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## The Special Position of Mexican Banks in the Execution and Enforcement of Financial Agreements

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# THE SPECIAL POSITION OF MEXICAN BANKS IN THE EXECUTION AND ENFORCEMENT OF FINANCIAL AGREEMENTS<sup>1</sup>

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Christopher P. Bauman: The next speakers are refugees from the Cleary Gottlieb firm, which you are quick to learn if you are around them for five minutes or more. Lic. Agustín Berdeja-Prieto is someone who I consider to be a very good friend of mine. He founded Berdeja y Asociados back in 1987, when he was about 21 or 22 years old, right? He also practiced in New York. He is a member of several organizations. He graduated from the Iberoamericana and also has an L.L.M. from Harvard.

In addition we have with us Mike Lubrano, who is with International Finance Corporation. He is Senior Securities Market Specialist in the Financial Markets Advisory Department. The International Finance Corporation is the private sector investment affiliate of the World Bank. He has worked both in New York and in Mexico City with very prominent law firms. He publishes frequently. He has degrees from Princeton, NYU and Harvard. Messrs. Berdeja and Lubrano will speak to us this afternoon on the role of Mexican banks in the execution and enforcement of financial agreements.

BERDEJA: Before we begin, Mike and I will comment on two items that Michell Nader discussed.<sup>1</sup> We will have the benefit of Michell sharing our panel later on. Mike wanted to comment specifically on the impact and convenience of the banking and securities commissions having been merged, and he has some views that he wants to share with you about that.

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\* The views expressed are entirely those of the authors and should not be attributed in any manner to International Finance Corporation, the World Bank, their affiliated organizations, members of their Board of Directors or the countries they represent.

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1. Michell Nader Schekaiban, *The Future of Mexican Financial Services*, 7 U.S.M.L.J. 159 (1999).

I personally was interested in your comment, Michell, on banks having to prepare a study for each disbursement before they agreed to lend money. The reason I have an interest in that is that it was part of my presentation. It is interesting that you think that this provision, and I will read it now for the audience, does not provide borrowers rights even if banks do not comply with their obligation in every case, under Article 65 of the banking law. My translation, and it is a literal translation of this article, is the following:

**Article 65 of the Banking Law:**

Before the granting of financing, banks shall estimate the economic viability of each investment project, the term for repayment thereof, the relationship between the various concepts in the borrower's financial statements or economic conditions, and the moral and managerial qualifications of the borrower without prejudice of the guarantees which may be necessary, as the case may be. The amounts, terms, repayment regime and, as the case may be, grace period of each financing shall maintain an adequate relationship with the nature of the investment project and with the present and foreseeable conditions of the borrower. The National Banking and Securities Commission shall ensure that banks duly observe the provisions of this Article.

Now, one, this Article states the need for better credit analysis by banks and I will talk about that extensively during my presentation; but, two, I wanted to comment that I do think that a borrower might use this in a case where a bank did not prepare the study to give the bank a hard time from a legal point of view. Further, I am aware of at least one circuit court decision confirming this, which is one of the issues the Supreme Court of Justice will decide very soon. We can talk about it later but I didn't want to leave out it here because I might forget it.

LUBRANO: Agustín and I thought that since I am not a Mexican lawyer, it would not be appropriate for me to discuss the special legal position of Mexican banks. However, because I have been working on the Mexican financial system and particularly have been using my observations on it in recent work that the World Bank and the International Finance Corporation are doing in Southeast Asia, it might be useful for me to give a little background on the basic characteristics of the Mexican financial system, with special emphasis on the shape of the banking sector.

When I end I would like to reflect on the question asked earlier on the merger of the Securities Commission with the Banking Commission. It is an issue that strikes near and dear to our hearts at IFC because we are extensive investors in the financial sector in Mexico. We have invested in banks, we have equity positions both in banks, non-bank financial institutions and a lot of industrial companies as well whose securities either are or, hopefully, one day will be listed on the exchange. One of the principal roles of my department at IFC, which is now called the Financial Markets Advisory Department, is advising on capital markets development, particularly the development of securities markets. The events that have occurred in the last few years with respect to the merger of the two commissions have been of special interest to us.

I would like to begin by first discussing the size of the Mexican financial system and in particular the banking system. I think it is important for folks to keep in mind, whether they be from Mexico or the U.S., particularly if they are from an

OECD country other than Mexico (and Mexico is an OECD country), that Mexico's financial system is very small compared to its sister countries in the OECD. There is a little chart that I have put in the book behind my notes and you will see that Mexico's loans to GDP ratio is about 1/3 of GDP. A low loans-to-GDP is common in most Latin American countries, but not all. For example, the numbers in Chile are much higher. The presence of non-bank debt is higher in a number of countries. Colombia in particular has an asset-backed securities mortgage market which Mexico, before the crisis, was only beginning to develop. The comparisons with Southeast Asia are very dramatic. Assets of the banking sector at the time of the collapse of the Thai economy in the summer of 1997 was about 165% of GDP. In Mexico you get to 150% of GDP if you count the government debt and that is still smaller than the credits of just the Thai banking system. Thailand, incidentally, has a per capital GDP roughly the same as Mexico, of course depending on exchange rates.

The ratio you will see in the chart (Annex 1) for the U.S. is a little misleading because banks are not the largest form of credit because of the presence of the commercial bond market. The private sector debt market is very large and term debt is very large in the United States. And on top of it you must add the U.S. government's debt market, which is very large. Mexico remains a bank-dominated system, notwithstanding the important roles that the brokerage community served during the time of bank nationalization, largely as a substitute for bank lending to large companies by developing the commercial paper market, and notwithstanding the emergence just before the crisis of a number of non-bank financial institutions like factoring and special purpose banking and mortgage banking, a number of industries in which IFC has invested heavily. The private sector debt component of the Mexican financial system is dramatically concentrated in the banks - 75%. You count into that as well the development banks which largely lend through the commercial banks.

Mexico historically has had a concentrated banking system. Besides Citibank, there were no foreign banks in Mexico until NAFTA. And in 1994 when the foreign banks were permitted to enter, they were just in the process of being licensed and getting up operations when the crisis hit. Of course many of them had no intention of becoming large banks; their business plans were that they would remain quite small.

Within the system I note in my paper the four largest banking institutions, Banamex, Bancomer, Serfin and Bital together represent 2/3 of the system's assets. Concentrated banking systems are not uncommon; in fact the U.S. system is the exception in having over 10,000 banks and no single bank representing any major percentage of the deposits or assets in the banking system. Canada, for example, has a very small number of banks, really about a dozen and the largest contribute or have among them the vast bulk of the assets. In Mexico the largest two banks traditionally each represent 20-25% of the banking sector.

The deposit base in Mexico is very different than that in most of the rest of the OECD, and also different from a number of developing countries. I would say that in Southeast Asia, generally considered high saving economies, you find a dramatic difference. The deposit base of the Mexican banks is largely super-jumbo deposits. We do not have, and the Mexican government has not made public, statistics on the deposit base available in the last couple of years. But the statistics that are available

indicate that over 60% of the funding was in deposits of over U.S. \$250,000. That was the top decile for which the government provided data. We do not have data broken down by deposits larger than U.S. \$250,000.00, but evidence would indicate that most of that 60% is probably in deposits of well over US \$1 million. This should not be that surprising, when you think that Mexico has long had a deposit guarantee scheme which implicitly guarantees the full amount of any unsubordinated debt of a bank. So the incentive to diversify among banks in a country where you have some sort of limits like, say, the \$100,000 limit that the FDIC insurance limit covers, is not there. I would also note that Mexican banks' funding is traditionally short-term, and gets shorter term after each bout of market instability.

Lending products in Mexico are, however, broader than the deposit base. Mexico has a substantial variety of consumer lending. Particularly after the privatization of the banks, there was a boom of credit card, mortgage and vehicle lending as well as a greater variety of instruments for business. As we will discuss in the panel later today, the shortcomings with respect to the legal framework for secured transactions and lending against receivables, equipment and inventories constrain the kinds of lending products that can be offered. We would argue, and have argued in the work that the World Bank has done, that such shortcoming have been both cause and effect of a concentration of lending to the largest companies in Mexico, which has constrained the development of small and medium enterprise and has macro-economic effects.

If you go to a Mexican city, you will see that there are branches of major Mexican banks all over the place. That is probably to be desired; particularly the mini-branches that are set up in supermarkets. These bring banks close to the public. However, you do not see this branching phenomenon outside the major cities. Fortunately, Mexico is a highly urban country. But if you actually track, as the World Bank has, the amount of municipalities that do not have a single banking institution in Mexico, it is still the majority. So the majority of the surface area of Mexico is uncovered by bank branches, although the majority of the population is.

Lots of explanations have been given over time as to why the Mexican banking system has its unique character. I do not pretend that the list that I am about to give is either completely accurate or comprehensive, but I want to throw these things out because I think they will be useful for our panel this afternoon.

I have on my list among macro-economic and structural factors that Mexico has a low *savings rate*, has had one for a long time, and it has been declining. In recent years just since the crisis, the total savings of the economy has increased, but that is a result of the crisis, basically to pay for the damages. *Income distribution* in Mexico is poor, relative to OECD countries. The large bulk of the population is probably not at income levels to engage in substantial financial savings.

*Statism and taxation.* Anyone who represents a Mexican employer knows that they complain constantly about how their salary payments, the actual cash that is handed over to the employees, represents only a small portion of the amount that the employer pays. Those go through systems like INFONAVIT (the state-owned housing institute) that basically convert what might otherwise be private savings into public savings. Many of those public savings are put to less than perfect uses, and I think INFONAVIT is an example. The recent pension reforms which privatize the management of pension savings are a step in the right direction, but we

still have to see how they perform, and the amount of money that goes into them is probably at this point still inadequate to support the kind of benefits that will be expected when the current generation retires.

*Limited foreign competition.* Until 1994 foreign banks were excluded. Generally when foreign banks are excluded, you would expect innovation to be impeded, particularly since, as Luis Martinez rightly noted, there was a lost decade in banking during nationalization. So the Mexican banking system was probably much in need of innovation and improved technology in 1991 and 1992 when the banks were re-privatized. We could also have a discussion about whether the foreign banks that have entered have in fact added anything. Plenty of times we find that foreign banks keep the better technology at home and they do not provide as much of it to the investee as we initially expect.

*Corporate sector factors.* Some of them will mirror factors discussed in other areas. A lot of these things overlap, but have to be categorized under one or another because of the linearity of writing a paper.

*Concentration of industry and limited domestic competition* - I think it is clear that Mexico's industry is very concentrated. The presence of groups and also the long periods of state ownership have reinforced that.

*The role of multinationals.* Large parts of the Mexican economy are controlled by multinationals or are parts of the multinational production chain. Maquiladoras are, I suppose, the classic example. That provides a funding source from outside the country which means that they do not necessarily have to depend on the domestic banking system for financing, or participate in the financial system at all.

*The presence of Mexican companies abroad.* A number of very important Mexican companies do operate abroad. For example, some companies that produce primarily for export do not finance in pesos at all. The last time I met with a chief financial officer of a major exporter, he told me they had no exposure at the holding company level to peso financing. They basically can access the U.S. and international capital markets.

*Bank-corporate affiliations.* This one is very common in the countries that IFC works in, but in Mexico the issue has become particularly highlighted in the fight over what to do about FOBAPROA. In fact, the people who purchased the privatized banks in many cases were the principal investors of industrial groups and, in fact, were favored by the government for that reason. When the first FOBRAPOA assistance was provided to Banca Serfin, the Mexican government and the Banking Commission publically defended the decision on the grounds that Serfin would survive and the shareholders of Serfin would eventually be able to come up with additional money that would be needed in the long term to save the bank because they were a substantial owner of Mexican industry. In the case of Serfin, VITRO was the principal industrial jewel of the controlling group. While ownership of banks by industrial groups may provide deep pockets for recapitalization, it also creates unavoidable conflicts of interest.

We have recently published a review of IFC investments in the financial sector, and one of the quotes we included was the question asked of Willie Sutton, the famous U.S. bank robber, "Why do you rob banks, Mr. Sutton?" and he answered, "Because that's where the money is." If someone were to ask why a glass company would purchase a bank, one of the reasons is because that is where the money is. The resources of the bank can be used within the limits of the law, or outside it, to

finance the industrial operation directly or to finance other companies affiliated by ownership or by their stage in the industrial chain.

*Proximity to the USA* is something that I do not think you can avoid looking at when you look at the characters and problems of the Mexican financial system. No developing country has a relationship with a single outside OECD industrial country in the way Mexico has. The relationship is absolutely unique. Mexican savers have very ready access to the U.S. financial system. Many have bank accounts in the United States. On a personal note, when I was in Mexico City and paid my landlady, the check would always come back with a stamp on the back from a San Diego bank. The ubiquitousness in Mexico of cash machines means that you can deposit your money in a U.S. bank account and take out cash in pesos any time you want in Mexico City, or at least any time the system is not down.

We have anecdotal evidence that it is not an uncommon practice among the substantial migrant community in the United States to deposit their earnings in their bank accounts in the U.S. and use these as a way to transfer cash from the U.S. to Mexico - you give your brother a card and he can take money out in Mexico City. We have no way of tracking this phenomenon - I take out money in Mexico City on my bank card, no one can tell whether I am a U.S. citizen on vacation or on business, or whether I am a Mexican using it to help my mom back home pay the bills.

Finally, *some historical notes* to mention. The nationalization period that was discussed before (I do not have to go into too much detail) basically meant that there was no banking being done in Mexico for much of the 1980s. By 1986 or 1987, which was probably the worst, or 1988, most of the assets of the banking system were government debt. They were being used to finance the government deficit. So the credit culture had evaporated among bank employees who make loans, who should follow the manuals, do the kind of analysis to make loans based on the feasibility of the project, the expected cash flow and the probability of repayment, separate from the guarantees that Agustín just recited from Article 65. In fact, as we quickly realized after the 1994-5 debacle, even much of the habit of papering loans was lost as well.

There have been *periodic bouts of real losses* on deposits in Mexico, principally at the times of major devaluations. So folks who can keep their money in assets that are not in danger of losing maybe 25% of its value overnight, try to do so.

I have on this list the *Mexdollar debacle* that Agustín reminded me of. Mexican banks can now offer dollar denominated deposits, and you would think people might use them to protect themselves from devaluations. But the experience in 1982 when the Mexdollars were actually frozen leads people to believe that Mexdollars are not as good as dollar dollars in U.S. banks outside Mexico.

*Legal regulatory issues.* The special position of Mexican banks as creditors is going to be the focus of Agustín's remarks so I will not get into those. The limitations on collateral will be discussed later this afternoon, that is, secured lending particularly against inchoate assets and movable goods as well as the aforesaid registries, and difficulties of enforcement. The asset-backed market has been very slow to develop and that has limited the ability of banks to get assets off their books and do new lending.

*Transparency in accounting and auditing.* To develop a reputation for transparency takes a long time and to lose it can happen overnight. Southeast Asia is an example of that.

Finally, *the unlimited guarantee of deposits* has led to, most analysts feel, a lack of market discipline on the banking sector. If you were to look at the spread between the best and the worst Mexican banks in the inter-bank market historically, you see it is very narrow, even though you know some banks are in much better shape than others. That is basically because the government stands behind them all, and that has led to less of a shaking out of bad banks than you would expect in a more market-structured system.

I wanted to mention this aside, so please pardon me for this; my formal presentation is over. The plan that we understood at the World Bank in 1994 for the merger of the two commissions made a lot of sense. That was, as Michell very correctly said, if you have a system where the major banks are affiliated with major brokerage houses, consolidated supervision is very difficult if you have separate people doing it. It would be a good idea to try to coordinate that to prevent duplication, and we are all for that.

But the plan that was presented, at least informally, was that supervision of the intermediaries would merge, but the supervision of the market- that is the behavior in the securities market, and the supervision of issuers in the securities market - would be spun off into a more or less independent SEC (Securities and Exchange Commission). That made a lot of sense because the specialized nature of supervision of stock exchanges, over-the-counter markets, that sort of thing, is very different from what a bank regulator does. In particular, there is a negative incentive. A bank regulator in a situation where the banks are going to hell in a handbasket is going to have an incentive to allow the securities market to be used to hide some of that or to allow unreasonable activities to rob securities investors of assets because the government does not stand behind those assets, whereas it does stand behind the bank deposits either explicitly or implicitly. So we usually are strong advocates of independence in the behavioral aspects of securities - the market supervision being in a separate entity, people who are clearly responsible for that and not responsible for whether the banks are solvent.

So the first stage took place, the merger of the two commissions. It is generous, I think, and again I am speaking for myself and not the institution, it is generous to say it was a merger. It was more in the actual physical nature of a hostile takeover, because if you look at the people who quit after the merger, they are mostly on the securities side. Mexico lost a lot of its institutional memory and skills when that merger took place. But the development of the next stage, which should probably have happened simultaneously - of the independent securities commission - never took place. We are still waiting for it. Maybe this sad situation has spurred in some ways greater self-regulation by the securities exchange, and that should always be the first defense for good, clean and efficient market, but you still need an experienced supervisor behind it. Thank you very much, and I will pass to Agustín.

BERDEJA: Thank you, Mike

The banking system in Mexico is in very dire straits. Who is responsible for it? I think if you ask ten different people, you'll get ten different answers. Not that one is right and the others wrong or anything like that. It is just that we are all affected by this new mess, and I think that we are all co-responsible. There are some



common notions going on here. For instance, we need more supervision from the authorities. I would not say more, but maybe better. We need a better legal system; we need to revamp the legal system. I would not agree to that extent. I think the bankruptcy code needs some amendments, especially in the procedural area, but that is not the solution in my view. So what is missing? I will not elaborate on that. I have seen Fernando Montes' piece in the binder and it is a very good one and he discusses many of the problems in this area.

The point that I am trying to make, and you will see once I finish, is that there is no good substitute for good credit analysis - nothing. Of course, the legal system has to do with it; of course, a better economy would benefit every bank; of course, better supervision would improve conditions of the Mexican banks. But nothing, nothing can replace good sound credit analysis.

My chart (Annex 3) compares the rights of ordinary creditors or corporations versus the rights of Mexican banks under the Mexican legal system. Keep in mind, though, that when I say ordinary corporations, I am also including foreign banks. Foreign banks which are not operating in Mexico as a multiple banking institution the way that other foreign affiliates are, are not treated by the law as multiple banks or regular commercial banks. I can call them just banks for purposes of our talk. There is a reference to affiliates of foreign banks in Article 45 of the law, Section D, and it compares them or gives them the treatment of multiple banks. But nothing in the law, and I do not think there would be a good rationale to substantiate an argument that foreign banks (not incorporated in Mexico) would have access to the benefits provided by the banking law to actual Mexican banks or affiliates of foreign banks operating in Mexico. So, with that caveat, let us see what advantages Mexican banks (some of them, of course) have in the execution and perfection of credit contracts.

One, the trust arrangement is by now very common and very much preferred for a variety of reasons as a way of securing transactions in Mexico. Who can act as a trustee in these arrangements? Only banks. And, since 1993, brokerage houses, insurance companies and bonding companies, which means along the lines of what Mike was saying where we have a system of financial groups which is actually controlled by banks. Banks continue to have that monopoly. This gives banks a great advantage in the perfection of their own guarantees. In the old days up until approximately 1996, no bank could create a trust to guarantee obligations of a borrower to that bank; it had to be a third bank. I think that the big banks realized that there was a lot of business that they were losing because of this, and now the law allows them to create their own trust agreements for obligations of borrowers to themselves. So that is one big advantage.

Of course those of you who are familiar with the civil law system know that we have this principle of free will, or autonomy of will, whereby you can create basically any kind of legal document provided you do not violate any legal provision or the public order. Therefore, one argument that can be made against what I am saying is that even though something is not regulated in favor of an ordinary creditor, you can create the instrument. I would say yes, but you would not necessarily have access to the same procedural advantages provided for banks who are riding on the back of a specific provision or a specific statute.

That having been said, we have industrial mortgages, another figure. The industrial mortgage is available to banks only, as per Article 67 of the Banking Law.

What is nice about an industrial mortgage is that, by law, it says that all of the mortgager's assets are being given as collateral in favor of the bank. One could again argue that if you create a mortgage in favor of a foreign creditor, and you provide for the specific language, you could actually come up with the same result. That is partially true, again. If you forget anything, though, you will see that you did not have an industrial mortgage and in trying to enforce your rights, you are just a mortgage creditor, you are not an industrial mortgage creditor. For example, a regular mortgage has certain limitations. Under Article 2895 of the Civil Code, a regular mortgage can only encompass assets which are specifically determined, whereas the industrial mortgage basically says "every present and future asset will be part of the mortgage". Again, one more advantage for regular banks in Mexico. Those are only two examples in the area of perfection or execution of credit contracts.

If we look at enforcement of credit contracts and credit in general, banks now have the advantage of being able to bring an executory action. For those of you who are not familiar with or well aware of what this means, basically it means that you can attach assets pre-judgment and the proceedings are designed to be summary versus ordinary commercial proceedings, which may take many years. So banks can provide a statement of account signed by their own in-house accountant, and this suffices to give them access to the executory action. The contract is an executory instrument, no matter what. That is a great advantage of course, and one that has been challenged as violating due process of law in more than one instance, but thus far we have not seen the courts willing to agree on that because they say that if the bank is providing a statement of account and, yes, it gives them the executory action, the borrower can also contest that and therefore is not being deprived of any property, and therefore there is no due process violation. That is the status of this privilege, if I can call it that.

We all suffer, and have suffered for many years, problems in proving personality or legal capacity to act on behalf of a corporation. Banks do not have to go through that. According to Article 90 of the Banking Law, an appointment certification issued by the Board of Directors' Secretary suffices to evidence the authority of the bank officers. This possibility is not available to ordinary corporations. Here I will make a stop. In some instances, you can understand advantages that banks have over ordinary corporations. This is not one of them. If this system is a fair system where the Secretary of the Board can provide a certificate and that is enough to evidence your capacity, we should allow this for ordinary corporations, I think. There is no difference in this respect, and no reason to give banks the advantage.

We have another advantage in this area for banks. You know that Article 2554 of the Civil Code has sort of three degrees of authority for attorneys in fact. One would be the basic lawsuits and collections, then acts of administration, and finally, acts of dominion as we call them (acts of ownership). If you want to give somebody the power to issue or subscribe or guarantee a negotiable instrument, you have to go to the Negotiable Instruments Law, Article 9, and say that you are giving them powers under Article 9 of the Negotiable Instruments Law. It is not that it is difficult, but you have to be aware of that. Otherwise, you might find out that your borrower's representative had no authority to do it. Well, as per the Banking Law, any power of attorney granted under Article 2554, Paragraphs 1 and 2 of the Civil

Code are deemed to include powers to issue and guarantee negotiable instruments, so there is another, perhaps unwarranted, advantage.

Another is in the area of execution and enforcement of a pledge. In the context of a breach of a contract and you are trying to enforce your pledge, if you are a regular creditor, an ordinary corporation, you have to apply to a judge for enforcement of your pledge. You want to get the assets sold and then you want to get access to the money. However, the banks can sell the pledged assets via two merchants or one commercial public registrar of the locality, and they can further apply the money immediately and set off the money from the sale of the pledged assets to the outstanding amount of their credits. Again, while I understand that this expedited process is desirable, I see no difference with any ordinary creditor who has a pledge. I think they should also enjoy the same privilege, and not be treated under a system which is very old and impractical, as has been said throughout the day.

More importantly perhaps, in the context of bankruptcy proceedings, if an ordinary creditor has a pledge of assets of the bankrupt company, those assets are part of the bankrupt's estate and you will have to prove that he had the rights over that pledge and he will be treated as a creditor with a special privilege, or (*creditor con privilegio especial*) under Article 264 of the Bankruptcy Code, fair and square. Now when it comes to a bank, the bank does not even have to go through that ordeal; the bank has access to an action to exclude the pledged assets from the bankrupt's estate. Again, and this is under Article 159, VI, d of the Bankruptcy Code. If the system for banks is a fair one here, I think it ought to be fair for any ordinary corporation; there is no reason to distinguish here between the rights of a Mexican bank, the rights of a foreign bank, the rights of a Mexican ordinary corporation.

Another advantage they have, which I touched on a little bit ago, is the following. Article 1391 of the Commerce Code lists documents which have executory action for an ordinary corporation. Whereas for banks, provided they executed their agreement under Article 68 of the Banking Law, anything they sign gives them access to the executory action. Again, here, it can be argued that banks will be more fair or that they are more knowledgeable of the circumstances of what they are doing than a regular ordinary corporation or a foreign creditor. This is again an area where I think it can be argued that any ordinary corporation or a foreign bank should have access to the same right.

Now this one is very interesting. Ordinary corporations, in requesting suspension of proceedings in the context of an *amparo* suit, have to provide a guarantee for third party losses and damages. This is very important; we are talking about the *amparo* suit or *amparo* proceedings, which always concern constitutional violations. If an ordinary corporation wants the judge to restrain somebody from doing something until the matter is adjudged, they have to provide a bond or some kind of guarantee to insure that if they do not succeed in their effort and there are losses or damages to a third party, the third party will have access to quick money for those losses and damages. This is very fair and I can understand it. Banks, however, under Article 173 of the Amparo Law are presumed solvent. And today, all the more, to think that banks are solvent vis-a-vis CEMEX or even VITRO or many other Mexican corporations is just an illusion -

LUBRANO: A heroic presumption.

**BERDEJA:** Right, a heroic presumption. And, frankly, it is unfair in this case in my view to give them access to this presumed solvency. What happens is that they can go and try to do anything they want in trying to get a suspension from an *amparo* judge, however outrageous, because there is no cost attached to it. So it encourages inefficiencies and also unfairness. Even worse, in litigating with the government in tax proceedings, they also enjoy this advantage even if they are being questioned by the Ministry of Finance on the way they treated depreciation of assets, just to give you an example. They do not have to post any bond. We all fear tax audits and we fear the tax authorities. Banks do not have to deal with this. They can go through the process knowing they will not have to post any guarantees even for unpaid taxes.

One final privilege which may be very subtle in terms of the language but has a great and important weight is this. Ordinary corporations are responsible for the acts of their employees in general. The principle, which is established in Article 321 of the Commerce Code, says that principals are responsible for all operations entrusted to their employees. That is fair again; that is understandable. In the case of banks, though, the language in the law, and this is Article 91 of the Banking Law, is that banks are responsible for the acts of their officers and employees "in the exercise of their functions." You can see the difference, as lawyers, between "all operations entrusted to the employees" and "in the exercise of their functions".

We have seen a case recently where a man showed up at a Mexican bank and tried to collect on a letter of credit. He delivered all the papers there, got the seals, and was told to come back in three days. Three days later he came back and found out that the officer he had dealt with had left the bank. So he tried to see other people, and then he was told that actually the officer had been stealing money from the bank and was on the run. He said, "I delivered the papers right on time and now you are telling me that I am late. However, here is the seal of the bank, the signature of your officer, and I brought the papers before the expiration of the term for presentment of the letter of credit. What do you want to do about it?" And the bank officer said, no surprise, "He was not exercising his functions." (It remains to be seen what scope the Mexican Courts will give Article 91 of the Banking Law.)

So you can see that Mexican banks enjoy a lot of special privileges under the current legal system and, yet, they are in very dire straits. In many cases as I have said during my presentation, I can very well understand that they enjoy these privileges. In others, I think that they should enjoy the same privileges as other creditors. But in general, I am going back to the same principle I started with. No matter what we do with the legal system, if we do not try to strengthen our capacity for rigorous, sound credit risk analysis, this will be just a cyclic problem, a systemic problem and we will not see the light of day in the Mexican banking system for centuries to come. Thank you.

## ANNEX 1

## SOME BASIC CHARACTERISTICS OF THE MEXICAN FINANCIAL SYSTEM

Mike Lubrano

**Size.** Mexico's financial system is relatively small relative to the country's GDP, notwithstanding a burst of growth in the banking system from 1991-1994. Total financial assets, including bank loans, corporate securities and obligations of the government amount to approximately 1.5 time GDP. However, much of this is government securities. Outstanding credits of the banking system amount to only approximately one-third of GDP, which is about average within Latin America, but significantly less than what generally prevails in other OECD members and in Southeast Asia.

**Intemediaries.** Mexico's financial system remains a bank-dominated system. Notwithstanding the important role played by the brokerage houses during the period of nationalization in the 1980s and the emergence of non-bank financial services such as leasing, factoring and mortgage banking in the 1990s, commercial banks still represent most of the assets of the financial system. Notably, the mutual fund industry, the insurance industry and the private pension industry remain small, leaving the system with out a strong institutional investor base. Non-bank financial institutions, such as leasing companies, that were not affiliated with banks were decimated by the 1995 crisis and have not recovered.

**Structure of Banking Industry.** Mexico has historically had a concentrated banking system. The entry of foreign banks since 1994 has not significantly changed the overall concentration of the system, since the major foreign players have expanded by purchasing the assets of troubled institutions. Accordingly, the four largest institutions (Banamex, Bancomer, Serfin and Bital) represent two-thirds of the system's assets. A handful of domestic and foreign controlled banks, each with five percent or less of the system's assets, represent the bulk of the remainder.

**Deposit Base.** The Mexican banking system is generally reliant on very large deposits and inter-bank credits (both from domestic and foreign sources). Retail depositors play a smaller role in overall bank funding. The current system for bank liability protection the *Fondo Bancario para la Protección de Ahorros* ("FOBAPROA") provides unlimited coverage for unsubordinated obligations of banks, so large depositors are more secure than if there were a cap on liability coverage. The most recent information available indicates that over 60% of funding was in deposits of greater than US\$250,000. Most of these deposits are probably in deposits of the peso equivalent of Over US\$1,000,000.

**Lending Products.** Lending products in Mexico are broader than the deposit base. Mexico has a substantial variety of consumer lending. Particularly after the privatization of the banks in 1995, there was a boom of credit card, mortgage and vehicle lending as well as a greater variety of instruments for business. However, attractive lending products for small and medium enterprises are more limited. Commercial loans typically require collateral in the form of real property or personal guarantees. The shortcomings of the legal/regulatory framework for

secured transactions severely limit the potential for lending against receivables, inventories and equipment.

**Branches.** Mexico's banks have historically concentrated their physical operations in urban centers. The bulk of bank branches are located in the largest cities and state capital (Of course, the country is highly urban and this is where the bulk of savers and customers are located.) Today, most municipalities (largely rural) remain without banking facilities.

### Explanations for Current Situation

A variety of explanations are typically voiced to explain why the Mexican financial system remains bank-dominated, concentrated and relatively small, while intermediating a relatively small amount of private savings without greater penetration in the retail markets. What follows is a no doubt an incomplete list. Some of the points would more accurately be presented under more than one heading

### Macroeconomic/Structural Factors

- **Low savings rate.** Mexico's private savings rate is relatively low and has been declining since the early 1980s. Prior to the current crisis, private savings was approximately 10% of GDP, public savings approximately 5%. Aggregate savings has risen sharply but probably only temporarily since 1995 as part of the macroeconomic adjustment. In recent years since the banking crisis, the total savings of the economy has increased, but that is a result of the crisis, basically to pay for the damages.
- **Poor income distribution.** Mexico's already poor income distribution has worsened in the past two decades. Middle-class savers have been hard-hit by the recent crisis. The large bulk of the population is probably not at income levels to engage in substantial financial savings.
- **Statism/Taxation.** Mexico's state-run pension, health, unemployment and housing finance schemes have historically absorbed resources that might otherwise have been channeled through the private financial markets. The recent pension reform promises to direct a greater share of such resources to the private financial markets.
- **Limited Foreign Competition (Protectionism).** The prohibition on foreign-controlled banks until 1994 and the subsequent limitations on their participation in the Mexican market certainly impeded technological innovation, and probably also constrained the growth of the system.

### Corporate Sector Factors:

- **Concentration of Industry/Limited Domestic Competition.** Mexican industry experienced a long period of state involvement followed by privatization to a

relatively small collection of private industrial groups; A large class of medium-sized industries not affiliated with financial groups has been slow to develop.

- **Role of Multinationals.** Important segments of the Mexican economy are dominated by multi-nationals, whose activities in Mexico can be financed more cheaply through the parent or directly from U.S. or international sources.
- **Presence of Mexican Companies Abroad.** Some large Mexican industrial groups have significant operations abroad, or are largely exporters, which provides them with greater access to financing through the U.S. and international markets. Exporters are good clients for dollar capital markets.
- **Bank/Corporate Affiliations.** Banks often share some degree of common control with large industrial groups and accordingly channel scarce resources to these affiliated borrowers.

### **Proximity to the United States**

- **Ready Access by Mexican Savers to the U.S. Banking and Financial system.** This permits Mexican savers to protect the real value of savings from the periodic threats of devaluation and inflation. In addition, it provides a mechanism for tax evasion.
- **Out-migration.** A significant part of the more dynamic lower classes spend a significant portion of their working (and saving) lives abroad. Mexican residents outside the U.S. provide relatives with access to options to domestic vehicles.

### **Historical**

- **Nationalization.** The period of state ownership of banks (1982-1991) undoubtedly held back the development of the system. By 1988/7, the system had become basically a mechanism for retailing government obligations, with over 66% of the assets of the banks consisting of loans to the government.
- **Periodic Bouts of Real Losses on Deposits.** Bouts of rapid devaluation and inflation, notably in 1982, 1986/7 and 1994/5 resulted in real losses to savers, discouraging deposits, particularly term deposits.
- **Mexdollar Debacle.** The 1982 freeze of dollar-denominated deposits in Mexican banks under the government of President Lopez-Portillo highlights the risks that even dollar-denominated savings through the Mexican financial system are risky.

## **Legal/Regulatory Issues**

### **Special Legal Position of Bank Creditors (Focus on Agustín Berdeja's Remarks)**

- **Limitations on Collateral.** Inadequacies in the legal framework for secured lending, and the poor state of registries and legal enforcement limit the types of lending instruments available.
- **Slow development of Domestic Asset-Backed Market.** Shortcomings in the legal framework and the absence of institutional investors limits the options of asset backed schemes to free-up bank capital or provide funding sources for competing non-bank institutions.
- **Transparency/Accounting/Auditing.** Relatively low standards for disclosure and accounting increases the risks of lending to unfamiliar borrowers. Enforcement of existing standards is also problematic.
- **Unlimited Guarantee of Deposits.** The Mexican governments historic commitment to stand behind all non-deposit liabilities of banks, and its failure to correctly price this guarantee, gives banks an important funding cost advantage and permits reliance on large depositors



ANNEX 2  
 SIZE OF MEXICAN FINANCIAL INSTITUTIONS AND MARKETS  
 (U.S. \$BILLION)

Category	1992	Percent Of Total	1993	Percent Of Total	1994	Percent Of Total	1995	Percent Of Total
Banks	133.2	50	164.5	48	136.6	45	123.9	56
Development Banks	46.4	18	62.9	18	63.2	21	53.6	11
Brokerage Firms	47.0	18	67.9	20	75.0	25	24.2	24
Mutual Funds	16.6	6	25.9	8	11.5	4	7.7	3
Insurance	8.1	3	9.8	3	6.9	2	6.4	3
Others <sup>a</sup>	12.5	5	13.6	4	9.8	3	6.2	3
Total	264.0	100	344.7	100	302.9	100	222.0	100

Category	Percent of GDP	1993	Percent of GDP	1994	Percent of GDP	1995	Percent of GDP
Assets of Fin. Institutions	79	344.7	94	302.9	80	222.0	88
Stock Market Capitalization	42	200.7	55	130.2	35	90.7	36
Outstanding Bonds	20	79.2	22	54.3	14	37.4	15
Government	13	43.8	12	32.1	9	17.7	7
Private <sup>b</sup>	8	35.4	10	22.1	6	19.8	8

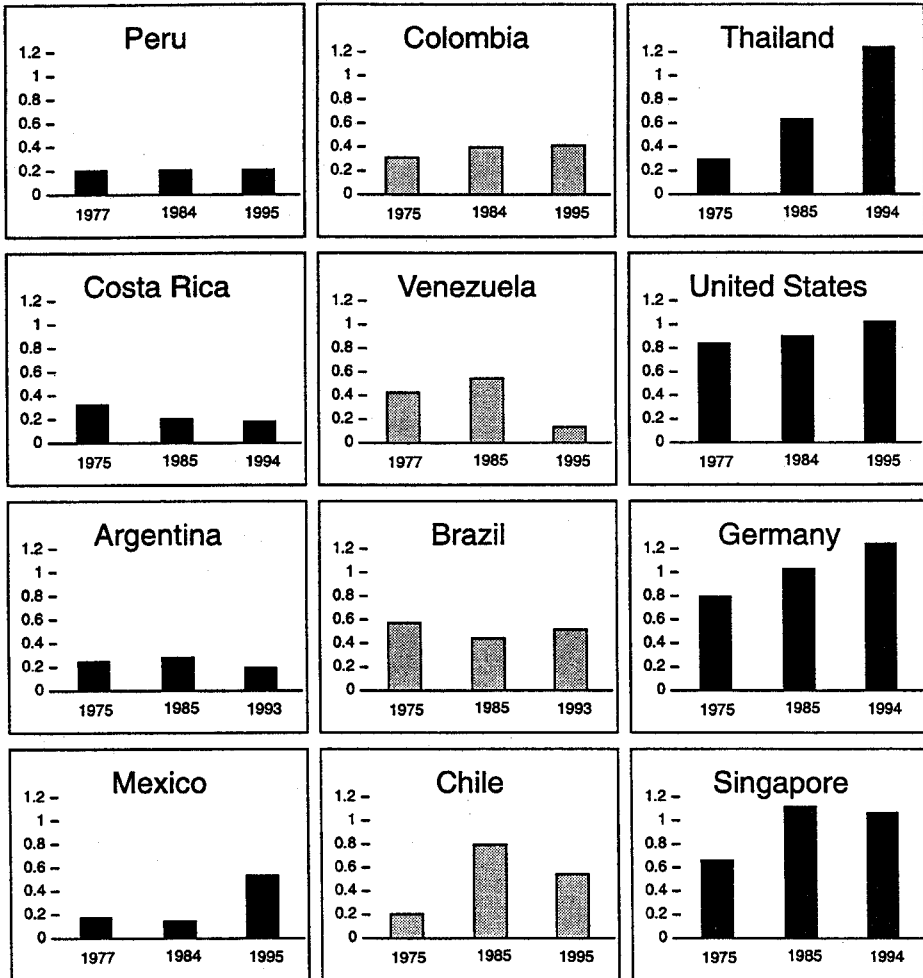
<sup>a</sup> "Others" includes credit unions, factoring companies, warehousing companies, bonding companies, exchange houses, and leasing companies.

<sup>b</sup> Includes certain bank obligations, real estate trust certificates, and direct corporate debt instruments.

Source: CNBV; Emerging Markets Factbook 1995, IFC; International Statistics, IMF.

Source: Paul Holden, "Collateral without Consequence: Some Causes and Effects of Financial Underdevelopment in Latin America"(1996; The Enterprise Research Institute for Latin America).

### Chart 1. Ratio of Credit to the Private Sector to GDP in selected Countries.



## ANNEX 3

## ORDINARY CREDITORS VS. BANKS: A BRIEF COMPARISON OF THEIR LEGAL FRAMEWORK\*

CONCEPT	MERCHANTS OR ORDINARY CORPORATIONS	BANKS
Mercantile Accounting	Accounting obligations of merchants. Merchants must keep an accounting system in compliance with the requirements provided in the Commercial Code (Código de Comercio) ("COCOM"): identify individual operations and their characteristics, include control and verification systems, have a ledger, etc. [Art. 33 of the COCOM]	The general rulings issued by the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores) ("CNBV") will regulate the accounting practices, the records and the documents relating thereto and the period of time during which they have to be kept. [Arts. 99-102 of the Credit Institutions Law (Ley de Instituciones de Crédito) ("LIC")] Every activity that involves a change in their assets or liabilities must be registered in the accounting records on the day it occurs. [Art. 99 LIC] The CNBV will establish the basis for the approval of the monthly financial statements and the annual balance sheet, which shall be audited by an external auditor appointed by the Board of Directors. Banks must report to the CNBV any irregularity. [Art. 101 LIC] The CNBV will establish the rules for the maximum estimate of assets and the minimum estimate of obligations

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\* Foreign banks are not multiple banks. I am not aware of any current decision granting to foreign banks or non-bank banks, by analogy or otherwise, the rights multiple banks enjoy under the Banking Law (LIC). Frankly, there seems to be no grounds for this rationale. Actually, the Banking Law only refers to affiliates of foreign banks operating in Mexico as multiple banks. [Art. 45-A, D]. In this respect, for purposes of my chart the term "ordinary corporations" would encompass foreign banks and non-bank banks.

**CONCEPT****MERCHANTS OR  
ORDINARY  
CORPORATIONS****BANKS**

and liabilities. Prior authorization from the Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público) ("SHCP") and for a period no longer than five years, banks may estimate the value of their assets to be the acquisition value. [Art. 102 LIC]

Commercial  
Deposit

There are not exceptions for banks. [Arts. 332-338 COCOM]

Special Rules:

In case of death of the deposit holder, the bank will deliver to the beneficiaries the corresponding amount. Any amount in excess of the limits established in the LIC will be distributed in accordance with applicable ordinary law. [Art. 56 LIC]

Conditions applicable to demand deposits may be modified by the bank (with at least ten days advance notice). Whenever the applicable legal requirements concerning book keeping and customer information, are complied with, the bank's accounting entries will be considered as prima facie evidence in court. [Art. 58 LIC]

Savings books will contain the information required in the corresponding conditions and they will be executory instruments (título ejecutivo) against the bank without need of a signature recognition or any other requirement. [Art. 59 LIC]

**CONCEPT****MERCHANTS OR  
ORDINARY  
CORPORATIONS****BANKS**

Statute of  
limitations

The most common statute of limitations for commercial matters is ten years. [ Art. 1047 COCOM ]

In accordance with the limits provided in section 56, amounts that have been in deposit for more than one year may not be attached. [Art. 60 LIC]

Interests on instruments without a maturity date must be concentrated in a global account if they have not been collected or capitalized during a period of five years. [Art. 61 LIC]

As an exception, the statute of limitations for claims against commercial and brokerage houses' agents is one year. [ Art. 1043 COCOM ]

Executory  
Instruments  
(Títulos  
Ejecutivos)

Certain instruments are executory instruments... [Art. 1391 COCOM]

The following are executory instruments:

- Final judgments and arbitration awards (res judicata).
- Public instruments.
- Judicial confession.
- Bills of exchange, orders of payment, receipts and promissory notes.
- Insurance policies.
- In the insurance area, decisions issued by experts in connection with the amount of damages.
- Invoices, current accounts and any other commercial contract recognized as validly executed by the debtor before the courts. [Art. 1391 COCOM]

-Savings books will be executory instruments against the bank, without need of a signature recognition or any other requirement. [Art. 59 LIC]

-Credit contracts or policies along with the account statements certified by an authorized (in-house) accountant will be executory instruments without need of a signature recognition. The account statement certified by an authorized (in-house) accountant will be, in certain cases, considered as prima facie evidence in court. [Art. 68 LIC]

-Documentary Credit Contracts will be an executory instrument to demand compliance of the obligations

**CONCEPT****MERCHANTS OR  
ORDINARY  
CORPORATIONS****BANKS**

Corporate  
Purposes

Corporations with an illegal corporate purpose or executing illegal acts in a frequent fashion ("habitually") will be null and void and if anyone requires it, they will be immediately liquidated. [Art. 3 LGSM]

thereunder. Banks do not take the risk for the quantity, quality or weight of merchandise. [Art. 71 LIC]

Banks can only carry out the activities described in this provision and no other activities. [Art. 46 LIC]

They are authorized to invest in shares of other corporations, except for those shares issued by the corporations described in articles 88 and 89. [Art. 75 LIC]

Banks need authorization from SHCP in order to acquire shares from corporations which provide services supplementary to their own services. [Art. 88 LIC]

Prior authorization from SHCP, banks can invest in equity of foreign financial entities.

Prior authorization from SHCP, banks can also invest in equity of mutual funds (sociedades de inversión), mutual fund management companies (sociedades operadoras de sociedades de inversión), retirement funds management companies (administradoras de fondos para el retiro), and mutual funds specialized in retirement funds. Likewise, prior authorization from SHCP banks can invest in the capital stock of auxiliary credit organizations (organizaciones auxiliares de crédito) when such organiza-

**CONCEPT****MERCHANTS OR  
ORDINARY  
CORPORATIONS****BANKS**

General requirements applicable to the incorporation

The corporation's charter must include:

- Name, nationality and domicile of the shareholders.
- Corporate Purpose, name and duration.
- Amount of the corporation's capital stock and paid in capital.
- Shareholders' contributions
- Corporate governance rules
- Appointment and powers of management
- Distribution of profits and losses
- Legal reserve fund
- Dissolution and liquidation events
- Number, value and nature of the shares
- Terms and conditions of payment of the unpaid portion of the shares.
- Rules applying to the distribution of profits to the founding shareholders
- Appointment of the statutory auditors
- Powers of the Shareholders' Meeting [Arts. 6 and 91 of the General Law of Mercantile Corporations (Ley General de Sociedades Mercantiles) ("LGSM")]

tions do not belong to financial groups, except for brokerage houses (casa de bolsa), insurance companies (instituciones de seguros) and bonding companies (instituciones de fianzas). [Art. 89 LIC]

Banks are corporations incorporated in accordance with the LGSM but with distinct characteristics: corporate purpose, unlimited duration, minimum capital stock, etc. [Art. 9 LIC]

CONCEPT	MERCHANTS OR ORDINARY CORPORATIONS	BANKS
Amount of the legal reserve fund	One fifth of the corporation's capital stock [Art. 20 LGSM]	Banks have to allocate at least 10 % of their net profits to the legal reserve fund until the amount of such fund is equivalent to the full amount of the paid-in capital. [Art. 99-A LIC]
Requirements for the incorporation of corporations	<ul style="list-style-type: none"> <li>-Two shareholders at least</li> <li>- Capital stock: \$50,000 Mex. Cy.</li> <li>-At least 20% of the value of each share payable in cash must be paid in.</li> <li>-The total consideration of the shares payable in kind must be contributed from the outset [Art. 89 LGSM]</li> </ul>	<ul style="list-style-type: none"> <li>-Minimum capital stock: equivalent to 0.12% of the net capital of the totality of banks [Art. 19 LIC]</li> <li>-Shares must be fully paid in cash when they are subscribed and must be deposited in a depository such as the Institute for the Deposit of Securities ("Indeval"). [Art. 12 LIC]</li> <li>Additional requirements: <ul style="list-style-type: none"> <li>-The SHCP's authorization along with the prior opinion from Mexico's Central Bank (Banco de México) ("BM") and the CNBV, are required to incorporate and operate a bank. [Art. 8 LIC]</li> <li>-The request shall include a general business plan and a deposit of the 10% of the minimum capital. [Art. 10 LIC]</li> </ul> </li> </ul>
Corporate Name	There are no special restrictions for the choice of the corporate name... [Art. 88 LGSM]	<ul style="list-style-type: none"> <li>Specific provision: Only banks can include in their corporate name the following words (in any language): bank, credit, saving, or trustee. Otherwise, a fine will be imposed and the company will be closed. [Arts. 105 and 107 LIC]</li> </ul>



CONCEPT	MERCHANTS OR ORDINARY CORPORATIONS	BANKS
Minimum capital stock	A minimum fixed capital stock must be maintained by variable capital corporations. [Art. 217 LGSM]	A net minimum capital stock is required for banks [Art. 50 LIC]
Capital Stock Structure	Shareholders may agree to divide capital stock in different classes of shares with special rights for each kind. [Art. 112 LGSM]	<p>Capital Stock:</p> <p>-Ordinary part: at least 51% of Series A shares, the rest may be Series A or B.</p> <p>-Additional part: Series L shares, no more than 49% of the capital stock [Art. 11 de la LIC]</p>
Restrictions to the transference of shares	The charter may establish that the transference of shares will require the Board of Directors' prior approval. [Art. 130 LGSM]	<p>-Series A shares: only Mexican individuals and entities and institutional investors can acquire them in addition to the government. [Art. 13 LIC]</p> <p>-Series B and L shares: their acquisition is subject to fewer restrictions [Art. 14 LIC]</p> <p>- No one is authorized to hold more than 5% of Series A and B shares, except with the SHCP's prior authorization and in no event more than 20%. [Art. 17 LIC]</p> <p>- Indeed, an authorization is required for any group of persons to acquire control of a bank, that is, more than 30%, control of the Shareholders' Meeting or the power to appoint the majority of the Board of Directors' members. [Art. 17 bis LIC]</p>

CONCEPT	MERCHANTS OR ORDINARY CORPORATIONS	BANKS
Classes of actions	Shares with limited voting rights : The charter may establish that certain shares will have voting rights only for Extraordinary Shareholders' Meetings where the following items are discussed: extension of the duration, early dissolution, change of the corporation's purpose or nationality, transformation and merger of the corporation. [Art. 113]	Series L shares provide voting rights only with respect to the following issues: change of the corporation's purpose, merger, spin-off, transformation, dissolution, liquidation and cancellation of the registry in any stock exchange (bolsa de valores). [Art. 12 LIC]
Shareholders' registry	Corporations must keep a Shareholders' Book... [Art. 128 LGSM] A corporation must register in the Shareholders' Book all share transfers... [Art. 129 LGSM]	Transfers made in violation of the law will not be registered. Shares transferred in violation of this provision will be sold to the bank at a price equivalent to 51% of the lower of their book and market value. [Art. 18 LIC]
Issuance of new shares	New shares will be issued only when all previously issued shares have been fully paid-in. [Art. 133 LGSM]	All shares must be fully paid in upon subscription and subsequently deposited at Indeval. [Art. 12 LIC]
Management of the corporation	The management of the corporation shall be the responsibility of a Board of Directors or a Sole Administrator [Arts. 142 and 143 LGSM]	The management of the corporation shall be the responsibility of a Board of Directors and a General Director. [Art. 21 LIC] The Board of Directors shall be comprised of 11 members or a multiple thereof; there are specific rules for the Board of Directors' integration. [Art. 22 LIC]

**CONCEPT****MERCHANTS OR  
ORDINARY  
CORPORATIONS****BANKS**

Powers of  
management

The Sole Administrator or the Board of Directors will have authority to represent the Corporation.... [Art. 10 LGSM]

The Sole Administrator/ Board of Directors and the managers of a corporation are deemed to have powers to issue, subscribe, etc... negotiable instruments [Art. 85 of the General Law of Negotiable Instruments and Credit Transactions (Ley General de Títulos y Operaciones de Crédito)("LTOC")]

The appointment of the Directors and managers must be registered at the Public Registry of Property and Commerce (Registro Público de la Propiedad y de Comercio) [Art. 153 LGSM]

The acts of their employees will be binding on their principals "for all operations entrusted to those". [Art. 321 COCOM]

Appointment  
of Directors

Minority shareholders (25% of the capital stock) are entitled to appoint one member of the Board of Directors [Art. 144 LGSM]

Specific Provisions:

An appointment certification issued by the Board of Directors' Secretary will suffice to evidence the authority of the Corporation's officers.

The powers of attorney must describe only the Board of Directors' resolution to grant it, the powers granted to the Board of Directors, and the appointment of the Directors. The powers of attorney granted in accordance with article 2554, 1st and 2nd para. shall be construed to include powers for issuing, subscribing, etc... negotiable instruments. [Art. 90 LIC]

The appointment of the officers and members of the Board of Directors must be registered in the Public Registry of Property and Commerce. [Art. 90 LIC]

In addition to the personal civil or criminal responsibility their employees may incur, banks are directly responsible for the acts executed by their officers and employees "in the exercise of their functions". [Art. 91 LIC]

Minority shareholders (10% of the capital stock) are entitled to appoint one member of the Board of Directors [Art. 22 LIC]

CONCEPT	MERCHANTS OR ORDINARY CORPORATIONS	BANKS
Requirements for being a director or manager	Those persons who are no longer legally capable of exercising commerce cannot be appointed as directors or managers. [Art. 151 LGSM]	Stricter requirements for being a member of the Board [Art. 23 LIC] Stricter requirements for being a General Manager [Art. 24 LIC]
Revocation of managers and Board members	Rules for the removal of Board members [Art. 155 LGSM]	The CNBV is empowered to determine, at any moment, the suspension or removal of the Board of Directors' members, general directors, statutory auditors and officers. [Art. 25 LIC]
Appointment of statutory auditors (comisarios)	Minority shareholders (25% of the capital stock) are entitled to appoint one statutory auditor [Arts. 171 and 144 LGSM]	One statutory auditor must be appointed by each Series of shares (A, B, L). [Art. 26 LIC]
Representation at Shareholders' Meetings	Representation shall be conferred as set forth in the by-laws or, at least, in writing. [Art. 192 LGSM]	Representation shall be conferred in formats issued by the bank for such purpose. [Art. 16 LIC]
Merger	No authorization is required.  Merger agreements will be registered at the Public Registry of Property and Commerce and published in the official gazette of the domicile of the merging companies. Each merging corporation must publish its last balance sheet.  The merger will become effective three months after the registration date. [Arts. 222-226 LGSM]	The SHCP's prior authorization is required along with the opinion from the BM and the CNBV. Specific procedures must be observed.  The SHCP's authorization and the merger agreements will be registered at the Public Registry of Property and Commerce. Merger agreements adopted by the Shareholders' Meetings will be published in the Federal Register (Diario Oficial de la Federación) and two daily

CONCEPT	MERCHANTS OR ORDINARY CORPORATIONS	BANKS
Dissolution and liquidation	The shareholders shall appoint the liquidators. [Arts. 229-249 LGSM]	newspapers of wide circula- tion in the domicile of the merging companies.  The merger will become ef- fective as of the registration date. [Art. 27 LIC]
Repurchase agreements	The LTOC regulates repur- chase agreements of negotia- ble instruments (títulos de crédito) in general. Repurchase agreements must be executed in writing. [Arts. 259-266 LTOC]	The dissolution and liquida- tion procedure will be carried out in accordance with the provisions of LGSM and the Law on Bankruptcy and Sus- pension of Payments ( <i>Ley de Quiebras y Suspensión de Pagos</i> ) ("LQSP"), with cer- tain exceptions. [Art. 29 LIC]  The Credit Institutions and Auxiliary Organizations Liq- uidation Trust, known as FIDELIC, must be appointed as liquidator or receiver. [Art. 29-I LIC]  There are specific rules for the execution of repurchase agreements.  The LIC applies only to re- purchase agreements involv- ing securities (valores).  Repurchase agreements must be executed in accordance with general rulings issued by the BM. [Art. 54 LIC]  Banks may execute repur- chase agreements on behalf of third parties without the assistance of brokerage houses when the purpose of

**CONCEPT**

**MERCHANTS OR  
ORDINARY  
CORPORATIONS**

**BANKS**

		such agreement is the "correct functioning of the payment system". [Art. 81 LIC]
Subordinated Bonds	<p>The LTOC regulates the issuance of bonds. [Art. 208 LTOC]</p> <p>There are specific requirements for the issuance of convertible bonds. [Arts. 210 bis-228 LTOC]</p>	<p>There are specific requirements for the issuance of subordinated bonds. [Art. 64 LIC]</p> <p>Subordinated bonds must comply with the general requirements applicable to banking bonds.</p> <p>The BM's authorization is required for the issuance of subordinated bonds. [Art. 64 LIC]</p>
Credits	<p>Ordinary corporations are not required to prepare a study determining the "economic viability of the investment projects".</p>	<p>Banks must prepare a study determining the "economic viability of the investment projects, the re-payment period thereof", etc. [Art. 65 LIC]</p>
Purchase finance agreements (crédito de habilitación o avío; crédito refaccionario)	<p>These contracts must be executed by means of a private contract, signed in three copies before two witnesses and ratified before the person in charge of the Public Registry of Property and Commerce.</p> <p>A portion of a crédito refaccionario may be applied to the payment of: (i) tax debts; and (ii) other debts incurred in connection with the purchase and/or exploitation of goods. [Arts. 321-333 LTOC]</p>	<p>Purchase finance agreements must comply both with the provisions of the LTOC and the provisions of the LIC.</p> <p>These contracts must be executed before a Commercial Public Registrar (Corredor Público), in a notarial deed, or in a private contract signed in three copies before two witnesses and ratified before a notary public, commercial public registrar, trial judge or the person in charge of the corresponding Public Regis-</p>

CONCEPT	MERCHANTS OR ORDINARY CORPORATIONS	BANKS
		try of Property and Commerce.
		The portion of the credit to be applied to the payment of tax or other debts cannot exceed 50% of the credit. [Art. 66 LIC]
Industrial Mortgage	Not regulated. Available?	Expressly available and regulated in detail for banks. [Art. 67 LIC]
Commercial pledge	In general, a pledge may be created by delivering the asset (possessory security) or by endorsing the negotiable instrument, as the case may be. [Art. 334 LTOC]	A pledge may be created simply by identifying in the credit document the assets the subject of the collateral. The collateral may be realized with the participation of one Commercial Public Registrar or two merchants from the locality, and banks have the right to set off the money received from the realization of the collateral against their credit. In certain cases, the pledge can be perfected without delivering the asset. [ Art. 69 LIC]
Commercial pledge on corporate credits [accounts receivable?] (créditos en libros).	...A pledge on corporate credits may be created if the applicable provisions of the LIC are complied with. [Art. 334-VIII LTOC]	In certain cases, the pledge can be perfected without delivering the asset. This kind of pledge can be created by (i) listing the credits in the credit agreement; (ii) identifying each account receivable as "pledged"; and (iii) the creation of a special registry by the bank. For purposes of the collection of the credit, the debtor is considered as an agent of the creditor with the

**CONCEPT**

**MERCHANTS OR  
ORDINARY  
CORPORATIONS**

**BANKS**

ensuing civil and criminal liabilities. [Art. 70 LIC]

Commercial Procedure

It may be involve litigation before the courts or arbitration proceedings... [Art. 1051 COCOM]

Any controversy may be resolved by the courts or the CNBV. A conciliation process is available. The CNBV, is authorized to fill in legal deficiencies of any claim. [Art. 119 LIC]

There is no time-period established to comply with the terms of the award.

In case of impossibility of conciliation, alternative dispute resolution methods will be suggested an.

When there is an executory document the conflicts shall be resolved by means of a summary commercial process. [Art. 1391 COCOM]

The parties must comply the award within a period of 15 days. [Art. 120 LIC]

In the absence of a special procedure, disputes will be resolved by means of an ordinary, as opposed to an executory, commercial process. [Art. 1377 COCOM]

When the credit is secured, the bank is empowered to pursue a summary, ordinary or any other commercial process available, and the bank will keep the collateral and its preference rights over it even if the secured assets are being sought by another creditor in an execution procedure. [Art. 72 LIC]

Trust

Ordinary corporations cannot act as trustees. [Arts. 346-359 LTOC]

Specific provisions Banks must keep separate accountings records for each trust arrangement. [Art. 79 LIC]

Banks must carry out trusts and commission operations through designated trust agents. Banks are responsible for the losses and damages caused for the non-compli-



**CONCEPT****MERCHANTS OR  
ORDINARY  
CORPORATIONS****BANKS**

ance of their obligations. A technical committee may be established; whenever a bank acts in accordance with this committee's instructions, the bank will be free of any liability. [Art. 80 LIC]

Employees assigned to carry out trust-related work shall not be considered as employees of the banks; in the event of a lawsuit brought by these employees against the bank the bank will use the trust assets to comply with the corresponding judicial decision, as necessary. [Art. 82 LIC]

Parties to a guaranty trust indenture are free to agree on the execution procedures. Absent such an agreement, the pledge execution procedures will be applied. Unless the debtor objects to the execution of pledge-like proceedings, the judge will order the compliance with the provisions of the trust indenture. [Art. 83 LIC]

**Strikes**

In the event of a strike, certain employees must continue working, i. e.: (i) employees of ships, airplanes, trains, buses which are in route; and (ii) employees of hospitals until all patients are transferred to another health institution [Art. 466 of the Federal Labor Law (Ley Federal del Trabajo)("LFT")]

During a strike, the Conciliation and Arbitration Board (Juntas de Conciliación y Arbitraje) will order that necessary branches remain open and those "strictly necessary" employees remain working. [Art. 121 LIC]

**CONCEPT****MERCHANTS OR  
ORDINARY  
CORPORATIONS****BANKS****Holidays**

Eight holidays are established in the LFT. [Art. 74 LFT]

The CNBV will determine the bank holidays for each year. If so decided by the CNBV, bank holidays will not be considered as working days for any legal purposes. [Art. 95 LIC] Bank holidays for 1998 are 14, including those under the LFT.

**Bonds to guarantee losses and damages which may be caused to third parties**

Legal proceedings shall be suspended upon the application of the claimant provided "sufficient guarantee" is furnished by the claimant to guarantee third-party losses and damages. [Art. 173 of the Amparo Law] Tax obligations liquidated by the government as well as other tax indebtedness must be paid or guaranteed. [Arts. 65, 141, 142 of the Fiscal Code of the Federation (Código Fiscal de la Federación)]

As long as a bank is not involved in bankruptcy or suspension of payments proceedings, it shall be presumed solvent and shall have no obligation to set up any legal deposits or bonds, including those required from other parties to grant a request for the suspension in an amparo law suit or tax obligations in tax proceedings. [Art. 86 LIC]

**Adhesion contracts**

Certain adhesion contracts must be registered in advance before the Consumer Protection Bureau (Procuraduría Federal del Consumidor). [Arts. 86 y 87 of the Federal Consumer Protection Law (Ley Federal de Protección al Consumidor)]

