

Secured Lending in Mexico: What's New

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What is the state of secured lending today in Mexico? Can banks lend on a secured basis, and if so, how? If things go wrong with the borrower, can you enforce and collect quickly and efficiently? While these complicated questions require separate answers depending on the type of loan and specific situation, these issues will be addressed by setting out the current landscape and providing an overview of current practices.

Historically, banks and other corporate lenders have taken a very cautious approach to lending in Mexico and this cautiousness continues today among U.S. and international lenders. Mexico has one of the lowest rates of corporate borrowing in the world. Mexico registered 26 percent of debt as a proportion of GDP during 2008, which is quite low compared to its peers in the region, such as Argentina (73 percent), Brazil (34 percent), Chile (52 percent) and the U.S. (65 percent).²

There are many specific reasons why lenders avoid doing business south of the U.S. border, but most relate to risk assessment. Some will relate to currency risk, as Mexico has in the past suffered major currency corrections. Others relate to the cultural or business risks. While Mexico was able to put one era of crime-related poverty and development into its past, it now continues to struggle with a drug war that provides consistent and unfortunately highly dramatic content for the world's press. There is also a cultural leaning in the Mexican business community to stay away from debt. Many company owners simply choose not to leverage their businesses as much as their foreign competitors, despite financial opportunities that leverage presents.

However, the key driver to this avoidance of debt may be that while it is possible to obtain mortgages and guarantees as well as other forms of security in Mexico, it has been extremely difficult to enforce on this security and realize the expected value. Historically,

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difficulties in security enforcement arise because in addition to the higher complexity (and cost) of the securitization process, secured lenders have to deal with potentially long and protracted litigation that sometimes takes several years. In the meantime, the value of the assets diminish.

Over the past 10 years, progress has been made. Not only has Mexico updated its insolvency law, the *Ley de Concursos Mercantiles* (LCM), but it has amended its negotiable instruments law, the *Ley General de Títulos y Operaciones de Crédito* (LGTOC), to simplify the pledge and the guaranty trust.

Options Available

While it may be more difficult than in other jurisdictions, lenders (local and foreign) can lend on a secured basis in

cated on the quality of the often-complex documentation required to support these loans.

When Things Go Wrong

What has kept people out of Mexico's market is this downside fear: "If things go south, even if I have security, I will never be able to realize on it!" How do banks and lenders address that today? A good start is making sure you understand the processes and have all of the most current, reliable legal and financial information so that you are able to move quickly and aggressively to act on your rights.

Prior to triggering legal action against the debtor, it is very important to know the status of your security—especially in the case of pledges on movable property and rights—to ensure that it is still in the debtor's possession. This, along with having all information available on the debtor's financial situation, will help focus the discussions with the debtor and legal counsel to define the best course of action.

Latin America Update

Mexico today. The laws provide for a lenders' ability to register its security and to enforce it. The most common forms of security taken are mortgages on real property, industrial mortgages on industrial facilities, and rights and pledges on movable property including collection rights. While security for property, fixed assets, shares and other long-lived assets remain in place for the life of the loan unless a restructuring occurs, security over revolving assets such as accounts receivable and inventory needs to be updated continuously as the specific assets change.

As a result, asset-based lending structures are not as common in Mexico, though the last decade has seen new legal structures put in place to allow lenders to more easily obtain security over revolving assets. These structures include "pledges without dispossession" and "security trusts,"³ the latter of which has not been well accepted in the market. As always, and regardless of the jurisdiction, much of the success of the credit will be predi-

The law in Mexico allows lenders to initiate legal actions to recover the security as soon as a default occurs. However, there are various provisions under which your rights to enforce may expire as early as 180 days after a default. It is extremely important to closely monitor the status of both the borrower and the collateral to ensure that required and prompt action is taken in the case of the default.

Taking enforcement action in Mexico is also not as efficient as it may be in other jurisdictions. Legal enforcement proceedings can be lengthy and cumbersome due to both the structural and cultural aspects of the Mexican legal system. Secured creditors are forced to file suit, serve notice, attach assets and continue legal proceedings for months or years, during which time the creditor may not sell the attached assets.⁴ This applies only if the borrower made and delivered a promissory note or other negotiable instrument to creditor. Without a

¹ The authors thank Gustavo Brauer for his specific assistance in the area of the Concurso Mercantil and other legal issues.

² Banxico, J.P. Morgan Economics and Economic Intelligence Unit (all 2008).

³ *Prenda sin desposesión and fideicomiso de garantía.*

⁴ There are some provisions made to accelerate the process for perishable goods.

continued on page 57

Latin America Update: An Update on Secured Lending in Mexico

from page 36

negotiable instrument, a motion for the attachment of assets may only be filed in court once the creditor has a favorable final judicial award and tries to enforce it, and the borrower does not pay voluntarily.

Bankruptcy

In a worst-case scenario, either the creditor or borrower may make use of the LCM to liquidate the borrower's assets and distribute the sale proceeds. The LCM is a federal law that applies throughout Mexico,⁵ and there are no state or local bankruptcy laws. The LCM regulates bankruptcy proceedings of business organizations and individuals that are considered to be merchants under Mexican commercial laws (generally referred to as "merchants"). The LCM is not applicable to personal bankruptcies of farmers, fishermen, *et al.*

⁵ The LCM has a specific section (Title Twelfth) that contains provisions regarding international cooperation in cross-border bankruptcies, similar to title 11, chapter 15 of the U.S. Code, but for practical purposes, the reader should consider that there is where similarities end, and should approach bankruptcies in Mexico as they are regulated by Mexican laws without trying to apply other legal provisions or interpretations.

While the LCM recognizes the rights of secured creditors in advance of general unsecured creditors, there are numerous other creditors who are given priority over secured debts. Specifically, in Mexico, labor laws provide that workers do not need to participate in bankruptcy proceedings.

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By law, each worker is entitled to payment in full of all wages accrued, plus severance pay, which in Mexico (subject to a plethora of variables not discussed in this article) is generally equal to three months' salary, plus 20 days' salary per year, plus 12 additional days' salary per year after the 15th year of employment.

This also means that if a worker (or a group of workers) sues the employer and obtains a final favorable judicial award, such worker(s) would be entitled to collect in full, notwithstanding that the employer is in bankruptcy, or that other workers in the company could have rights too. In fact, a worker enforcing a substantial judicial award could deplete the employer of all assets, and other workers or secured creditors obtaining final favorable judicial awards would get nothing.

Conclusion

Secured lending in Mexico carries similar risks as it does in other countries, albeit perhaps with higher risk due to potential difficulties regarding enforcement. As in any jurisdiction, secured lenders (or any lenders) need to focus on ensuring that they obtain proper legal documentation of all agreements, need to closely monitor the debtor and any security provided, and be vigilant to ensure that action is taken at the first sign of trouble. ■

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