

Article Title: ARCHIVE | Legal Criteria: Legal Reforms Spur Mexican Securitizations Data: Mexico's local securitization market is the most active domestic market in Latin America, with recent issuances backed by consumer loans, trade receivables, federal tax-participation flows, partial credit guarantees, and construction bridge loans, as well as the country's first-ever MBS transaction. A favorable interest rate environment and growing investor sophistication have encouraged market growth and the securitization of new assets. Significant legal reforms have further empowered the market by providing greater clarity on legal issues while making ABS more attractive to investors. Nevertheless, Standard & Poor's Ratings Services believes that legal issues continue to present challenges when structuring transactions due to the complexity of the Mexican legal system and the absence of case law on issues relevant to securitizations.

Key Federal and State Legal Reforms The principal Mexican legal reforms relating to securitization have taken place at both the federal and state levels. At the federal level, the key changes have included amendments to the Ley General de Títulos y Operaciones de Crédito (the Negotiable Instruments and Credit Transactions Law) in 2000 and 2003; the enactment in 2001 of the Ley de Concursos Mercantiles (the Insolvency Law), which replaced the prior bankruptcy law; and amendments in 2001 to the Ley del Mercado de Valores (the Securities Market Law). At the state level, changes have been made to provisions in many of the state civil codes that relate to the perfection of a sale of assets, particularly in the context of MBS. Reforms to the federal laws included two key developments for the securitization market: first, Mexican trusts known as "fideicomisos" were expressly permitted to issue debt and second, a new instrument known as the certificado bursatil was created. The certificado bursatil could be issued by trusts with fewer formalities than other instruments and could be issued in multiple series of debt or equity. Now Mexican trusts issuing certificados bursatil have become commonplace in securitizations. Mexican trusts are generally favored by issuers of securitizations, as there is little difficulty in making such entities bankruptcy remote because they are governed by a trust agreement and, by definition, are not subject to the insolvency law. The trusts, which are used as special-purpose vehicles, are also not subject to entity-level tax. Changes to many of the state civil codes have provided greater certainty on the legal issues of the true sale of assets by an originator to the Mexican trust, as a special-purpose entity, particularly for MBS transactions. Before the reforms, which have now been completed in the vast majority of Mexican states, the transfer of mortgages required formal notification of the underlying obligors under the loans and registration of the transfer with the public registries in the state where the property was located to perfect the transfer against the obligors and third-party creditors of the originator, respectively. In those states where the civil codes have been modified, the requirements for notification and registration to perfect the transfer or sale of assets have been eliminated when mortgages are sold by financial or social security institutions to the special-purpose entity and the seller retains the servicing of the mortgages. However, while the changes to the state civil codes have simplified the transfer issues in the context of MBS, the formal requirements of the civil codes still apply to other asset types that may be securitized. These requirements, which determine how to perfect the sale of assets to a Mexican trust, as a special-purpose entity issuer, are complex, as they may differ for each asset type. Moreover, since no single statute has been passed to govern securitization transactions in Mexico, securitizations involving other asset types may be subject to different requirements based on where the asset is located. Since there are 32 different civil codes, one for each of the states and the federal district, the principal legal challenge in most ABS transactions is determining the manner in which to satisfy notification and registration requirements to properly perfect the transfer of receivables in relation to the underlying obligors and third-party creditors.

Notice to Obligor and "Deemed Consent" Structures Generally, it is necessary to notify the underlying obligor to perfect the sale against such obligor. There is some uniformity under the civil codes with respect to the delivery and receipt of notice. Notice is generally deemed delivered only if it is made judicially, with the presence of two witnesses or with a notary public, and notice is generally deemed received by an obligor if the obligor was present at the transfer and does not object to such transfer or has knowledge of and accepts such transfer. In many securitization structures, providing formal notice to a large number of obligors would be cumbersome and costly. In these cases, Mexican legal practitioners have devised "deemed consent" structures in an effort to comply with these requirements. These structures typically provide for notification to a large number of obligors through notices of the transfer contained in monthly account statements. Usually, the obligor

will have an option to reject the transfer or will be deemed to have accepted the transfer if payments continue to be made in respect of the account statements. Standard & Poor's believes that these structures generally satisfy the notification requirements for securitizations in light of specific reforms made to other Mexican laws. However, as these structures are relatively new, it is important to note that their validity has not been ruled on by Mexican courts. Standard & Poor's will generally require that deemed consent structures be used to satisfy the notification requirements, unless a specific asset type is subject to different notification requirements and evidence is provided that such requirements have been satisfied. Another legal issue that must be resolved is the perfection of the sale of receivables in relation to third-party creditors. In Mexico, perfecting a sale of assets against third parties involves either the registration of the transfer in a public registry or a transfer by a public deed. The transfer of certain assets, such as secured commercial loans, must be registered in a public registry to be effective against third parties. In that case, the sale of receivables must also be registered in the applicable registry. For other asset types, a public deed would be required to satisfy the perfection requirements. Standard & Poor's will request from counsel evidence that such requirements have been satisfied.

Many Legal Issues Not Yet Resolved In rating a Mexican securitization transaction, Standard & Poor's will also review legal issues related to the commingling of funds in the account of the originator, the ability of a court to set aside a transfer in the insolvency of the originator, and the ability of a debtor to set off from its payments to the trust amounts owed by the originator, among other matters. While the new Insolvency Law has clarified many of these legal issues, these issues continue to present challenges due to the relative absence of court cases addressing these issues in the context of securitizations. For a more detailed description of Standard & Poor's legal criteria for securitizations in Mexico, please see the article "Legal Issues in Mexican Asset-Backed Securitizations," available on RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. It can also be found on Standard & Poor's Web site at www.standardandpoors.com. Click Credit Ratings and find the desired article under Ratings Criteria.