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# Mexico

## Chamber of commerce:

Confederación de Cámaras Nacionales de Comercio, Servicios, y Turismo  
Balderas 144  
Col Centro  
CP 06070 México City  
México  
Tel: +52 55 5722 9300  
Email: [comentarios@concanaco.com.mx](mailto:comentarios@concanaco.com.mx)  
Web: [www.concanaco.com.mx](http://www.concanaco.com.mx)

## Professional body:

Barra Mexicana  
Colegio de Abogados  
Varsovia 1  
Colonia Juarez  
06600 México City  
México  
Tel: +52 52 08 3115  
+52 52 08 1355  
Email: [contacto@bma.org.mx](mailto:contacto@bma.org.mx)  
Web: [www.bma.org.mx](http://www.bma.org.mx)

## Controversy over foreign government investments in Mexican financial institutions

Marco Nájera  
Gardere Arena y Asociados and Gardere Wynne Sewell  
Mexico City

As soon as foreign governments announced they were taking equity positions in the largest financial institutions to save them from bankruptcy, Mexican financial laws began to be tested. The issue arose from a phrase contained in different financial laws providing that no foreign governments shall participate, *in any manner*, in the capital stock of a Mexican financial institution. Because most of the financial institutions receiving aid had a subsidiary or an affiliate in Mexico (*Mexican affiliate*) that would indirectly benefit from these governmental infusions of capital, the plain reading of the statute, particularly the phrase *in any manner*, caused a stir.

In particular, this aid created a political discussion as to whether indirect ownership by a foreign government of a Mexican affiliate caused the Mexican affiliate to be in breach of the law. If so, a breach could cause adverse consequences, including losing its charter. On the one hand, nationalists took this opportunity to demand the Mexican government hold the Mexican affiliates in breach of the law. Others in the government analysed the origin of the prohibition and worked toward a resolution that was more amicable to a global economy. What ensued was weeks of rhetoric interpreting and reinterpreting Mexican law, which highlighted the unfounded but omnipresent national sentiment against foreign governments that *own a piece of Mexico*.

The issue was settled, for the moment, by the Ministry of Finance (*MF*) when it issued a press release stating that Mexican law was not breached by the indirect aid to Mexican affiliates for a variety of reasons. While a press

release is not a binding communication, it was enough to calm the waters. The communication provided some legal analysis but left many issues open, specifically issues related to investments in insurance companies, which have additional concerns beyond the scope of this article. Unfortunately, without a binding opinion, the legal question remains unsettled. The arguments for the opposing politicians are simple to make: *in any manner* means any manner, case closed. The other side used a more sophisticated analysis of the Mexican legal system. In the end, we believe that the MF's political position has a solid legal basis.

To understand this conclusion an examination of the legal axioms of the proposition is helpful. First, foreign governments providing equity investments in parent companies or affiliates are not directly participating in the equity of a Mexican affiliate. Their participation is indirect. Second, Mexican affiliates derive their existence from national law as modified by international treaties adopted by Mexico, and have a special regime that is not applicable to other financial institutions. Third, as opposed to other jurisdictions like the United States, which recognise the existence of extraterritorial law, Mexican law is applicable only to transactions and events occurring within Mexican territory or to transactions where the parties agree to submit to Mexican law. Additionally, Mexican law does not govern whether a foreign government is entitled to own equity in financial institutions outside of Mexico. There is not a single provision in the law that establishes the manner in which a parent of a Mexican affiliate should be capitalised. Fourth, the specific provisions governing Mexican affiliates do not include the restriction against foreign government participation, *in any manner*, in the capital stock of said affiliates. In summary, this restriction should only apply to financial institutions that are not Mexican affiliates.

Based on the arguments mentioned above, it appears evident that the interpretation of *in*

*any manner* refers to investment by a foreign government directly into the Mexican affiliate. The one caveat to this argument derives from certain international treaties, such as Nafta, which provides that foreign governments are not allowed to invest *directly or indirectly* in different types of Mexican financial institutions. This provision followed the laws of Mexico at the time Nafta was enacted. However, since then the underlying law has changed replacing the *directly or indirectly* language with the *in any manner* language. This revision to the statute would invalidate the reservation made in Nafta due to the more advantageous interpretation of Mexican law.

However, support for the non-breach position can also be found in Nafta and similar treaties. These treaties provide that each government shall be allowed to adopt or maintain reasonable measures based on prudent reasons, including measures to protect investors and customers as well as the leverage and integrity of financial institutions. This approach ensures the stability of the financial system of a country and, thus, indirectly provides that Mexico should not penalise Mexican affiliates because of investments made by foreign governments in foreign entities to preserve the integrity of their own financial systems.

Even though debate has subsided, the legal issue still exists and may flare up again in the future. The Mexican government seems to understand this, and it is expected that the MF will promote legislation to resolve the issue. Such legislation would provide clarity to determine when the participation of a foreign government in the capital of Mexican financial institutions should be prohibited, and when exemptions should apply, such as extraordinary situations like the current global financial crisis.

It is likely that the reform will introduce the following concepts.

(i) Undue participation of foreign governments to influence the Mexican financial system is proscribed.

(ii) Limits to distribution of dividends by financial institutions with foreign government investments when their solvency and equity/debt ratio is affected.

(iii) The obligation to offer public investment (up to 50%) in the stock of Mexican financial institutions, if the participation by foreign governments remains in place during more than three years.

(iv) Specific sanctions.

Until then, financial institutions will swing in the uncertainty between the political arguments without the safety of legal precedent, as evidenced by the non-binding press release of the MF.