5 billion) of the market's overall US\$7.1 billion in issuance.

In each year since 2004, the total RMBS issuance amount has increased dramatically over the previous year (see chart 1). Last year was no exception: The amount of new RMBS issuances grew 38% over 2006, and the accumulated issuance amount grew 90% over the same period. This is a result of new mortgage originators tapping the market, such as BBVA Bancomer, which underwrote a five-year Mexican peso (MXN) 20 billion program.

Chart 1



To date, Sofoles (Mexican nonbank mortgage originators) and Infonavit (Mexico's largest mortgage institution) have been the key players in the burgeoning RMBS sector, with 51% and 32% of outstanding issuance, respectively. However, since the first commercial bank RMBS transaction in December 2006, bank participation has increased to 18%. In 2007, HSBC Mexico S.A. and BBVA Bancomer S.A., the two commercial banks with the largest mortgage portfolios in Mexico, structured their first RMBS transactions.

In 2008, we expect Infonavit and commercial banks to be the main agents for RMBS growth in Mexico. We foresee Sofoles' continuing with their traditional securitization programs, but we also expect them to explore new securitization models, such as the HiTo Danish mortgage model, a standardized and direct market funding securitization model, which we rated in December 2007. Other new opportunities include nontraditional structures, such as time-tranching and covered bonds. Time-tranching is the division of a tranche's senior piece into two pieces with the same credit risk but different expected durations, which can increase the deal's investor base. For covered bonds, Mexican regulators are currently looking into adjusting the legal framework to allow for domestic public issuance, since issuers can now only offer covered bonds privately or in the international markets.

New Asset And Deal Types Continue To Reach The Market

Another factor behind the Mexican structured finance market's growth is the ongoing diversification of the types of assets going into securitizations. In 2007, we participated in the debut of auto finance and equipment leasing securitizations. We also rated more traditional ABS assets, such as bridge loans for construction projects and personal loans. In 2008, Standard & Poor's expects auto loan deals, dealer floorplan transactions (which are wholesale auto deals), and credit card securitizations to hit the market for the first time.

State and municipality securitizations are becoming more complex, with the issuance of asset types other than federal tax revenues. Also, more securitizations are including longer tenors, ranging from 25 to 30 years. Banco Mercantil del Norte (Banorte), one of the most active lenders in this market, securitized a part of its loan portfolio last year in a US\$500 million collateralized loan obligation (CLO) transaction, which we rated 'mxAAA'.

Over the next few years, domestic commercial mortgage-backed securities (CMBS) issuance may begin to emerge because lessees of shopping malls, office buildings, warehouses, and hotel assets may be able to leverage their lease payments through CMBS structures. We're also expecting synthetic structured finance transactions, including credit- and market-linked notes, to generate large issuance amounts for 2008. In 2006 and 2007, Standard & Poor's rated several synthetic transactions secured by foreign currency-denominated sovereign bonds. We also expect the use of partial-credit guarantees to continue.

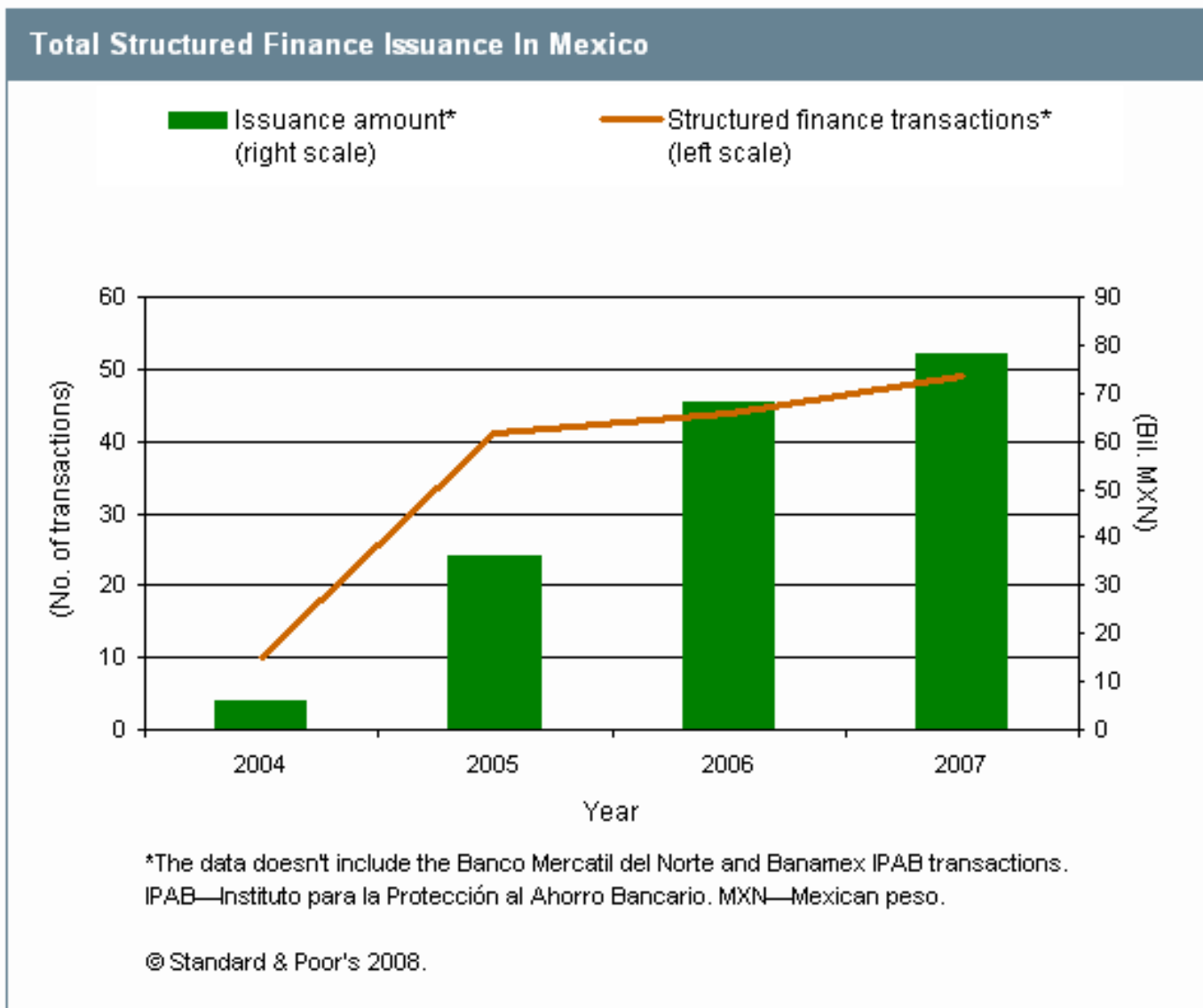
Expectations for the first Mexican asset-backed commercial paper (ABCP) conduit issuances continue to build for 2008. Deutsche Bank Mexico S.A. has received regulatory approval for a proposed multiseller conduit and is expected to proceed as opportunities arise. In addition, other traditional market players are seeking to take advantage of investor demand for short-term securities. Standard & Poor's anticipates that growing investor interest in alternative investment opportunities, coupled with the attractive yields offered by securitized products, will result in the growth of a robust ABCP market in Mexico.

Our Outlook On The Mexican Structured Finance Market

Although its growth might not be as vigorous as we've seen in previous years, the Mexican structured finance market continues to consolidate to meet funding and investment needs, which provides very flexible risk allocation advantages for issuers, originators, and investors.

Total structured finance issuance volume rose 15% to US\$7.1 billion in 2007 from US\$6.2 billion in 2006 (see chart 2). As asset securitization becomes more familiar to some originators, growth is steadier.

Chart 2



If economic conditions remain stable in Mexico, we expect to see comparable growth in structured finance issuance amounts and the number of transactions during 2008 as in 2007, given the inclusion of new structured products and new participants in existing structured markets, such as RMBS.

The future of the performance of Mexican ABS hinges on the continued stability of income levels and employment. Worker-borrowers who derive income from the informal economy represent an increasing proportion of ABS pools, and their ability to repay financial obligations is especially vulnerable during economic shocks. Consumer lending has grown in Mexico in recent years, and a less-benign economic environment may affect some obligors' ability to repay these loans. As such, borrowers' ability to manage consumer debt, including consumer loan products that depend on payroll deductions, is a key factor in our credit risk and surveillance analysis.

Since the first Mexican securitization in late 2001, no Mexican ABS transaction has defaulted on any payment; performance across asset classes has been stable, and no material credit deterioration of any rated Mexican structured finance transaction has occurred. We will continue to closely monitor all outstanding ratings on Mexican structured finance transactions and adjust our loss expectations for new issuances as appropriate, given both historical and expected economic, market, and performance conditions.

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