CLIENT UPDATE

PROPOSED AMENDMENTS TO FINANCIAL LAWS

On May 8, 2013, President Enrique Peña Nieto submitted to the Mexican Congress a proposal to amend various Mexican financial laws.

The proposed reform's objectives include increasing the volume of credit by both Government-owned development banks and private banks, fostering innovation and competition in financial markets, and strengthening capital adequacy and regulatory requirements in the post-crisis regulatory reform environment.

The following are highlights of the proposed amendments:

- Mexican Government-owned development banks will enjoy added flexibility to determine rates, credit terms and credit risk control measures.
- The Mexican Federal Mortgage Corporation (*Sociedad Hipotecaria Federal*) will enjoy the guarantee of the Federal Government.
- The proposal seeks to simplify procedures and reduce costs involved in the assignment of secured loans, and in the foreclosure upon collateral.
- A number of proposed changes seek to foster competition and innovation in Mexican capital markets, including amendments to foster development of investment funds, public offerings directed at specific segments of the investing public, and flexibility in the design of new types of securities.
- An amended and restated Financial Groups Act will permit a greater degree of flexibility in permissible investments by holding companies and distribution of products and services by operating companies.
- The proposal confirms a number of steps taken since the 2008 crisis to ensure that the government-led backing of the financial system does not encourage irresponsible risk-taking.
- Providers of financial products will face increasing regulatory, supervisory, and enforcement requirements from many quarters including Banco de México (Mexico's Central Bank), the National Banking and Securities Commission and the National Consumer Financial Services Protection Commission.

Consumer Finance Enforcement and Regulatory Developments

The regulatory, supervisory and enforcement powers of the twelve-year-old National Consumer Financial Services Protection Commission ("CONDUSEF") are strengthened with respect to providers of consumer financial products and services.

CONDUSEF is empowered to review standard contract and transaction slip forms. CONDUSEF may stop the use of "abusive" provisions in such forms. Implementing regulations should define the meaning of the term "abusive". Such regulations should also define activities which are deemed to be considered at variance with sound financial practices.

CONDUSEF shall supervise the creation of specialized consumer attention units to be created or reorganized, as appropriate, by financial institutions. A new system of arbitration in financial matters is to be created with the coordination of CONDUSEF.

Requirements to transfer consumer loans from one provider to another are eased, to allow consumers to more easily benefit from better conditions arising in the market.

A Bureau of Financial Institutions is proposed to be created by CONDUSEF, for purposes of allowing consumers to keep abreast of service records (for example, records of consumer complaints) by providers so as to promote informed decision making by consumers.

CONDUSEF may request other regulators to consider adopting actions to strengthen consumer protection measures in their jurisdiction. The proposal confirms the power of the Federal Competition Commission, to impose sanctions in connection with unfair practices relating to fixing of interest rates.

There is likely to be a regulatory focus on debt collection practices, debt sales, credit reporting , and payday and deposit advance products.

Consumer Finance Intermediaries

The proposal seeks to provide flexibility with respect to the mechanisms to achieve capital adequacy, and operational requirements of small and medium-size consumer finance intermediaries, including among others, savings and loans institutions and credit unions.

Mexican Development Banks

The proposal seeks to provide Mexican Government-owned development banks with added flexibility to determine rates, credit terms and credit risk control measures. Development banks also would be empowered under the proposal to invest in both, domestic and foreign affiliates whose main activities coincide with those of the relevant development bank.

In a significant reassessment of Federal Government policy followed between 2002 and the present time, the proposal states that obligations undertaken by the Mexican Federal Mortgage Corporation (*Sociedad Hipotecaria Federal*) would enjoy the guarantee of the Federal Government. This is aimed at facilitating the availability of funding to, as well as the securing of better funding terms by, the Corporation. The Federal Mortgage Corporation is a corporation chartered by Congress, whose mission is to promote stability and affordability in the housing market by financing mortgages from banks and other non-bank lenders.

Secured Transactions

The proposal seeks to simplify and shorten legal proceedings to foreclose upon collateral in secured transactions. In particular, there is a simplification of procedures for attachment of goods. In case of lack of qualified bids in a court-ordered auction sale, the creditor may obtain a transfer of the goods being auctioned at 2/3 of the court-approved sales price. A pledgee of a cash pledge may foreclose upon and adjudicate the pledged funds without a need to follow execution proceedings before a court.

A new type of federal court specialized in commercial matters is proposed to be created. Such courts would hear (i) bankruptcy proceedings, (ii) commercial suits (where the plaintiff elects to sue before federal rather than local courts), (iii) recognition and enforcement of domestic and foreign arbitral awards, and annulment of arbitral awards when arbitration is conducted in Mexico, and (iv) certain types of commercial class action suits.

Bankruptcy

The proposal permits a corporation whose insolvency is deemed to be imminent to file a petition for bankruptcy 90 days before the date on which it reasonably believes it will become insolvent.

Bankruptcy courts are proposed to be granted discretion to expand the "date of retroactivity" (i.e., the date preceding the date of bankruptcy to which the effects of bankruptcy are deemed to apply) beyond the 270 days prescribed as a general rule under the bankruptcy statute.

Affiliate companies may file for joint bankruptcy proceedings.

The proposal provides that trust assets must be separated from the bankruptcy proceedings, including those of a bankrupt settlor corporation, in the absence of a fraudulent transfer.

Bonded Warehouses and Multiple Purpose Financial Corporations

The proposal seeks to create a federal registry where bonded warehouses must register all (i) deposit certificates and deposit slips, (ii) underlying goods, (iii) deposit facilities, and (iv) certain transactions required under applicable regulations. Such federal registry would replace the existing registries kept by each bonded warehouse.

Multiple purpose financial corporations (i.e., corporations authorized to grant financing in connection with specific fields of economic activity) are required to be registered with CONDUSEF.

Resolution of Banks

Mexico adopted from its inception the Basel III capital framework. The proposal continues with the trend of Mexican regulations to raise the required capital ratios and narrow what constitutes capital, so as to increase local capital and liquidity.

The proposal seeks to achieve a harmonized set of rules to implement preventive and corrective actions, bank resolutions and structural reform measures to address too-big to fail concerns, including potential measures for the separation of activities into different legal entities and for increased local capital and liquidity.

The proposal establishes certain principles to govern bank resolutions in Mexico. The first principle is recognition of write-down and bail-in as tools to facilitate the prompt recapitalization of a failing bank or successor bridge institution. The second principle is that shareholders and unsecured creditors would be required to bear losses before public funds are injected into the resolution process. Only after these private sources of recapitalization are used would there be recourse to funds of the Federal Institute for the Protection of Banking Savings (the federal deposit insurance entity) and Bank of Mexico (Mexico's Central Bank), in the form of bridge loans in case of the latter.

The proposal defines stress testing requirements for banks, combined with a requirement to conduct the stress tests once every year. Banks would be required to calculate risk weights under the Basel framework, and apply the relevant calculation when evaluating capital adequacy. Preventive measures would be required to be implemented rapidly, to achieve a satisfactory capital adequacy level. Should such measures fail to be effectively implemented, corrective measures should follow, including definition and implementation of a recapitalization plan, a prohibition to declare dividends, a suspension of share repurchase plans, a mandatory conversion of subordinated debentures, and a suspension in payment of bonus and other extraordinary compensation to management.

Should corrective measures fail to be effectively implemented, the Federal Institute for the Protection of Banking Savings is granted ample powers to design the best method for resolution of a bank, with the concurrence of the National Banking and Securities Commission, which may include resolution and liquidation of the relevant bank or reorganization of the bank to function during a conditional period, after which the bank may continue operating with lesser controls or may be altogether liquidated.

The approval of the Banking Stability Board is required in respect to a plan for resolution of a systemically important banking institution.

Investment Funds

The proposal seeks to simplify the requirements for incorporation, merger, dissolution and functioning of investment companies. While such objective makes sense to allow a more flexible regime in the operations of investment companies, some cosmetic changes would appear to be unnecessary. Investment companies are proposed to be renamed as investment funds. Some definitions which appear in other leading statutes such as the definition of "securities", are unnecessarily defined in the proposal, which may lead to confusion and problems of interpretation in certain scenarios. One hopes that Congress will streamline the proposal so as to avoid cosmetic changes and repetitive definitions.

According to the proposal, the renamed investment funds can be incorporated by a sole shareholder which will be normally be the operating company of the investment fund (rather than by a minimum of two shareholders as required under Mexican corporate law). The operating company shall adopt resolutions that would normally pertain to the shareholders' meeting or the board of directors, as appropriate, of a corporation. Shareholders different from the operating company of the investment fund, shall enjoy the economic benefits of the fund's operations, but will not participate in the regular decision-making processes of the same.

The proposal seeks to strengthen the rules for performance and accountability of service providers of investment funds, such as operating companies, distribution companies and valuation companies.

Capital Markets

A new type of public offering directed to a limited type of offerees is contemplated under the proposal.

The conversion of an investment promotion stock corporation (an intermediate vehicle, before a corporation converts into a listed corporation) to a listed corporation is proposed to be made under a more flexible timetable, to be achieved in 10 years or at the time equity reaches the equivalent of 250 million "investment units" (equivalent at present to US$ 94 million), whichever occurs earlier.

The proposal seeks to regulate in an explicit manner a type of trust certificates developed by market practice which permit the trustee to invest in securities, real estate or real estate trust certificates and securities markets indices. Calls for additional capital can be made to holders of such trust certificates.

A registry of offerings made abroad, of securities issued either in Mexico or by Mexican issuers, is proposed to be created.

Issuers are required to maintain a registry of persons with access to information relating to relevant events of the issuer during a period of five years following the date of access to related information by such persons.

The proposal seeks to regulate investment advisors for the first time. An investment advisor would be a person that regularly provides discretionary portfolio management services and advisory services. Investment advisors would be required to register with the National Banking and Securities Commission and comply with implementing regulations to be issued by the same.

Banco de México

The regulatory, surveillance and inspection powers of Banco de México (Mexico's Central Bank) are proposed to be expanded.

Banco de México's expanded regulatory powers would include the power to issue regulations with respect to (i) monetary and exchange policy, (ii) development of financial markets, (iii) payment systems, and (iv) public interest protection.

The proposal seeks to expand Banco de México's surveillance and inspection powers with respect to banks and certain designated non-bank entities.

Violations of applicable regulations can be made subject to fines for an amount up to 5% of paid-in capital of institutions in breach of the same.

Financial Groups Act

The proposal seeks to amend and restate in its entirety the Financial Groups Act.

In 1990, the Mexican Congress passed the Financial Groups Act, pursuant to which banks, securities firms and non-banking financial institutions may become affiliated through common ownership under a single holding company and may offer supplementary services to the public. Although the separation and specialization of services between banks and non-banking financial intermediaries is maintained, the subsidiaries of financial groups are able to provide combined and supplementary services to the public.

Financial groups may be formed by a holding company and the following subsidiaries: (i) banks; (ii) brokerage firms; (iii) insurance or bonding companies; (iv) auxiliary credit organizations; (v) investment fund operating companies; (vi) companies that distribute shares of investment funds; (vii) operating companies of investment funds that invest pension funds; (viii) multiple purpose financial corporations; and (ix) micro-finance corporations. A financial group must be comprised of no less than two of the above-mentioned subsidiaries, which may belong to the same type with the exclusion of multiple purpose financial corporations.

The holding company of a financial group is required to own no less than 50% of the ordinary or voting portion of the capital stock of its subsidiaries, and may invest in less than 50% of the capital stock of affiliated companies, not controlled by the holding company.

In order to foster the diversification of ownership, the Financial Groups Act establishes as a general rule that no more than 5 percent of the capital stock of a holding company may be

owned by a single stockholder, unless a higher percentage is authorized by the Ministry of Finance. The Ministry of Finance has discretionary power to authorize the ownership of 20 percent or more of their capital stock by a given stockholder or group of related stockholders, with the previous favorable opinion of Banco de México and the lead regulatory commission. The 20 percent diversification limit does not apply to foreign financial institutions under certain treaties including among others, NAFTA and the Treaty with the European Union. Certain foreign investors, including U.S., Canadian and European financial institutions may invest in up to 100 percent of the capital of a holding company of a financial group.

The proposal introduces welcomed flexibility. Specifically, foreign governments will be allowed to participate in the capital stock of holding companies of financial groups in connection with (a) temporary support capitalization programs, and (b) investments made by government trust funds provided the same (i) do not act as a government, (ii) have decision-making bodies independent from the relevant foreign government, and (iii) the government trust fund would not control the holding company. Mirror provisions are established in the proposal in respect to banks.

The Financial Groups Act contains rules for permissible investments by the holding company and the operating companies of financial groups. Basically, the holding company may invest in the capital stock of permitted subsidiaries and permitted affiliates, in shares issued by real estate companies and other corporations destined to provide services to the operating companies of the financial group, in no less than 99% of the capital stock of sub-holding companies and in foreign financial institutions.

The Financial Groups Act establishes rules to assure the financial and operational separation of the members of the group, to prohibit intrusion by one of them into areas reserved to others, and to prevent a commingling of funds among them. The holding company must adopt regulations to avoid conflicts of interest among subsidiaries of the group, prevent the improper use of confidential information and ensure that transactions among them are carried out on arms' length basis. The holding company may not grant credit, repurchase its own shares (unless it obtains the prior approval of the Ministry of Finance) or conduct financial activities reserved to operating companies of the group. Specific rules regulate transactions executed by brokerage firms or banks for the account of third parties with securities issued by members of the financial group to which they belong.

The proposal establishes that subsidiaries of the group may market related products or services manufactured or rendered by companies which are not affiliated with the group, provided the identity of the producer is conspicuously identified in marketing materials distributed to the public.

In order to increase the prospect for continuing financial stability of each member of a group, the Financial Groups Act requires that a guaranty agreement be executed between the holding company and each subsidiary of the group pursuant to which the holding company must guarantee the obligations of each subsidiary vis-a-vis third parties.

The by-laws of the holding company may (i) include restrictions on the transfer of shares, provided the same do not bar the acquisition of control, (ii) include mechanisms to resolve disputes between shareholders and (iii) limit responsibility of management and directors, within reason.

The board of directors of a holding company is required to appoint an audit and a corporate governance committee, which shall be comprised of independent directors.

The National Banking and Securities Commission, the National Insurance and Bonding Commission and the National Retirement Savings Systems Commission may issue regulations to deal on a consolidated basis with (i) solvency, (ii) risks, (iii) internal controls and (iv) disclosure requirements.

In case of financial trouble by the holding company, the Federal Institute for the Protection of Banking Savings may lend funds to the holding company secured by a lien on its shares, or may invest in its capital stock, in order to bring its financial position within acceptable parameters. A number of preventive and corrective measures are included in the Financial Groups Act.

Serious violations to the rules governing organization and operation of financial groups may cause cancellation of its authorization to operate as such by the Ministry of Finance.

The proposal seeks to strengthen civil and criminal liabilities.

Secured Loans

The proposal seeks to simplify procedures and reduce costs involved in the assignment of certain secured loans.

In sum, secured loans can be assigned, while maintaining the original security and the priority of payment of the respective loan. In those instances in which the assignor is a bank, a multiple purpose financial corporation or one of the government-owned lending institutions, the steps to perfect the assignment are simplified and streamlined.

In order to perfect an assignment, it is sufficient to obtain (i) a certificate of amounts owed, (ii) evidence of payment to the assignor, (iii) registration of the assignment by electronic means in the relevant public registry, and (iv) registration in the relevant public registry of property in respect to mortgages.

The proposal establishes that the Federal Government shall enter into coordination agreements with state governments, so that there will be no registration fees, or these shall be kept to a minimum, in connection with registration at local registries of property. One hopes that such coordination will be promptly put into place, so as to reduce related expenses to a minimum and allow debtors to benefit from assignments of debt to those lenders offering better terms in the market.

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Please do not hesitate to contact us with any questions.

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November 15, 2013