

## Secured Lending 2011 - Mexico

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### 1 Are lenders required to register or be licensed by any government entity to lend to local borrowers?

No, there is no need to be licensed or registered to lend to local borrowers in Mexico. In general any entity or individual, foreign or national, may freely carry out financing activities in Mexico with Mexican borrowers, provided that the resources used on the financing are not raised in Mexico from the public as only banks and other licensed financial entities can raise capital directly. Licences or governmental approvals are generally only required for lenders considered as financial entities such as banks, insurance companies and regulated non-bank financial institutions (*sofomes reguladas*).

However, certain tax benefits (lower withholding rates for interest payments) might be available to foreign lenders that are registered before the registry of foreign banks, financial entities, pension, retirement, and investment funds of the Ministry of Finance.

### 2 Must lenders register or be licensed by a government entity to take a security interest or mortgage on collateral?

No. Lenders do not need registration or a licence from the government to obtain a security interest or mortgage on collateral. A security interest will be created in favour of any lender, either foreign or Mexican, provided that all requirements for the creation and perfection of such security interest have been observed. Certain structures however, such as the industrial mortgages may be only available for Mexican licensed banks and other credit auxiliary entities.

### 3 Are lenders required to register loans made to local borrowers? Are the borrowers required to register the loan?

Generally speaking, unless specifically required owing to the type of collateral, there is no need to register loans made to local borrowers. Registry in any case will not be required for the establishment or perfection of the security interest but to make it effective and valid before third parties and to rank the priority of the loan versus other debt incurred by the same borrower. Therefore, lack of registry of those securities will only affect the priority of the security before third parties, but not their validity before the borrower.

Because of the type of collateral over which the security interest is formed, Mexican law provides that security interests created through:

- *creditos refaccionarios* (special purpose loans to finance the start-up costs of an agricultural or industrial enterprise, usually including the financing of fixed assets such as the purchase of equipment and machinery);
- *creditos de habilitacion y avio* (special purpose loan to finance the continuation of an operating agricultural or industrial enterprise and limited to working capital such as the acquisition of raw materials, salary payments and ordinary business operation costs);
- industrial mortgages (floating lien over all the assets constituting a business, including immovable property, inventory, operational cash and accounts receivable);
- real estate trust; and

- non-possessory pledges must be registered in the appropriate public register office.

### 4 Are there any exchange controls in effect?

No. There are currently no exchange controls in Mexico.

### 5 What taxes apply to foreign lenders or loans?

Interest paid on loans granted by a foreign resident is taxable under title V of the Income Tax Law. Foreign residents with no permanent establishment in Mexico are bound to pay such tax over the interests paid from a source of income in Mexico.

Regarding interests, the law provides that the source of income is located in Mexico when the funds are placed or invested in the country, or when the interest is paid by a Mexican tax resident or by a foreign resident with a permanent establishment in Mexico.

Borrowers making interest payments to foreign lenders must withhold the applicable income tax. Different withholding tax rates apply to foreign lenders, which generally vary from 4.9 per cent to 30 per cent (lenders located in tax havens might be subject to a higher tax rate). Foreign banks registered with the registry of foreign banks, financial entities, pension, retirement and investment funds of the Ministry of Finance are subject, in general, to a 10 per cent withholding tax rate (see question 1).

It is important however, to review the specific tax treaty provisions, if applicable, to determine any additional tax benefit. Likewise, other tax considerations should be considered on the borrower's side such as that for income tax purposes, loans in cash over 600,000 Mexican pesos must be reported by the Mexican borrower to the tax authorities within fifteen days of receipt, otherwise the loan amount is considered accruable income.

### 6 Are there any financial-assistance restrictions or other special considerations regarding the provision of guarantees by a local subsidiary of a borrower?

Essentially, there are no restrictions on financial assistance in Mexico and guarantees issued by a company to support its parent company's obligations would be generally valid in Mexico. In fact, it is typical under cross-border financing that Mexican subsidiaries are often required to give upstream guarantees to support loans made to their parent companies and as long as certain formalities are followed, such as making sure the by-laws specifically allow for the guarantee to be provided, an upstream guarantee is generally valid. However, lenders should be cautious and bear in mind that fair consideration to the subsidiary providing the guarantee and that the transactions are made on arm's length terms are relevant issues to consider for tax reasons as well as within insolvency and bankruptcy scenarios. Granting of a guarantee by a subsidiary gratuitously and without any corporate benefit or consideration may be deemed a fraudulent transfer by a bankruptcy court if granted within 270 calendar days preceding the insolvency declaration of the subsidiary. In this event the guarantee might

be considered void. In addition, when possible, it is important for lenders to obtain the guarantee from a bankruptcy remote subsidiary to avoid risks of a substantive consolidation if the parent company goes into bankruptcy. Trusts and other structures and strategies are available to minimise this risk and should be evaluated on a case-by-case basis by local counsel.

### 7 What are the principal types of security interests available to lenders in your jurisdiction for security interests over stock, real property, personal property, receivables or bank accounts? Are certain structures more preferable?

There are different alternatives available for lenders in Mexico for structuring a security package. Different options may apply upon the nature of the asset and often times more than one type of asset (eg, stock and assets) are involved.

#### Mortgage

A right in rem is generally granted over real property (standard real estate mortgage) but can also be applicable to certain moveable assets (such as vessels and aircraft) or to a combination of both types of property (as in the industrial mortgage mentioned above). The purpose of a mortgage is to secure the performance of an obligation and its priority for payment; if a default occurs, the creditor can judicially request foreclosure over the collateral and get paid from the proceeds derived from the sale of the asset.

#### Pledge

A pledge is another type of right in rem normally granted over all types of rights and moveable property such as shares, equipment, negotiable instruments and accounts receivable. The purpose of a pledge is to secure the performance of an obligation and its priority for payment; if a default occurs, the creditor can judicially request foreclosure over the pledged asset and get paid from the proceeds derived from the sale of the asset. Pledges can be either possessory or non-possessory:

- Possessory pledge – the pledgor is dispossessed of the asset by the lender to guarantee the performance of the obligation.
- Non-possessory pledge – the borrower maintains possession and operation of the pledged asset. This is a very useful vehicle for the creation of floating liens over assets for which possession and operation should remain with the borrower, as in those cases where the pledge covers the entire assets of the borrower's enterprise.

#### Guarantee trust

As one of the most flexible vehicles available under Mexican law, when used as a guarantee device, the guarantee trust can be used to secure payment of an obligation by transferring into the trust all types of assets (real property, moveable assets and rights). Through the guarantee trust agreement the borrower (settlor) transfers title to a trustee in order to secure payment and priority of an obligation. Should a default occur the lender (beneficiary of the trust) can foreclose over the collateral by requesting the trustee to execute the trust's assets to pay the outstanding debt. For tax purposes, to the extent that the borrower conserves the right of recovering the assets transferred to the trust no tax impact will occur on such transfer.

#### *Credito refaccionario* and *credito de habilitación o avio*

As mentioned earlier these two types of special purpose loans can only be used for production and specific business purposes. *Creditos refaccionarios* are usually granted to the borrower to finance the purchase of fixed assets such as equipment, land, instruments or other materials to start operating a farm or business. Through this credit facility a statutory security interest would be automatically created over the acquired assets to secure payments to the lender. *Creditos de habilitación y avio* are usually granted to finance working capital necessary for the continuation of an operating agricultural or industrial enterprise. As in the *refaccionario* credit facilities, a statutory security interest would be automatically created over the assets acquired from the proceeds to secure payments to the lender.

#### Personal guarantee or commercial bond

A personal guarantee granted by a third party (guarantor) contains a promise to pay or perform an obligation in the event of non-fulfilment of an obligation by an obligor under an agreement. When granted by a licensed bonding company it is called a bond.

#### Aval

An *aval* is a personal guarantee granted by a third party (guarantor) comprising a promise to pay a negotiable instrument on its due date in case of default by the drawer. The guarantor is to be considered jointly and severally liable with the obligor and the creditor may collect payment directly from the guarantor without exercising its rights against the obligor.

A decision on which structure or security vehicle should be used requires an analysis on a case-by-case basis. In general such study would take into account the size of the financing and the type of assets available as collateral. For instance, although guarantee trusts have proved to be a very effective vehicle, their costs are considerably higher than other security options; thus, use of a possessory pledge over certain assets may be more cost-effective than a guarantee trust while at the same time the opposite could be true under a different scenario.

### 8 Is title insurance available?

Yes, it has been available since from 2001, when the Mexican subsidiary of Stewart Title Guaranty Company was incorporated and became the first insurance company specially devoted to offering admitted title insurance in Mexico, both for lenders and real estate owners. Since that date, other players such as LandAmerica Title Insurance Company and Fidelity National Title also incorporated licensed subsidiaries in Mexico, with the latter recently (2009) acquiring the entire business portfolio of the former (now in a winding-up process) as part of the market consolidation. It is important to mention that in general, unless some exception may apply, non-admitted insurance purchased to cover risks located in Mexico sold by unlicensed insurance companies are null and void.

### 9 How are security interests created, perfected and terminated?

#### Mortgage

Mortgages are always created in writing. Mortgages securing debt over a threshold amount of approximately US\$1,600 must be notarised. As mentioned in question 3 there is generally no need to register a mortgage for its perfection; however, for the security to be valid and preferential before third parties, it needs to be registered in the appropriate public registry. It would normally terminate in the event of:

- the collateral disappearing;
- the secured debt being terminated or repaid;
- expiry of the debtor's right over the collateral;
- expropriation;
- debt remission;
- foreclosure; and
- prescription by statute of limitations.

#### Pledge

Pledges are always created in writing. Perfection of a pledge varies upon the type of pledge (possessory or non-possessory) and the kind of assets to be pledged. In general, the expiration of the underlying debt secured by a pledge will also cause the pledge to be terminated.

A possessory pledge may be perfected by delivery of bearer instruments or goods to the creditor; endorsement of negotiable instruments in favour of the creditor and also by recording the pledge in the corporate ledger of the debtor in the case of nominative negotiable instruments (shares, for example); by delivery of bearer instruments or goods to a third party; or by delivery of non-negotiable instruments and notice to the creditor, when applicable; the pledge requires recording in the case of *refaccionario* or *avio* credit facilities.

Non-possessory pledges securing debt over a threshold amount of approximately US\$85,000 must be notarised. As mentioned in question 3 there is gen-

erally no need to register a non-possessory pledge for its perfection; however, for the security to be effective and preferential before third parties it needs to be registered in the appropriate public registry of commerce.

#### Guarantee trust

Such trusts are always created in writing. Guarantee trusts over immovable property must be notarised and recorded in the corresponding public registry of property; trusts over moveables securing debt over a threshold amount of approximately US\$85,000 must be notarised.

A guarantee trust would normally terminate:

- if its purpose is completed;
- if it becomes impossible;
- upon written agreement between the parties;
- if it was created to accomplish fraudulent transfers;
- upon lack of payment of the trustee's fees;
- upon foreclosure; and
- upon expiration of the underlying debt.

#### *Credito refaccionario and credito de habilitación o avio*

These are always created in writing. As mentioned before there is generally no need to register these credit facilities for perfection; however, for the security to be valid and preferential before third parties it needs to be registered in the appropriate public registry of commerce. There are no special considerations for its termination.

#### Bond

Bonds must be in writing when granted by a bonding company (financial institution) but such requirement is no longer needed when a bond is granted by an entity or an individual (however, it is advisable to have it executed in writing). There are no special considerations for its perfection or termination.

#### Aval

An *aval* must be in writing and written into the negotiable instrument. There are no special considerations for its perfection or termination.

### 10 What are the formalities of execution for local security documents? Are proceedings before a notary required, or may pledges be executed extraterritorially?

In addition to the considerations mentioned in question 9, some other formalities exist. Individuals executing security documents on behalf of the borrower require sufficient and specific authority to grant a security interest over the borrower's assets. Different powers of attorney should be granted depending on the type of assets to be secured as collateral; for instance, security vehicles involving negotiable instruments require different authority from those involving immovable property and should be reviewed case by case, considering both the types of assets and security to be granted and whether such powers of attorney were granted locally or not. In addition to having sufficient authority, in the event that security documents are being executed by foreign signatories in Mexico certain requirements under Mexican immigration laws should be considered. In general, powers of attorney granted abroad will be valid in Mexico, but it shall be noted that in order to duly render their legal effects in Mexico, powers of attorney granted abroad shall comply with several substantive and formal provisions arising from Mexican Law. Mexico is a signatory of the Protocol on Uniformity of Powers of Attorney to be Used Abroad of the Pan-American Union, also known as the Washington Protocol of 1940. Also, powers of attorney executed and notarised in countries that are signatories to The Hague Convention Abolishing the Requirement of Legalisation for Foreign Public Documents, do not have to be legalised for use in Mexico if they bear the 'apostille'.

Likewise, certain rules for perfecting the security interest should be followed (for instance real estate mortgages over a threshold amount should be granted before a notary public), as described above, thus, limiting the possibility of executing security documents extraterritorially as notary publics may only act within their territorial limits. However, even in those cases where the pres-

ence of a notary public is not required it is uncommon for security documents to be executed abroad as formal requirements under Mexican laws need to be followed in order to guarantee enforcement of the security interest.

### 11 How are security interests recorded? Are lien searches available to determine the existence of other liens?

Security interests are generally recorded as follows:

- real estate mortgage – the notarised document containing the mortgage is registered in the appropriate public registry of property;
- vessels and aircraft mortgages – the notarised document containing the mortgage is registered in the maritime public registry or the civil aircraft registry;
- pledge – the pledge is registered in the public registry of commerce;
- guarantee trust – the notarised document containing the real estate transferred to the trust is registered in the appropriate public registry of property;
- *credito refaccionario* and *credito de habilitación o avio* – the document containing the secured assets should be recorded in the appropriate public registry of commerce; and
- lien searches are available on all kinds of public registries and lenders may also have access to private credit bureaus where positive and negative data from firms and individuals will be available.

In addition, last year several legal provisions were amended and included into the Commerce Code for the creation of the Registry of Security Interest on Moveable Goods (Registro Unico de Garantias Mobiliarias) as part of the Public Registry of Commerce. While this new registry is not yet in effect (it is planned to start operating in August 2010), it will surely become an important tool for lenders and facilitate both lien searches on moveable property and transparency with respect to the priority of the credit and the identity of the collateral. While the regulations pertaining to this new section of the public registry of commerce have not been issued yet, its operation is intended to be fully automatic and generate immediate filing and registry reports by digital means, therefore avoiding current delays caused by the participation of government officials in the registration process. Officers from the Ministry of Economy, judges and public and commercial notaries will carry out filings into this registry directly.

### 12 What are the registration or recordation fees and taxes applicable to taking a security interest over assets?

Registration, recording fees and notarial fees vary from state to state and in some states registration duties are based on the value of secured labels. In addition, some filing offices recognise a cap on the filing fee while others do not. Because of this variety, it is not uncommon that registration fees for the same transaction may vary significantly from one state to other; in those cases changing the borrower's domicile may be a relatively easy and quick solution to take advantage of jurisdictions on which recording fees are capped. In any event, lenders and counsel should evaluate this impact at an early stage in order to avoid last-minute delays. With respect to taxes, in general stamp or other duties are not payable, federal income taxes will only be caused if the granting of the security interests is deemed a transfer for tax purposes and some local taxes may also be applicable. In any event an evaluation should be made on a case-by-case basis.

### 13 How is a security interest enforced?

Security interests in Mexico are enforced by means of a judgment issued or recognised (in case of foreign sentences or arbitral awards) by the proper court. As an exception, a non-judiciary proceeding is available to enforce security interests granted through a non-possessory pledge or a guarantee trust, pursuant to the out-of-court procedure provided in articles 1414 bis to 1414 bis 6 of the Federal Commercial Code. This procedure, obviously intended to facilitate foreclosure over the collateral, might end up also being resolved in court if any of the parties does not comply with the terms of the non-judiciary proceeding.

Regarding the judiciary proceedings, Mexican law provides that once a final judgment is considered *res judicata*, the security interest will be subject to a public judicial sale in the form of a public bid to pay the creditor with the sale

proceedings. If no interested bidders appear, the security interest's property may be transferred directly to the creditor.

#### 14 How are foreign judgments enforced?

A final judgment issued by a foreign court can be recognised by Mexican courts without the need of re-examination of the merits of the case if:

- it is obtained in compliance with the legal requirements provided in the international treaties to which Mexico is a party regarding letters rogatory, and in compliance with all legal requirements of the loan agreement;
- it is strictly for the payment of a certain sum of money, based on in personam (as opposed to in rem) action;
- the judge or court rendering the judgment was competent to hear and judge the subject matter of the case in accordance with accepted principles of international law that are compatible with Mexican law;
- service of process is made personally on the defendant (to ensure due process);
- it does not contravene Mexican Law, public policy of Mexico, international treaties or agreements binding upon Mexico or generally accepted principles of international law;
- the applicable procedure under the laws of Mexico with respect to the enforcement of foreign judgments (including the issuance of a letter rogatory by the competent authority of the jurisdiction requesting enforcement of judgment, the certification of the firm judgment as authentic by the corresponding authorities of such jurisdiction in accordance with the laws thereof) is complied with;
- the action in respect of which such judgment is rendered is not the subject matter of a lawsuit involving the same subject matter among the same parties, pending before a Mexican court;
- it is final in the jurisdiction where obtained;
- the courts of such jurisdiction recognise the principles of reciprocity in connection with the enforcement of Mexican judgments in such jurisdiction; and
- it fulfils the requirements to be considered authentic.

If a foreign judgment meets all of the above-referred requirements, the Mexican judicial authority can perform the public bid mentioned in the last paragraph of our response to question 13.

Likewise, Mexico is a signatory party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and internally enacted in the Commercial Code legal provisions pursuant to the 1985 UNCITRAL Model Law on International Commercial Arbitration in order to guarantee enforcement and recognition of foreign arbitral awards. As in the case of foreign court rulings, a Mexican court will not review the merits of the case and will consider valid and enforceable an arbitral award issued abroad. The party seeking enforcement need only to provide certified translations into Spanish, as the case may be, of the following:

- a certified copy of the arbitral award; and
- an original of the agreement on which arbitration was agreed by the parties.

Mexican courts may only deny enforcement to an arbitral award if: due process formalities were not followed; it relates to a matter that may not be subject to arbitration pursuant to Mexican laws; or it contravenes public policy.

#### 15 Is the access of foreigners to local courts restricted in any way? Is a New York loan agreement, or other agreement governed by foreign laws, enforceable in local courts? What steps (other than translation) must be taken prior to seeking enforcement locally of such an agreement?

Access of foreigners to local courts is not restricted in any way. Foreigners are granted the same access to court as Mexican nationals as a constitutional right.

A New York loan agreement or any other agreement governed by foreign laws is fully enforceable in Mexican courts unless it violates public policy or international comity.

All applicable requirements are listed in our response to question 14.

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