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I. Introductory Comments

On behalf of my company, Standard & Poor's Ratings Group, let me begin by expressing my appreciation for your kind invitation to speak at this conference so I can share with you the basics of the ratings process. Through the years, some misconceptions have developed about debt ratings, to the point where first-time issuers equate seeking a rating with, to use a cliche, having to undergo a root canal procedure...without anesthesia...by a student dentist...who is trembling with nervousness.

I could layer the analogy further, but before we reach the brink of squeamishness, let me assure you, S&P's approach is guided by a desire to be fair. Our analysis is independent, but relies on the financial material, background papers, and face-to-face meetings with management to gather the information which is an integral part of the process of determining the appropriate, accurate rating. We strive for a cooperative relationship with issuers, because we have found that approach enables us to serve investors best.

Now, a cooperative relationship will not necessarily yield a rating that will please every issuer. I have the psychological scars to prove that. But S&P's integrity is a cornerstone of the debt market's ability to make informed decisions. Without that trust, without that credibility in S&P's word, the banks and other issuers we rate would face greater difficulties in obtaining the capital they need to support economic development at appropriate interest rate levels. Our rating is our bond.

This is an exciting time in your nation's economy. Mexico is transforming itself from a country where public ownership of banks and industry is being replaced by private enterprise. Increasingly, free market policies are opening borders to two-way commerce that, I believe, will elevate the living standards, improve per capita income, and create new markets in, and for, Mexico, Canada, and the United States.

As industries gear up to serve new markets, they will need more capital. As consumers reap the benefits of free trade, they will need more consumer credit for home loans, installment debt, and other purposes. According to our analysis, the movement to a private banking system will be one factor helping to open the way for increased consumer activity, creating opportunities for Mexican banks in what has been an underbanked economy.

It is my hope that by explaining the rating process here today, at least as it is practiced by my S&P colleagues, we will erode some of the concerns and misperceptions about the ratings process. I will also recount the beginnings of S&P, and the evolution of the business, two inextricably linked occurrences. And, in explaining the rating process, I trust it will become apparent that securing a debt rating is a vital step in a financial institution's capability to attract investors, to participate in global markets, and, ultimately, strengthen Mexico's voice and participation in international commerce.

II. History of Ratings and S&P

While Standard and Poor's Corporation is best known for its ratings and financial analyses, its history is that of a publishing firm, a tradition that remains vital to our business today. Henry Varnum Poor began publishing *The History of Railroads and Canals of the United States* in 1860, a volume designed to provide investors with assessments of the railroads' financial strength. As a precursor for S&P's international standing as a rating agency with offices here, in London, Tokyo, Paris, Melbourne, Madrid, Frankfurt, Stockholm, and Toronto, many of the investors served by Poor's railroad book were European. Years later, in 1906, Standard Statistics began publishing previously unavailable financial information on U.S. industrial companies, moving into bond ratings in 1923. In 1941, Poor's Publishing and Standard Statistics merged to become S&P, which 25 years later became part of

McGraw-Hill, a leading international publishing, media, information, and financial services firm. While S&P is best known for its debt and credit ratings and financial information, our roots in publishing our deep, and guides our responsibility to the investment community. We report on the creditworthiness of issuers, objectively, in an open atmosphere of disclosure about how we operate, and with a sense of balance and fair play.

Today, S&P rates $2 trillion in outstanding debt issued in more than 70 countries. As I am sure you know, we recently expanded our investment in Mexico through our acquisition of Calificadora de Valores, an action which demonstrates our belief, and commitment, to serving Mexico and Latin America. Caval will continue to provide ratings for the domestic market while S&P will continue to serve those Mexican issuers needing an international rating to attract investors outside of Mexico, whether for peso or foreign currency debt. We will use separate rating scales but work together, endeavoring to assure consistent criteria and ratings quality. S&P will bring to the table its long, broad-based experience, while Caval brings its deep knowledge of local conditions.

We are proud that S&P was the first agency to publish detailed explanations on its rating criteria and methodology; proud to be the first to publicly identify its watch list, called "CreditWatch", proud to be the first to establish seminar programs outlining and illuminating our ratings criteria, and proud to be the first to incorporate forward-looking outlooks in published papers. Our analysts are directly accessible by phone to investors, issuers, underwriters, investment banks, and the media. And to ensure their accessibility, S&P publishes their direct phone lines with every article they write. If we are entrusted to measure a bank's **creditworthiness**, in return, we must do everything possible to ensure our **credibility**. Finally, it is important to note that S&P operates with **no** government mandate and is independent of any investment banking firm, bank, or similar organization. Recognition as a rating agency ultimately depends on investors' willingness to accept it judgement.

III. S&P's Ratings

Perhaps because S&P's ratings are composed of letters, from 'AAA' to 'D', there is a tendency to presume that an S&P rating is a performance grade, a measure of how the company is doing. But the rating is what it is: A measure of credit risk assigned to a specific debt issue or class of debt instruments.

Now, it would be disingenuous of me to claim the notion of the rating is totally isolated from performance. But there are factors other than performance which enter into a rating, and performance encompasses more than a rating. For instance, a company might undertake a large borrowing that would leave it highly leveraged, potentially leading to a downgrade. But, for justifiable reasons, company management might proceed with the financing if it determined modern equipment would improve efficiency and productivity with the gains worth the increased risks. S&P's ratings are not recommendations to purchase, sell, or hold securities. Nor do they incorporate factors that prudent management might deem are worthwhile actions, either from an economic or a social point of view, but which, from an isolated credit standpoint, might influence the rating. Our ratings are not, nor should they be, viewed as a general purpose evaluation.

IV. S&P's Rating Process

In markets outside the U.S., S&P provides ratings only when asked to do so by issuers. We believe the practice of rating only upon request is the best way to provide the market with intelligent, informed opinion as to the issue's credit risk. Without access to information only management can provide, the quality, and the accuracy, of the rating are diminished.

Generally, we are contacted directly by the issuer, an investment banker, or a financial adviser. In launching the process, we ask for all published material relating to the issuer's finances, including annual reports covering five years and filings with governmental securities agencies. S&P then assigns an analytical team, generally two or three analysts, who review the documents and identify any issues that warrant discussion with management.

As we review this material, the bank or issuer is preparing a more detailed presentation. At this stage, the S&P team is interested in learning about how the bank is organized, its lines of business, branch network, market share, and similar general information. S&P will need to know about the issuer's accounting practices, and will be seeking more information about problem loans, provisions and charge-offs. We should also get information on the formal risk control procedures and limits, both on the lending and on the market position taking side.

While it is helpful to have some specific narrative describing the issuer's activities and financial profile, it is preferable, from our standpoint, to mainly have internal reports which describe the bank's operations, limits, controls, and positions. Our analysts are knowledgeable in interpreting such data, and tables and materials published in Spanish would pose no problem.

This is followed up by our meeting with the issuer, which I would describe as a discussion, not an inquisition, and certainly not a trip to the dentist. In meeting with the issuer, we generally expect to spend two working days reviewing the information we have received with management. In the case of a new banking system, we would also want to devote some time to meeting with the regulatory agencies in order to learn about it.

In our meetings with management, we have found it is productive to have one or two individuals who are broadly knowledgeable in the bank's overall operations stay with us to make the meetings flow smoothly. We will, however, want to meet with the top officials of major operating departments, either the chief or an associate, to discuss their department's operations. Specific departments vary from bank to bank, but generally include the people responsible for retail, commercial, and corporate lending, loan review, deposit gathering, international operations, treasury, asset and liability management, internal inspection and the chief financial officer. Other than this last meeting, which typically covers results and projections, the meetings focus on general discussions of operations and shouldn't repeat the written information previously supplied.

Of course, it is extremely important to meet with the bank's chief executive. We want to understand management's philosophy, its overall direction, and strategic focus. This is an informal discussion, designed to educate us about the bank's future vision.

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V. Rating Criteria

Having gathered our data, we begin to formulate the rating. We will begin by considering the banking system's strength and the operating environment. Do regulators maintain tight controls on the bank? Does the system permit competition? Is the economy stable? Is the bank operating in a free market, or an oligopoly? Have the regulators installed adequate safeguards to oversee operations?

While those issues are distinct from the bank's management, in a sense, they are factors in our equation. Certainly, a bank operating in a weak economy with inadequate regulation would concern us regardless of the bank's apparent strength. Further, we cannot rate a bank, or for that matter any issuer, higher than its country's sovereign debt rating. This stems from the fact that the government has the power to tax, impose exchange controls, and -- admittedly extreme -- expropriate funds. Thus, in the extreme, actions the government takes to safeguard it own credit can prevent other issuers from servicing their debt.

The good news, although what I just said wasn't necessarily bad, is that S&P does rate domestic currency higher than foreign. So Mexico's foreign currency is rated 'BB+' but its local currency debt 'AA-'. And, it is the 'AA-' that serves as the ceiling for Mexican banks' local currency debt and certificate of deposit ratings.

Once we look at the system, we analyze the bank's own strengths and weaknesses, starting with the more qualitative aspects. Among these are the bank's position within the country, whether its market share gives it any tangible operating benefits, its importance to the country, ownership and likelihood it will be supported by shareholders or the government in case of difficulty. We look at its diversification and the riskiness of its major lines of business. And we formulate an opinion as to the quality and depth of management, and the adequacy of its systems and controls.

Finally, we consider the more quantifiable factors: asset quality, liquidity, profitability, and capital. The slides show a small sampling of the ratios that we analyze for the Mexican banks.

SLIDES

While many measures are utilized when analyzing the strength of a bank, asset quality is often the prime factor which differentiates banks operating within the same or similar environments. The first consideration when assessing asset quality is the types of assests, and, more particularly, loans in the bank's portfolio. The primary areas of concern are diversification and risk. Broadly speaking, S&P analyzes the loan book through breakdowns by geography, collateral, maturity, industry sector, and type of borrower. The process of credit approval, including lending criteria, is also carefully reviewed.

SLIDE

Profitability, which we mainly measure using variations of return on assets, is also a key. Profits are the first line of defense against losses, the main means of building capital, an important factor in maintaining confidence, and one measure of management performance.

The analysis of control over the asset and liability mix included both the external and internal factors affecting interest, maturity, and currency matching. For all of the above, S&P is keenly interested in management's record of reacting to changing circumstances.

For repaying foreign currency obligations, we are most concerned about the bank's direct access to foreign exchange. Government regulation, of course, is a significant factor when determining bank liquidity. In some nations the liquidity of the banks is regulated to implement monetary policy and control loan growth. The liquidity of large international banks is primarily derived from its ability to continue to raise funds from many markets under all circumstances. In this regard, S&P studies the recent history of the bank, how often it has funded in the international markets and what its requirements for funds will be in the future.