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Securitisations in Mexico

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In Mexico, the market for securitisations has considerably expanded. While mortgage-backed securitisations played a leading role in terms of market growth in recent years, institutional investors are now turning to other types of asset-backed securities. New deal structures are being put in place to finance different kinds of asset, either privately by lenders or institutional investors or through publicly placed securities. Assets used to back these transactions include short-term trade receivables, commercial real estate leases, receivables from sales of real estate developments and service agreements. Mexican companies often turn to these schemes as an attractive financing alternative.

The expanding trend of infrastructure growth under public-private partnerships is also increasing the number of assets available to be financed through securitisations. The Mexican government has announced an ambitious infrastructure programme for the coming years, which includes hospitals, schools, universities, sports facilities, water treatment plants, municipal waste processing facilities, administrative offices for government branches and roads. The government is also granting concessions for the construction and operation of new highways, trains, bridges and other similar projects. Some of these concessions are based on shadow toll structures or under other forms of service contract that allow the use of current expense government funds to alleviate regulatory burdens and budgetary constraints. In addition, a programme established by the Mexican government to grant concessions to private investors for the operation and maintenance of the toll roads that were recovered as a result of the 1995 financial crisis is now underway.

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In line with this market trend, the framework for securitisation transactions in Mexico has been gradually modernised. A number of regulatory improvements are still desirable, but existing rules allow for the implementation of these transactions with reasonable certainty from a legal standpoint. A number of Mexican laws have been enacted or amended, making structured finance and securitisations easier to implement. The new Securities Market Law, enacted in 2006, includes rules applicable to the issuance of securities by Mexican trusts to implement asset-backed securitisations. In addition, the National Banking and Securities Commission (CNBV) has published rules for the registration of *certificados bursátiles fiduciarios*, a specific type of security issued by securitisation trusts.

In line with the opening up and deregulation of the Mexican financial sector, a number of financial laws have been amended to provide for a more diversified, less regulated market. Under new regulations, anyone may engage in the business of granting loans or leasing or factoring activities without the need to secure prior governmental authorisation, and with no restriction on foreign investment.

The less formal requirements allow for more flexibility to implement financing structures.

Transaction documents

Securitisations are usually carried out through special purpose trusts. The assets transferred by the originators to the estate of these trusts include the collection rights from the asset being securitised. In a few instances, the trusts are also used to hold title to certain key operating assets of the originators in order to cover potential events where operators of productive assets may need to be replaced.

Normally, the originators act as settlors of the trust, while a Mexican financial institution acts as trustee. Under Mexican law, in transactions involving the issuance of securities only Mexican banks or brokerage houses may act as trustees. These institutions have special trust divisions and act through special trust delegates.

The trust agreement includes the designation of beneficiaries. In a securitisation trust the holders of securities issued by the trust are named first-place beneficiaries. When securities issued by the trust are placed in the Mexican market, the holders of such securities are represented by a common representative, normally a stock brokerage house or a banking institution, and such common representative also executes the trust agreement. Structures that include subordinated tranches generally include subordinated holders as second-place beneficiaries. The settlors also commonly act as beneficiaries in third place in order to receive residual interests to the trust assets once the securities have been repaid and all other trust obligations have been complied with. This helps to avoid the transfer being treated as a sale for Mexican tax purposes.

The trust agreement includes detailed provisions setting forth the purposes of the trust and the authority conferred to the trustee. Under Mexican law, a trustee may use the trust assets only as specifically set forth in the trust agreement. The use of trust assets in a different manner would be *ultra vires*, may be invalidated and could subject trustees to personal liability.

Securitisation trust agreements include the creation of different accounts and funds on which the amounts received by the trust are deposited, and a waterfall with a specified order of priorities for the use of such funds. These accounts and the waterfall are designed to guarantee payment of issuance and maintenance expenses, debt service and other reserves.

In addition to the trust agreement, transactions are usually implemented in Mexico through an assignment agreement whereby receivables are transferred to the trust. The trust acts as assignee and the originators act as assignors. In some transactions, these contracts may be substituted by a factoring agreement that provides more flexibility, especially with regard to the perfection of the transfer of collection rights from multiple debtors.

The trust also enters into all financing agreements and other documents. If the financing is obtained through the issuance of securities, a prospectus should be prepared and approved by the CNBV if the securities

will be issued and placed on the Mexican market. Securities commonly issued are *certificados bursátiles fiduciarios*, a special form of security regulated by Mexican securities market law. Securities placed in Mexico must be registered at the National Securities Registry. When securities are to be placed outside Mexico, CNBV approval and registration are not necessary. In such cases, issuing trusts are required only to file notice with the National Securities Registry for statistical purposes.

Debt securities issued by a Mexican trust and placed in the Mexican market shall be rated by at least one rating agency. If the securities are to be placed with Mexican pension funds, two ratings are necessary.

The trust agreement should specify in detail permitted trust activities and actions required from the trustee, so that little or no authority is left to the settlors or to any other party. However, it is common to create technical committees that take certain limited decisions and provide instructions to the trustee in cases where the trust agreement is silent. These technical committees are often composed of three members and are controlled by the investors.

During the life of the transaction, the originators provide management and collection services with respect to the receivables transferred to the trust estate. These services are provided under service agreements. In many cases it is also common for independent third-party contractors to be hired to act as servicers, and in certain cases as bond administrators, to provide reporting and administration services to the trust. These services are also provided through contracts executed by the trustee. In some cases, back-up servicers are hired; back-up operators are also considered in other cases where the operators of the assets used to generate receivables may be replaced.

Transfer formalities

Under Mexican law, the general rule is that a debtor's consent is not required to transfer collection rights into a securitisation trust, unless otherwise agreed. However, when the asset to be securitised derives from a contract,

concession, permit or other similar document, the terms and conditions thereof should contain clear rules with respect to the assignment of rights and the assignment of collection rights should be expressly allowed.

In some cases, the assignment of collection rights should be made with formalities. Mexican statutes contain different provisions depending on the nature of the right to be assigned. Assignment agreements often need to be notarised by a Mexican notary public.

As a general rule, the assignment should be made in writing and should be notified to the corresponding obligor. The notification should be made in person either before a notary public or before two witnesses. In cases where the securitisation involves collection rights from numerous obligors (eg, in the case of trade receivables securitisations), this requirement may present a challenge. However, recent regulations applicable to factoring may be taken advantage of when structuring securitisations, particularly those backed by short-term receivables. As opposed to prior provisions which established that only current receivables could be subject to factoring, any right of credit of any nature may now be subject to factoring. Factoring agreements may be entered into with or without recourse. In addition, the management and collection of receivables subject to factoring may be either kept by the factoring entity or delegated to the originator or to a third-party servicer. In most cases there is no need to secure a debtor's prior consent in order to include its receivables in a factoring arrangement. Strict rules regarding the notification of the assignment of receivables, which constituted a stumbling block in trade receivables securitisations, are now considerably eased if a factoring agreement is used. Notifications to customers may now be made through different means, including the use of certified mail, fax and email. Moreover, in cases where the originators continue to perform management and collection activities, the notification requirement may be dispensed with. Therefore, a securitisation of commercial receivables from different obligors would usually include factoring agreements entered into between the trustee and the originators.

Special rules apply for the assignment of mortgage securitisations. The transfer of mortgages granted in favour of Mexican banking institutions or other financial entities requires no notification to the debtor in cases where the original mortgage creditor continues to act as servicer. If the original mortgage creditor ceases to provide management and collection services, a notification of the assignment would need to be provided to the debtor.

Bankruptcy-related considerations

As collection rights are transferred to the trust estate, it is important to ensure that:

- the reorganisation or bankruptcy of the originator would not affect the estate of the issuing trust, so that if the originator became subject to such proceeding the trust would be able to continue to service the debt with no interruptions;
- the creditors of the originator would not have an action against the trust; and
- the trust estate would not be deemed to be a part of the bankruptcy estate.

This implies a careful analysis of the effectiveness of the transfer of the assets into the trust estate as a true sale.

In common law jurisdictions, a two-step transfer is generally required in order to achieve this result; a transfer is made to a special purpose entity, which in turn transfers the assets to another special purpose entity, which then issues the debt. However, under Mexican law it is clear that the transfers made in favour of a trust imply a transfer of title of the corresponding assets or rights into the trust estate, and therefore a two-step transfer is not necessary. Mexican statutes governing the creation of trusts expressly state that the institution acting as trustee receives title to the assets that constitute the trust estate. Upon a transfer to a trust, the transferred assets no longer belong to the originator and are owned exclusively by the trust. The originator has exchanged such assets for a different asset consisting of the proceeds from the financing obtained

by the trust, and in some cases the rights as a beneficiary of the trust (albeit subordinated to debt repayment).

Consistent with this, Mexican law provides that the institution acting as trustee should account for the rights or assets so transferred and should maintain them separate from its other assets. Such statutes also provide that the assets that a trustee holds by virtue of a trust agreement are to be dedicated exclusively to the specific purposes of the trust, and that they are not available to satisfy other liabilities of the institution acting as trustee.

Mexican bankruptcy law expressly states that assets forming part of a trust may be separated from the bankruptcy estate of the party that created the trust, even if such assets were in the possession of the bankrupt party. Thus, Mexican law provides that unless there is a fraudulent conveyance, the trust estate is separate and independent from the estate of the originators, even if the originators are subject to a bankruptcy proceeding and materially hold possession of such assets.

Certain tax considerations

Appropriate tax and accounting treatment is critical in a securitisation transaction. In most cases, it is intended that for tax purposes the debt issued by the trust must not be included in the balance sheet of the originators, and the transfer of collection rights into the trust must be accounted for as a sale and not as a financing. Accounting rules applicable in Mexico, while not as developed as in the United States or other countries, generally follow the principles of securitisation accounting in the United States.

There are very specific rules that apply to Mexican trusts and that should be carefully analysed when implementing a securitisation. It is generally intended that the transfer of assets into a trust is treated as a sale not for tax purposes, but only for other legal and accounting purposes, and that the trust should not be classified as a separate entity for tax purposes.

In most cases a transfer of assets to a trust estate made by the settlors of the trust will not be treated as a

sale for Mexican tax purposes to the extent that the settlors retain certain residual rights over the trust estate. This is generally achieved through the inclusion of the settlors as beneficiaries of the trust. In most cases status as trust beneficiaries is subordinated to the rights of the investors and other stakeholders in the securitisation.

An additional tax issue to be addressed is the characterisation of the trust as a special vehicle not engaged in tax-generating activities.

Pursuant to Mexican legislation, commercial, industrial, agricultural and other similar activities are considered to be entrepreneurial activities. These activities are generally subject to Mexican income taxes and other forms of taxation in Mexico. When such activities are carried out through a trust, the trust becomes subject to taxation in connection with such activities as if it were a commercial entity. Therefore, it is vital that the activities carried out by a securitisation trust not be deemed to fall within the scope of 'entrepreneurial activities'.

No specific rules or criteria have been published by the Ministry of Finance or contained in Mexican tax regulations to clarify when a trust is deemed to be a special purpose trust for entrepreneurial activities. Thus, advisers involved in the structuring of a securitisation and in the preparation of relevant documentation should be careful to design the transaction so as to make it clear that the trust will not be classified as separate tax entity.

Certain judicial precedents deal with this issue, and criteria published by the Mexican Institute of Certified Public Accountants also shed light on this issue. In general terms, a trust is not deemed to be a special purpose trust for entrepreneurial activities to the extent that its purpose is not to engage regularly in commerce, industrial, agricultural or similar profit-generating activities, or

activities of a speculative nature. Unless a trust regularly engages in such activities, it will not be classified as a special purpose trust for entrepreneurial activities even if it carries on one or more transactions that are acts of commerce *per se* (eg, the issuance of securities, the purchase of receivables or even the execution of a factoring agreement), to the extent that these actions are circumstantial and isolated, as opposed to ordinary activities with a view to generate profits. Securitisation trusts should be designed to make it clear that they are merely vehicles to conduct a financing transaction, rather than to carry out entrepreneurial activities.

In addition, while for accounting purposes the debt issued by a securitisation trust should be off-balance in regard to the originators, for Mexican tax purposes it is normally treated as debt of the originators as opposed to debt of the trust.

In cases where factoring agreements are included within the securitisation structure, Mexican value added tax includes clear rules applicable to value added tax recognition and application.

Recently, a number of Mexican tax laws were amended as part of a comprehensive tax reform. Notably, a new flat tax for business (the *impuesto empresarial a tasa unica* (IETU)) has been established. The IETU applies a flat rate based on cash flow with few deductions and may be offset against Mexican income tax results. Interest payable is not deductible from the IETU, although it may be deducted for income tax purposes. As a result, this new tax may have an impact on Mexican companies whose income tax computation results in an effective income tax payment lower than that payable under the IETU.

It is therefore essential to review the accounting and tax implications of a proposed structure carefully before launching an asset-backed securitisation.