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Mexico's TIIE, TIIE Funding Rate and Forward-Looking Compounded TIIE Funding Rate

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The Interbank Equilibrium Interest Rate (*Tasa de Interés Interbancaria de Equilibrio*; "TIIE") has historically been one of the principal benchmark rates in the Mexican financial system, reflecting the cost of interbank funding among banking institutions for various tenors, traditionally 28, 91 and 182 days. This rate is determined and published by *Banco de México* and has served as the basis for the calculation of interest under a broad range of financial products and instruments, particularly those denominated in Mexican pesos.

Banco de México calculates TIIE based on quotations submitted by multiple banking institutions in Mexico. The rate is determined daily for the 28 and 91 day time periods, and weekly for the 182 day time period, taking into consideration the funding conditions estimated by the participating institutions.

Notwithstanding its historical relevance, traditional TIIE shares certain characteristics with other international benchmark rates that, in recent years, became subject to regulatory scrutiny because their methodologies relied on forward-looking estimates provided by financial institutions rather than on transactions actually executed in the market. This gave rise to concerns regarding representativeness, transparency and susceptibility to manipulation.

In this context, and in line with the trend observed in the principal international financial markets, several years ago the Banco de México introduced the **TIIE Funding Rate** (*Tasa de Interés Interbancaria de Equilibrio de Fondeo*; "TIIE Funding Rate" or "TIIE-F") with the objective of strengthening the integrity and stability of Mexican financial market through the adoption of a benchmark rate based on real and observable market transactions.

The design of the TIIE Funding Rate adhered to international standards established by organizations such as the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO), which have promoted the global transition toward risk-free, or more specifically, nearly risk-free benchmark rates. Currently, the overnight TIIE Funding Rate constitutes one of the main near risk-free reference rates in Mexico. Its calculation is based on transactions actually executed in the Mexican interbank market, particularly wholesale overnight repurchase transactions entered into by multiple banking institutions and brokerage firms and secured by government securities, including securities issued by the Federal Government, the Institute for the Protection of Bank Savings (*Instituto para la Protección al Ahorro Bancario*) and Banco de México itself. Banco de México publishes such rate daily based on transactions effectively observed on the immediately preceding business day.

Various jurisdictions have migrated from traditional or forward-looking interbank rates toward new benchmarks based on actual market transactions. Among the most relevant examples are the transition from USD LIBOR to SOFR in the United States, including variants such as Daily Simple SOFR, SOFR Compound and SOFR Average; from LIBOR to SONIA in the United Kingdom; and from CDOR to CORRA in Canada. In each of these cases, the objective has been to replace benchmark rates based on bank estimates with metrics supported by actual transactions, thereby reducing discretion-related risks and enhancing market transparency.

As part of this transition process, the 91 and 182 day TIIE ceased to be eligible as reference rates for new contracts as of January 1, 2024, while the 28 day TIIE ceased to be used for new contracts as of January 1, 2025. Notwithstanding the foregoing, transactions arising from existing agreements entered prior to such dates may continue to use the aforementioned rates until maturity. Likewise, Banco de México has expressed its intention to continue publishing traditional TIIE indefinitely to ensure continuity and stability for currently outstanding transactions.

Similar to developments in other jurisdictions, for example, with the creation of the Average SOFR (NYFed SOFR) in the United States, and for the purpose of facilitating the transition from traditional TIIE to the TIIE Funding Rate, Banco de México developed the so-called Forward-Looking Compounded TIIE Funding Rates (*Tasas de Interés Interbancarias de Equilibrio de Fondeo Compuestas por Adelantado*; "Compounded TIIE Funding Rates"). These rates allow the applicable interest rate to be known at the beginning of the relevant interest period and are published daily. For each business day, the applicable Compounded TIIE Funding Rate is calculated using the compounded average of the TIIE Funding Rates observed during the immediately preceding 28, 91 or 182 calendar days. In this manner, such rates seek to replicate, from an economic and operational standpoint, certain characteristics of the former term TIIE rates, thereby facilitating the contractual and operational adaptation of market participants.

The main differences among traditional TIIE, the TIIE Funding Rate and the Compounded TIIE Funding Rate are as follows:

	TIIE	TIIE -F	Compounded TIIE Funding Rate
Nature	Term rate (forward-looking)	Overnight rate (backward-looking)	Term rate (backward-looking)
Tenor	28, 91 or 182 days	1 day	28, 91 or 182 days
Calculation	Bank quotations	Actual interbank market transactions	Actual interbank market transactions
Risk	Includes credit risk	Nearly risk-free	Nearly risk-free
Level	Higher (as it incorporates credit risk)	Lower (as it does not incorporate credit risk)	Lower (as it does not incorporate credit risk)
International Equivalent	US LIBOR, LIBOR, CDOR	Daily Simple SOFR, SOFR Compound, SONIA, CORRA	30, 90 or 180 day Average SOFR

From an economic and regulatory standpoint, benchmark rates incorporating credit risk components, such as traditional TIIE, tend to generate less stable spreads, greater volatility during periods of financial stress and less accurate valuations. In contrast, risk-free rates based on actual executed transactions, such as the TIIE-F or the Compounded TIIE Funding Rate, do not themselves incorporate components such as credit risk, lack of liquidity, operational costs or profit margins, all of which should instead be reflected in the spread or margin agreed upon by the parties.

In light of the foregoing, we recommend reviewing Mexican peso denominated credit agreements, including those entered into between related parties or affiliates, as well as other financial products and instruments referencing traditional TIIE, in order to assess the legal and financial implications and benefits of updating or replacing such benchmark with the TIIE Funding Rate or the Compounded TIIE Funding Rate, incorporating, where appropriate, the corresponding adjustment or fallback mechanisms.