

Deregulation of Credit, Financial Leasing and Factoring Activities in Mexico

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I. Introduction

Two important legislative events have modified the legal regime applicable to Limited Scope Financial Institutions or Mexican Non-Bank Banks (*Sociedades Financieras de Objeto Limitado*), also known as Sofoles (“Sofoles”), Financial Leasing Companies (*Arrendadoras Financieras*) (“Financial Leasing Companies”) and Factoring Companies (*Empresas de Factoraje Financiero*) (“Factoring Companies”) and deregulated in Mexico credit, financial leasing and factoring activities: (i) the amendment to the Banking Law (*Ley de Instituciones de Crédito*) (“Banking Law”) of November 30, 2005 and (ii) the amendments to various laws to deregulate financial leasing and factoring activities and create entities denominated Multiple Purpose Financial Companies (*Sociedades Financieras de Objeto Múltiple*) (“Sofomes”) as unregulated financial entities.

In Mexico any entity or individual may carry-out credit activities. Credit activities are regulated in Mexico by the General Law on Negotiable Instruments and Credit Operations (*Ley General de Títulos y Operaciones de Crédito*) (“LGTOC”). Notwithstanding the foregoing, in December 23, 1993, Article 103 of the Banking Law was amended to require entities that receive funding from the capital markets and place such funds with the general public through loans, to conduct said activities under the form of a Sofol, an entity regulated by the Mexican government and subject to the regulations on credit, accounting, etc., similar to banking regulations.

The creation of the Sofoles was aimed to limit the entry of non-bank banks to Mexico under the North American Free Trade Agreement (NAFTA)¹ and establish regulatory barriers to U.S. and Canadian Non-Bank Banks requiring any U.S. and Canadian Non-Bank Bank that wanted to operate in Mexico to do so through the incorporation of a Sofol, prior authorization from the Mexican government.

In 1981 financial leasing was regulated and factoring operations were regulated in 1990. It was said that the reason to regulate financial leasing and factoring was to promote these operations and establish a legal framework different from that of banking activities. At that time (1982-1990) the banking sector in Mexico was state-owned.

¹ NAFTA became effective on January 1, 1994.

In 1990, legal amendments privatized banking activities; however, financial leasing and factoring continued to be regulated under the General Law of Ancillary Organizations and Credit Activities (*Ley General de Organizaciones y Actividades Auxiliares del Crédito*) (“LGOAAC”). Regulations to Sofoles, Financial Leasing Companies and Factoring Companies brought the following adverse consequences (a) debtors assumed that the Mexican Government backed-up these entities, (b) they inhibited competition, (c) they imposed an unnecessary administrative burden, and (d) they inhibited financial innovation. The foregoing derived in the increase of operating costs and therefore in higher interest rates to consumers.

The Mexican government has reconsidered the necessity to continue regulating credit, financial leasing and factoring activities and not only amended the legal framework applicable to credit activities but also that of financial leasing and factoring activities. The Mexican government has considered that it is not necessary to regulate financial activities that involve taking risks by placing credits or loans (either through the form of loans and credits, or financial leasing or factoring operations) since the entities carrying-out this activities do not receive funds from the general public through deposits or other forms and do not form part of the Mexican payments system and therefore there is no public interest to protect. Generally, these entities fund themselves through loans or securities placements which are already highly regulated.

II. Deregulation of Credit Activities

On November 30, 2005, Articles 2 and 103 of the Banking Law were amended and as a consequence thereof, the requirement that credit activities through entities that obtain funds for such activities by placing securities was lifted and commercial companies may now freely receive funds by placing securities in the capital markets to place such funds with the public-at-large through loans and credits. Prior to said amendment, these activities were restricted to financial entities authorized to operate as a bank or Sofol.

Pursuant to this amendment, any Mexican company may place securities in the Mexican capital market to obtain funds and credits from banks to grant credits without any license and such credits do not need to be granted to a specific sector of the economy as Sofoles have to. There are no specific limitations to foreign investment in these Mexican companies.

Notwithstanding the foregoing, commercial companies do not have the tax and procedural privileges Sofoles currently have referred to in Paragraphs 1 and 2, Section IV of this Article.

III. Deregulation of Financial Leasing and Factoring Operations

A Bill with amendments to a wide range of laws² to deregulate financial leasing and factoring operations and create the Sofomes was approved by the Mexican Congress on April 27, 2006 and will become effective upon its publication in the Official Gazette of the Federation (*Diario Oficial de la Federación*) (“DOF”), subject to the terms set forth therein. The Bill provides that financial leasing and factoring operations should no longer be reserved activities allowing any commercial entity to carry-out said activities without any authorization or supervision from Mexican financial authorities.

These amendments repeal the regulations to financial leasing and factoring operations from the LGOAAC and include said activities as general credit operations under the LGTOC with minor adjustments.

IV. Sofomes

A. Creation and legal framework of Sofomes

The Bill will create the Sofomes as unregulated entities dedicated professionally to grant loans and credits and enter into financial leases and factoring operations. Sofomes will be governed by the LGOAAC.

The Bill defines Sofomes as an unregulated entity which purpose is to carry-out credit, leasing and/or factoring activities. Sofomes may operate with their own resources or with funds received from banks or from the placement of securities. Sofomes are not allowed to receive deposits from the general public. Sofomes are not regulated nor subject to the supervision³ of the National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*) (“CNBV”) and do not require any authorization from the Ministry of Treasury and Public Credit (*Secretaría de Hacienda y Crédito Público*) (“SHCP”) or any other authority to operate.

Sofomes shall have the same tax and procedural privileges that Sofoles, Financial Leasing Companies and Factoring Companies currently have; provided that (i) seventy percent of their assets consist in credit, leasing or factoring portfolio, or (ii) seventy percent of their income comes from the management of said portfolio.

The referred privileges are the following:

² The Bill amends the LGOAAC, the LGOAAC, the Banking Law; the Insurance Law (*Ley General de Instituciones y Sociedades Mutualistas de Seguros*), the Bonding Law (*Ley de Instituciones de Fianzas*); the Financial Groups Law (*Ley para Regular las Agrupaciones Financieras*), the Savings and Popular Credit Law (*Ley de Ahorro y Crédito Popular*), the Foreign Investment Law (*Ley de Inversión Extranjera*); the Income Tax Law (*Ley de Impuesto Sobre la Renta*); the Value Added Tax Law (*Ley del Impuesto al Valor Agregado*) and the Fiscal Code of the Federation (*Código Fiscal de la Federación*).

³ As an exception, Sofomes directly or indirectly linked to a Mexican bank will be considered regulated entities and will be subject to the supervision of the CNBV and regulations issued by the SHCP and CNBV.

1. Tax privileges

(i) The loan portfolio does not compute for the calculation of the asset tax (*impuesto al activo*).

(ii) Interests arising from transactions of commercial loans do not bear value added tax.

2. Procedural privileges

(i) Account statements certified by an authorized officer are considered enforceable before Mexican courts as negotiable instruments (*títulos ejecutivos*).

(ii) Mortgages may be assigned without having to notify the debtor nor register the assignment with the Public Registry nor notarize said assignment with a Public Notary.

B. Consequences arising from the creation of Sofomes

1. Sofoles, Financial Leasing Companies and Factoring Companies are allowed to continue under their current legal regime under the supervision of the CNBV for a transition period of seven years counted from the date of publication in the DOF of the Bill.

2. By the end of the transition period, the authorization from the SHCP will be automatically revoked and Sofoles, Financial Leasing Companies and Factoring Companies will have to amend their By-Laws to delete any express or implied reference which may infer that they are ancillary credit organizations or that they are authorized to operate by the SHCP and file them with the SHCP prior to the end of the transition period.

3. The validity and existence of the contracts entered into by Sofoles, Financial Leasing Companies and Factoring Companies prior to the end of the transition period will continue in effect until their termination and would not require to be ratified.

4. Contracts entered into by Sofomes and advertising material should expressly provide that they are not authorized by the SHCP and that they are not subject to the supervision and surveillance of the CNBV.

5. Sofomes will be subject to Anti-Money Laundering Regulations.

6. The National Commission for the Protection of Users of Financial Services (*Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros*) (“CONDUSEF”) will have jurisdiction over Sofomes.

7. Insurance and Bonding Companies may invest in securities issued by Sofomes.

8. Foreign investors may contribute up to 100% of the shares of the capital stock of Sofomes and they will not be subject to the Rules for the Establishment of Affiliates of Foreign Financial Institutions (*Reglas para el Establecimiento de Filiales de Instituciones Financieras del Exterior*).

9. During the transition period, Sofoles, Financial Leasing Companies and Factoring Companies will continue to be subject to the legal regime currently in effect.

10. Notwithstanding the foregoing, if a Sofol, a Financial Leasing Company or a Factoring Company wishes to operate as a Sofome prior to the end of the transition period, it may be converted into a Sofome by holding a General Extraordinary Shareholders’ Meeting for such purposes and amend its By-laws. Thereafter, it would have to register the Minutes of General Extraordinary Shareholders’ Meeting with the Public Registry of Commerce and file a notice of its conversion into a Sofome with the SHCP. The Sofome will also be required to give notice of its operations to the CONDUSEF within 10 days from the registration of the notarial instrument with the Public Registry of Commerce.

Should you have any question on the New Rules and its effects, please contact *Michell Nader S.* (5255) 5267-4507; mnader@jnn.com.mx or *Yves Hayaux-du-Tilly L.* (5255)5267-4573; yhayaux@jnn.com.mx.