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Securitisation

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Deloitte Legal Mexico has participated in countless international transactions spanning a wide range of practices, industries and sectors, and handles matters in English, Spanish, Chinese, Taiwanese, Portuguese, Korean and Japanese. Deloitte Legal Mexico's key practice areas are corporate M&A, banking & finance, real estate, energy & natural resources, infrastructure, capital projects, project finance, in-

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1. Structurally Embedded Laws of General Application

1.1 Insolvency Laws

Based on the provisions contained in the Bankruptcy Law (*Ley de Concursos Mercantiles*, hereinafter CBL), the Mexican legislator incorporated the legal framework to secure the survival and viability of companies in a situation of general breach of obligations. The objective of this framework is the implementation of a process aimed to increase the value of bankrupt companies, while focusing on their preservation. For the purposes of this restructuring process, it is necessary to make a prior analysis of the status of each property owned or held by the company (ie, the issuer) prior to declaring such entity as formally bankrupt.

According to Article 71 of the Securities Market Law (*Ley del Mercado de Valores*, hereinafter SML), it is possible to separate from the bankruptcy estate certain credits that are subject to a trust agreement (*fideicomiso*), so that they are separated from the bankruptcy assets. However, if the trust agreement by which these assets are transferred is executed within the 270-day period prior to the declaration of bankruptcy by a judge, it is presumed that the act was carried out in fraud to creditors and other third parties.

In Mexico, it is also possible to carry out the abovementioned transfer through a true sale or a secured loan. The main difference between these figures is that whereas in a true sale it is considered that the property of the accounts receivable has been transferred by the issuer, in a secured loan these assets continue to be part of the originator's patrimony and are subject to the bankrupt procedures – however, these type of agreements grant the creditor a preferential right within the bankruptcy procedures.

According to Article 83 of the SML, a public securitisation, for the transfer and acquisition of these type of assets, will require the authorisation of the Banking and Securities Commission (CNBV). The respective plea must be accompanied by, among others, the legal opinion issued by an independent lawyer about the legal validity and enforceability of the trust agreement, as well as the legal acts for the transfer of ownership over the goods or trust rights.

1.2 Special-Purpose Entities

As indicated in the preceding section, property belonging to the trust will not be part of the bankruptcy assets. It is for the foregoing and based on the provisions of the SML that a trust is constituted as a Special Purpose Entity (SPE).

This SPE must have the character of irrevocability, and only credit institutions, brokerage firms and operating companies of investment companies may act as trustees of such trust. Also, as detailed below, it is highly recommendable that the tax and accounting structure of such a trust is considered

as transparent for tax purposes, in order to avoid certain income tax rules.

Also, the trustee of a trust issuing indexed fiduciary certificates (ie, those that represent rights with respect to securities, goods, derivative financial instruments or other assets that seek to replicate the behaviour of one or more financial market indexes or reference parameters) is prohibited to: (i) have any type of link with the indexes generators, and (ii) maintain custody of the trust assets.

In accordance with the provisions set forth in the CBL, the issuing trust must have a technical committee (special board), in charge of executing the instructions of the trustees, with at least 25% independent board members.

1.3 Transfer of Financial Assets

Assets subject to a trust will not be considered as part of the bankruptcy assets, provided that the corresponding contract or contribution had not been made before the declaration of insolvency, knowingly defrauding the creditors. For the enforceability of such transfer, assets transferred to the trust must be registered in the Sole Registry of Movable Guarantees (*Registro Único de Garantías Mobiliarias*).

1.4 Construction of Bankruptcy-Remote Transactions

For the collection rights of a certain contractual transaction to be transferred into a trust, the authorisation of the debtor is not necessary, unless otherwise agreed in the original agreement.

If the parties have agreed that such authorisation is necessary, it should be supported through the corresponding notification document. In the event that nothing has been agreed upon, the notification of the assignment must be carried out through a notary public.

It is possible for legal practitioners to obtain opinions on bankruptcy-remote transactions; however, such may not be valid for the tax and administrative authorities.

2. Tax Laws and Issues

2.1 Taxes and Tax Avoidance

Securitisations in Mexico are usually structured in order to be 'pass-through' vehicles for tax purposes. When structuring a trust (such as an SPE), an appropriate tax and accounting treatment is essential in order to avoid withholdings and other adverse tax consequences. Generally, the intention of the parties is that the transfer of assets into a trust is not treated as a sale for tax purposes (in accordance with the Mexican Tax Code) but only for other legal purposes, therefore such an SPE is not classified as a separate business entity (*fideicomiso de actividades empresariales*).

2.2 Taxes on SPEs

As previously mentioned, a transfer of assets to a trust estate made by the settlors of the SPE would not be treated as a sale for Mexican tax purposes to the extent the settlors retain certain residual rights over the trust estate in accordance with Article 14 of the Mexican Federal Tax Code. This is generally achieved through the inclusion of the settlors as beneficiaries of the trust (*fideicomisarios*). The status as trust beneficiaries is, in most cases, subordinated to other third party rights (such as investor rights or financial institutions rights).

2.3 Taxes on Transfers Crossing Borders

Pursuant to Mexican law, tax withholdings deriving from payments to foreign creditors apply with respect to interest payment at rates varying from 10% up to 40% of those foreigners whose main tax residence is registered in a country considered to be in a 'preferential tax regime' (*refitpres*).

An additional tax issue to be addressed is the characterisation of the trust as a special vehicle not engaged in tax-generating activities – this is not considered as a vehicle to carry out business activities, which tends to be subject to Mexican income tax provisions. In the event such situation happens, the trust becomes subject to taxation in connection with such activities as if it were a separate business entity. It is therefore of the utmost importance that the activities carried out by this type of SPE trust are not deemed to fall within the scope of business activities.

2.4 Other Taxes

There are no other specific general provisions, rules or criteria published by the Ministry of Finance (*Secretaria de Hacienda y Crédito Público*) or contained in Mexican tax regulations clarifying when a trust is deemed to be a *fideicomiso de actividades empresariales*; however, trusts may also be subject to VAT law in Mexico, depending on the activities carried on by such vehicles.

In conclusion, it must be made clear that a securitisation SPE is merely a vehicle to conduct a financing transaction, rather than to carry out commercial activities or industry services.

2.5 Obtaining Legal Opinions

It is possible for legal practitioners to receive opinions on securitisation trust transactions; moreover, as described above, a legal opinion is an essential requirement for the authorisation of a public securitisation offer by the CNBV.

3. Laws and Regulations Specifically Relating to Securitisation

3.1 Specific Disclosure Laws or Regulations Laws and Regulations

In Mexico there are specific requirements and rules to be able to carry out securities public offers. Such rules are

established in the SML, as well as in the General Provisions Applicable to Issuers and Other Participants in the Securities Market, which establish prior approval from the CNBV as a main requirement.

Forms of Disclosure

Public or private offerings are allowed in Mexico as material forms of disclosure. However, to obtain the approval for a public offering, the issuer must submit an application form to the CNBV, containing, among other aspects: (i) an informative brochure (prospectus); (ii) relevant corporate documentation of the issuer; (iii) a copy of the contracts or previous agreements with buyers, shareholders, directors; (iv) an abstract with the notice of public offering with the securities information; and (v) an opinion issued by an independent legal counsel in relation to the main aspects of the offer, including the price.

Principal Regulators

The CNBV is the institution in charge of reviewing, regulating and approving the actions of both individuals and corporations as well as credit institutions. Likewise, the Mexican Stock Exchange, although it does not have a direct participation in securitisation matters, is in charge of overseeing and supervising compliance with the obligations and procedures established by the SML in relation to the issue of securities. A third government sponsored entity is the Securities Deposit Institute (INDEVAL), which is the only authorised agency to serve as the depository of public securities.

Also, several other governmental agencies may participate as issuers; specifically, the State Productive Enterprises – ie, *Petroleos Mexicanos* (PEMEX) and *Comisión Federal de Electricidad* (FCE) – may issue debt bonds and securities in both the Mexican and international financial markets. Finally, some governmental development banks and agencies may act as sponsors of securitisations, particularly those aimed at the development of infrastructure, energy and social welfare.

Violations and Penalties

The SML is the instrument in charge of establishing the sanctions applicable to the issuers in case of not complying with the requirements established in such law. In case of carrying out activities (such as the public offers mentioned in the previous paragraphs) without prior authorisation from the CNBV, penalties vary from five to 15 years in prison. Likewise, those who make public offers without having their registration in the corresponding registry may receive a sanction varying from three to fifteen years.

3.2 General Disclosure Laws or Regulations

See above, 3.1 Specific Disclosure Laws or Regulations.

3.3 'Credit Risk Retention'

There are no laws or any special regulation on credit risk retention in Mexico. However, Mexican financial laws estab-

lish the guidelines and parameters by which credit operations must be carried out.

3.4 Periodic Reporting

Both the SML and the General Provisions Applicable to Issuers and Other Participants in the Securities Market establish as a requirement for issuers to submit a series of reports to the CNBV, namely: (i) continuous reports related to corporate acts, agreements adopted, etc, (ii) quarterly reports that include financial statements and the results of operations and the financial situation, (iii) annual reports containing the annual financial statements, an opinion of external audit, (iv) reports on restructurings such as mergers.

Likewise, the aforementioned law establishes a requirement for the issuers to file a notice before the CNBV regarding the relevant events at the moment they become aware of them, as well as informing the CNBV about unusual movements in the market related to prices or volume and/or changes in the supply and demand of their securities or their price.

The CNBV is empowered by the SML to request, as a precautionary measure, the suspension of the registration of the securities of an issuer in the Registry for a term not exceeding 60 business days when the presentation of any of the reports is omitted or notices mentioned in the previous paragraphs.

3.5 Activities of Rating Agencies (RA)

Rating agencies' securitisation activities are regulated by the CNBV; among the activities carried out by them are conducting studies and analysis, as well as issuing opinions about the credit quality of an entity or issuance.

Currently, in Mexico there are only seven rating agencies – Fitch México, S&P Global Ratings, Moody's de México, HR Ratings de México, Verum, DBRS and AM Best. A rating agency's main objective is to analyse and inform the market about the risks of an investment.

The penalties applicable to the Rating Agencies are established in the SML, which establishes that the authorisation to operate as a rating agency may be revoked for committing serious infractions or repeatedly infringement of the rules as stipulated in the aforementioned law.

3.6 Treatment of Securitisation in Financial Entities

In general terms, the financial legislation applicable in Mexico has been created in accordance with (and adheres to) the provisions established in the Basel rules, taking into account that there are naturally certain differences.

3.7 Use of Derivatives

The SML has included a series of provisions that regulate such matters. In fact, Article 364, subsection I of the SML

provides that people who have privileged information may not carry out or instruct the holding of transactions with optional securities or derivative financial instruments that have such securities or securities as an underlying asset.

Moreover, since 2015, the Central Bank of Mexico (*Banco de México*) issued secondary general provisions (*circulares*) in relation with the requirements for the entities that intend to carry out derivative transactions – specifically, administration requirements (such as objectives, goals, and procedures for carrying out the transactions with customers and other intermediaries in the market and the maximum tolerance of market risk, credit risk and any other risks considered acceptable for the entity in the market) and other operational requirements.

3.8 Investor Protection

Within the Mexican legislation, the SML establishes a series of general rules that financial institutions and brokerage firms must comply with in order to protect investors. Also, through the general provisions applicable to securities issuers (*Disposiciones de carácter general aplicables a las emisoras de valores*) the CNBV has set the standards of transparency, confidentiality and anti-money laundering requirements that any issuer should observe for the protection of and reporting to its investors. The CNBV is therefore the responsible institution for verifying the compliance of such provisions and ensuring that financial institutions and brokerage houses comply with confidential and secret information; failure to do so will result in the institution being obliged to pay damages.

3.9 SPEs or Other Entities

Regarding the use of securitisation trusts in Mexico, see 1.2 **Special Purpose Entities**, above.

3.10 Activities Avoided by SPEs or Other Securitisation Entities

Whenever there is a securities issue through a public offer and these securities are placed among the investing public, such offer and issue must be subject to the provisions of the SML.

3.11 Material Forms of Credit Enhancement

There are many forms of enhancement for securitisations applicable in Mexico, including the following: (i) non-dispossessionary pledges, (ii) valuation report of assets (tangible and intangible) given as collateral, (iii) cash reserves or deposits, (iv) letters of credit and credit default swaps, and (v) concentrator accounts.

3.12 Participation of Government Sponsored Entities

As referred to above in 4.1 **Specific Disclosure Laws or Regulations**, there are several governmental agencies involved in the securities market, such as the CNBV (regulator),

the BMV (stock exchange), INDEVAL (depository of the securities issued through public offers) and others, such as PEMEX, CFE or even the Bank of Mexico, that may act as issuers or sponsors, as the case may be.

3.13 Entities Investing in Securitisation

Pension fund managers (*Administradores de Fondos para el Retiro – afores*) and other private sector entities regularly invest in securitisations in Mexico; material rules may vary depending on the rules of the specific securitisation trust, as well as in the type of securities held by such trust.

Afores and other qualified investors may also invest in capital development certificates (CKDs) that are structured as trusts. The securities issued by a CKD are publicly registered and traded (although the liquidity of the market is quite limited).

The CNBV also issued rules in December 2015 to regulate a new vehicle called the Investment Project Certificate (*Certificado de Proyectos de Inversion – CERPI*). The CERPI is an investment vehicle intended for sophisticated investors only. The certificate would be issued through the BMV in the form of a restricted offering for investors (eg, pension funds and insurance companies) and would focus on a specific project rather than a pool of assets or portfolio companies.

For CERPIs and CKDs, *afores* are allowed to acquire 100% of a structured instrument as long as it does not exceed 3% of the pension fund entity (SIEFORE) net assets. The *afore* must have a co-investor for the project with at least 20% participation for issuances less than MXN4 billion or 50% for higher issuances.

The Mexican financial authorities have also enacted the rules for the creation of specific real estate securities trusts (FIBRA) and a new Energy and Infrastructure Investment Trust (FIBRA-E) that provide vehicles for investment in projects or assets of the energy and infrastructure sector, including activities such as generation, transmission and distribution of electricity, roads, highways and railways, among others.

4. Documentation

4.1 Bankruptcy-Remote Transfers

Please see the description above regarding the use and characteristics of securitisation trusts in Mexico, in particular those related to the true sale of assets in order to avoid being subject to the bankruptcy procedures or the secured loan agreements that grant the creditor a preferential right within the bankruptcy procedures.

With regard to private offerings, trusts may also be structured in order to securitise accounts receivable of a private

entity among one or more investors. This is usually made through a package of trusts attached to one master trust agreement (as well as the corresponding administration agreement), by which a sole administrator, acting as a servicer, administers the receivable rights between the investing companies (banking institutions).

4.2 Principal Warranties

In general terms, issuers should back-up securitisation transactions with personal and/or in rem collateral agreements (such as pledges, mortgages or other asset-based securities). The issuer is liable to the trustee for the existence and lawfulness of the assets being securitised in any transaction; the trustee shall enforce such liability for the benefit of the investors only if the conditions for such enforcement are met (usually as provided in the specific agreement). If the assets transferred to the trust do not exist or are unlawful, the trustee may bring civil as well as criminal actions against the issuer, as such party will be held responsible to modify the terms of the agreement in case the securitised asset ceases to exist or becomes unlawful.

Recent judicial precedents have incorporated in Mexico punitive damages, as long as they are a direct and immediate consequence of a fraudulent action carried out by the issuer.

4.3 Principal Perfection Provisions

As indicated in 1.3 **Transfer of Financial Assets**, above, assets transferred to the trust must be registered in the Sole Registry of Movable Guarantees (*Registro Único de Garantías Mobiliarias*).

4.4 Principal Covenants

In this regard, parties in a securitisation usually look both at the positive obligations (to protect, promote and provide) and also at their negative obligations (to abstain from violations). Also, based on financial or operational considerations, financial covenants – such as financial leverage, credit ratings or eligibility rules – may be negotiated and be enforceable (if agreed by the parties) without prior judicial notice.

4.5 Principal Servicing Provisions

Usually, this type of financial transaction is executed together with a management services agreement (*contrato de administración*), by which a third party acts as the trust manager and is obliged to act for the benefit of all the parties and to operate in accordance with the rules, warranties and provisions set forth in such agreement and the securitisation trust itself.

Also, Mexican law allows brokerage firms to provide investment advisory services to make recommendations or offer personalised advice to a client and provide investment management services through the decision-making process, including advice on the investment in public securitisation trusts.

4.6 Principal Defaults

In our experience, the principal defaults may arise from: (i) failure to pay accrued interests included in the transaction documents; (ii) failure to comply with the financial covenants; (iii) bond administrator's breach, failing to comply with their obligations under the administration agreements of the transaction; and (iv) breach of governmental contracts.

4.7 Principal Indemnities

In securitisation trusts, contractual penalties are quite common, as the judiciary process for the enforcement of liquidated damages can become a time consuming and expensive procedure.

The main breaches which an issuer may incur are related to the payment of the principal and/or interest agreed in favour of the investors. Notwithstanding the foregoing, the SML, with the aim of protecting the market, has established certain obligations for issuers in the event that issuers fail to comply with the preparation and delivery of the financial and corporate reports, including as a consequence the suspension of the registration of the securities of the issuer in the National Securities Registry for a term not exceeding 60 business days.

Additionally, the SML provides penalties for individuals who, having the obligation to maintain confidentiality, or secrecy, provide by any means or transmit privileged information to third parties.

4.8 Other Principal Matters

Usually standard contractual terms are incorporated into securitisation trusts. It has now become common to include privacy, data protection, anti-money laundering and other similar regulatory provisions, to ensure an effective compliance by all the parties, as personal data and sensitive financial and commercial information are usually transferred as part of the transaction.

5. Enforcement

5.1 Effectiveness of Overall Enforcement Regime

In accordance with the provisions of the SML, the legal opinion issued by a licensed external lawyer shall be (depending on the case) on the following aspects:

- the legal validity of the securities and their enforceability against the issuer, as well as the powers of the subscribers, at the time of issuance;
- the due constitution and enforceability of the guarantees and powers of the person who grants them, as well as the procedure established for their execution, in the case of guaranteed instruments;

- the legal validity and enforceability of the trust agreement, as well as the legal acts for the transfer of ownership or ownership over assets or trust rights, where applicable, and in the case of issues under the protection of trusts.

Therefore, it becomes clear that the enforceability will vary from one operation to another. It is suggested to review the legal opinion in each case.

6. Roles and Responsibilities of the Parties

6.1 Issuers

In accordance with the SML, the issuer is the entity that requests and, where appropriate, obtains and maintains the registration of its securities in the National Securities Registry. Likewise, the fiduciary institutions will be included when they act with the referred character, only with respect to the corresponding trust patrimony. As already mentioned, in a securitisation, the figure that is regularly used as SPE is a trust. As indicated in the body of this document, the issuer has the obligation to present financial and corporate reports, periodically and publish relevant events, among others.

6.2 Sponsors

Although sponsorship is not a regulated activity itself, it is common practice for banks, investment advisors and brokerage firms to sponsor securitisation transactions among qualified or sophisticated investors, as well as with private investors, depending on the type of underlying securitised asset or project.

Governmental development banks have recently promoted the use and acquisition of special types of securities, such as CKDs, CERPIs and FIBRAs, as detailed above.

6.3 Underwriters and Placement Agents

According to the provisions of the SML, securities market intermediaries will be: (i) brokerage firms, (ii) credit institutions, (iii) operating companies of investment companies and retirement funds, and (iv) distribution companies of shares of investment companies and financial institutions authorised to act with the aforementioned character of distributor.

To organise and operate as a brokerage house, authorisation from the CNBV is required, with the prior agreement of its governing board. This authorisation shall be granted to the public limited companies organised in accordance with the special provisions contained in the SML and, in matters not foreseen by the latter, in the provisions of the General Law of Commercial Companies. By their nature, these authorisations will be non-transferable and will not imply certification on the solvency of the brokerage house in question.

6.4 Servicers

Please see 3.5 Activities of Rating Agencies (RA), above, regarding the use of management services agreements.

6.5 Investors

In accordance with the SML and due to fiduciary certificates representing an individual participation of their holders in a collective credit, the holders' meeting will be the body empowered to make decisions in charge of them. The decision making will be done in accordance with the provisions that the General Law of Credit Titles and Operations sets for the obligations, both for the installation quorum and for the voting quorum. The holders must be represented by a common representative.

On complex security instruments – eg, CKDs, CERPIs and FIBRAS – investors need to meet special conditions and to qualify as sophisticated investors, such as pension funds or private equity funds focused only on this type of investment or infrastructure projects.

6.6 Trustees

As previously stated, only credit institutions, brokerage firms and operating companies of investment companies may act as trustee in this type of trust. Trustees are in charge of a trust and the ownership of the assets that comprise it, and are bound by the instructions of the grantor for the benefit of a third party (beneficiary).

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7. Synthetic Securitisations

7.1 Synthetic Securitisation

Since there is no specific prohibition, it is presumed that there is no impediment to carry out a synthetic securitisation. However, it is not something that is usual in Mexico.

Considering that there are no specific provisions in this regard, a synthetic securitisation must be subject to the general provisions of the securitisation which include the authorisation of the CNBV, the preparation of the prospectus, and the issuance of legal opinions.

8. Specific Asset Types

8.1 Common Financial Assets

Assets used to back these transactions include short-term trade receivables, auto leases, loan receivables, commercial real estate leases, receivables from sales of real estate developments and service or manufacturing agreements.

Collateral management companies, servicers or companies with experience in monitoring collateral for asset-based lending transactions, are required to perfect a pledge of inventory (by delivery to the lender or a third party) and finance loans secured by inventory (such as *aviso* credit or *refaccionario* loans).

8.2 Common Structures

Usually the most common structures are (i) asset-backed securities statistics structured through mortgage loans, consumer loans (including auto loans), and (ii) company loans (including small and medium-sized enterprises, and leases loans).

In some securitisation transactions, a pledge over the collection account is granted in favour of a financial entity in order to mitigate the commingling risk derived from a potential insolvency of the servicer.

Mexican companies usually turn to these schemes as an attractive financing alternative, instead of resorting to banking or financial institutions credits.