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ROLE OF CERTIFICADOS BURSATILES, COLLATERAL ARRANGEMENTS AND OTHER IMPORTANT ASPECTS OF RAISING INFRASTRUCTURE FINANCE
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1. INTRODUCTION

The origin of the Certificado Bursátil is a recommendation made in October 2000 by the Consejo Mexicano para el Desarrollo Bursátil (hereinafter Consejo) to the Mexican authorities to amend the existing regulation in order to create a new negotiable instrument similar to a debt bond and denominated Bono Bursátil. The idea of the Consejo was to merge the figures of a Pagaré and Obligación under Mexican law, thereby creating the Bono Bursátil.

Why would someone want to merge these two concepts? The reason for such recommendation is directly related to the legal structure of both the Pagaré and the Obligación. Pursuant to Mexican Law, a Pagaré evidences individual credits and Obligaciones are used to document collective credits.

The issuance of Obligaciones by limited liability corporations involves, among other things, (i) a general shareholder’s meeting, (ii) the elaboration of a specific balance sheet and financial information, (iii) notarization and registry before the Property and Commerce Registry, (iv) the appointment of a common representative for the holders of the debentures and the rules that will regulate such holders, and (v) specific approval from the Governance Board of the Mexican Banking and Securities Commission (CNBV). Such requirements made it very difficult and therefore expensive to issue such Obligaciones and restricted their use to long-term and large transactions.

On the other hand, even though it is comparatively easier to issue a Pagaré, the nature of such instruments is basically to document unsecured individual credits without any specific clauses for representations, warranties, events of default, or acceleration remedies. Therefore, in practice, it presents several problems on judicial claims.

Now that we have explored basically how Pagarés and Obligaciones work under Mexican law, you can probably figure out why the Consejo recommended merging both instruments into the Bono Bursátil. The Consejo recommended the merger of the Pagaré and Obligaciones to create the Bono Bursátil in order to create a new

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1. The Certificado Bursátil is a new instrument for financing federal organizations and municipalities.
2. The Consejo Mexicano para el Desarrollo Bursátil is the Mexican Counsel for Securities Development.
3. The Pagaré is a promissory note.
4. An Obligación is a debenture.
5. The Bono Bursátil is a local debt note.
security instrument that combined the flexibility and simplicity of the Pagaré and that could also incorporate certain clauses regarding the terms and conditions of the debt. Finally, as a result of the Consejo’s recommendation, an amendment to the Securities Market Law (SML) was passed by the Mexican Congress in June 2001 that included the Certificado Bursátil in the list of securities authorized to be issued in the Mexican securities market.

Characteristics and Advantages

Pursuant to the SML, a Certificado Bursátil is a negotiable instrument that can be issued in the local market by limited liability corporations, federal government-controlled entities, states, municipalities and financial entities acting as fiduciaries in irrevocable trusts established for such purposes. As recommended by the Consejo, the issuance of Certificados Bursátiles is not subject to many of the requirements established for Obligaciones or similar debt notes, such as the requirement to draft an indenture, hold a shareholders’ meeting, or obtain a resolution of the board of directors.

Certificados Bursátiles are bearer notes that represent a certain debt from the issuer payable to their holders pursuant to the terms and conditions established therein, and can be issued in different series, granting the same rights to the holders of each series.

Requirements

The issuer must obtain authorization from the CNBV to publicly offer Certificados Bursátiles and must have them registered with the National Securities Registry. Additional requirements may have to be met depending on the nature of the issuer and the specific characteristics of the Certificado Bursátil. However, in most cases the application should be accompanied by, among other things, general information about the issuer, financial statements, credit ratings, the public offer notice, offering circular, a favorable opinion from the Bolsa Mexicana de Valores (BMV), and opinions from auditors and external legal counsel.

Acceleration and Foreclosure

Unlike other debt notes, Certificados Bursátiles may provide the terms and conditions under which the debt will be accelerated due to an event of default incurred by the issuer. Due to the nature of negotiable instruments, the foreclosure of Certificados Bursátiles is subject to the judicial summary proceeding provided for in the General Law of Credit Instruments and Transactions.8

7. The Bolsa Mexicana de Valores is the Mexican Stock Exchange.
8. See LEY GENERAL DE TÍTULOS Y OPERACIONES DE CRÉDITO, D.O., 27 de agosto de 1932, available at http://www.economia.gob.mx/pics/pip1376/f1.27.pdf (last visited March 31, 2004). The Ley General de Títulos y Operaciones de Crédito contains provisions, concerning, inter alia, credit instruments such as promissory notes and bills of exchange, the pledge of credit instruments and shares of stock, as well as certain credit transactions such as secured and unsecured commercial loans, trusts and securities loan agreements.
Recent Offerings

Due to the advantages of issuing Certificados Bursátiles rather than other notes as a result of the amendment to the SML, this instrument has rapidly become one of the most popular debt instruments for local issuers. During 2002, several states and municipalities issued debt represented by Certificados Bursátiles for an amount of approximately U.S. $550 million. During the same time period, private companies issued debt represented by Certificados Bursátiles for an amount of approximately U.S. $3.8 billion.9

2. COLLATERAL ARRANGEMENTS AND STRUCTURES

Programs and Specific Transactions

Certificados Bursátiles can be issued either through a program authorized by the CNBV that contemplates a maximum amount of debt to be issued in one or more transactions, each of which has to be authorized by the CNBV, or through a specific approval granted for a single transaction by the CNBV. Programs are commonly used for larger transactions. Even though the terms and conditions of the Certificados Bursátiles issued in a program have to be identical, it grants the issuer flexibility in the amount to be issued and in the interest rates, through either fixed or floating rates, that can be molded to the market conditions.

Recent Transactions, Collateral and Structures

Since the amendment of the SML, state and municipal governments (either directly or through a trust established for such purpose) and private entities have issued Certificados Bursátiles. Private entities typically issue Certificados Bursátiles through the securitization of receivables that are affected or assigned to a trust that may issue the Certificados Bursátiles or simply act as a “lock box” for such receivables. State and municipal governments have used three different structures when issuing Certificados Bursátiles. The first one is what I call a textbook case of “traditional financing structure guaranteed by participaciones federales.” This structure has been used by many states and municipalities, including the Municipality of Guadalajara, and involves the participaciones federales as a collateral and source of payment of the Certificados Bursátiles.

In this specific case, the Municipality of Guadalajara directly issued Certificados Bursátiles in order to repay previously acquired debt and allocated the remainder to “productive public investment” pursuant to the Mexican Constitution. Guadalajara also established a trust that would receive future participaciones federales, constitute several reserve funds, and pay the principal and interest of the debt through the structure outlined in Figure 1.

10. The participaciones federales are the amounts derived from taxes that, once received by the Mexican federal government, are distributed among the states and then redistributed by such states to their corresponding municipalities.
The second case is a structure that was used by the State of Mexico for the securitization of a local payroll tax. In this transaction, the *Certificados Bursátiles* were issued by a master trust established by the State of Mexico for such purposes and the amounts obtained were allocated to "productive public investment" pursuant to the Mexican Constitution. The master trust, using a very innovative structure, receives the payroll tax directly from its collection channels, banks and gathering office, and uses such proceeds to constitute several reserve funds and pay the principal and interest of the debt. Payment of the *Certificados Bursátiles* issued by the master trust was guaranteed to the holders by the State of Mexico, through the structure outlined in Figure 2.
The third case is a structure that was used by the State of Chihuahua for the securitization of the proceeds received from the operation of four federal and five state highways. In this transaction the Certificados Bursátiles were issued by a master trust established by the State of Chihuahua for such purposes and the amounts obtained were destined to repay previously acquired debt derived from the construction of the highways and the remainder was allocated to "productive public investment" pursuant to the Mexican Constitution. The master trust receives the cash amounts collected by the operator of the highways and uses such proceeds to constitute several reserve funds and pay the principal and interest of the debt. Due to its size (U.S. $250 million) and rating (AAA by Fitch/AA+ Standard & Poors), this is the most important securitization made during 2002 and probably one of the most important transactions related to infrastructure finance in Mexico. This securitization is achieved through the structure outlined in Figure 3.
3. LEGAL ISSUES FOR ISSUERS, UNDERWRITERS AND INVESTORS

Restrictions on Foreign Investors in State and Municipal Transactions

Pursuant to the Mexican Constitution, states and municipalities are not allowed to directly or indirectly contract obligations or loans in foreign currency or with other nations or foreign corporations or individuals. The Supreme Court of Mexico has not yet interpreted this prohibition for the purpose of structured finance through the use of Certificados Bursátiles. There are two interpretations. The most conservative one considers that even if a trust or other special purpose vehicle is established in order to issue the Certificados Bursátiles, it should be considered as an indirect financing and is therefore forbidden by the Mexican Constitution. The second and most aggressive interpretation states that since several federal courts have already ruled that a trust is an entity with a different personality than the settlor, and considering that the payment of the financing acquired by such trust is limited to its assets and cannot be required to the settlor (i.e., the state or municipality involved in the transaction), and the Certificado Bursátil is a negotiable instrument enforceable only against its issuer and/or guarantor, a Certificado Bursátil issued by a trust established for such purposes by a state or municipality can be validly acquired by a foreign entity, as long as such state or municipality does not guarantee payment of the Certificados Bursátiles.

11. See MEX. CONST., art. 117, Fr. VII.
Constitutional Restrictions on State and Municipal Transactions

In addition to the restrictions on foreign investors, the federal constitution establishes that states and municipalities, decentralized organizations, and public corporations may not contract obligations or loans, unless such loans are used for “productive public investments” pursuant to rules enacted by the pertinent legislative body and to their annual budgets. Again, the Mexican Supreme Court has yet to determine exactly what a “productive public investment” means for constitutional purposes. Local legislatures have interpreted this concept in a broad manner. Pursuant to local laws and regulations, “productive public investments” include almost any investment made by states and municipalities that is related to public services provided to citizens, be they productive or not. This definition includes investments made in health care and facilities, museums, streets, drinking water, and highways.

In practice, states and municipalities have issued Certificados Bursátiles to repay previously acquired debt and there are several opinions as to whether such repayment is a “productive public investment” or not. The prevailing opinion is that as long as the original debt had a higher cost (i.e., a higher interest rate) and was destined to a “productive public investment,” states and municipalities are allowed to restructure it through the use of Certificados Bursátiles. Notwithstanding the above, in December of 2002 several representatives of the local congress began an Acción de Inconstitucionalidad against the decree that authorized the securitization made by the State of Chihuahua, among others, on the basis that the proceeds from the issuance of the Certificados Bursátiles were not destined to “productive public investment” but to repay previously acquired debt. The Mexican Supreme Court has ruled in favor of the State of Chihuahua, but for procedural reasons only. Therefore, nothing has been resolved regarding the correct interpretation of Article 117, Fr. VII of the Mexican Constitution.

In our opinion, such Acción de Inconstitucionalidad should not proceed because it lacks certain procedural requirements. However, if the Mexican Supreme Court decides to study and resolve this proceeding, it is possible that the corresponding resolution will determine what a “productive public investment” is for constitutional purposes.

Common and Conflicting Interests Among Issuers, Underwriters and Investors

In any public transaction, issuers, underwriters and investors have common and conflicting interests. Issuers and underwriters are interested in making a legally sound structure that is attractive to potential investors in the market and that allows them access to reasonable interest rates. However, issuers are only willing to make the concessions necessary to obtain the interest rate that they are seeking and have to limit the acceleration clauses, reserves, events of default and rights in the specific structure in order to protect their interests in a potential conflict with the holders of the notes. On the other hand, the investors would like to obtain every possible

12. An Acción de Inconstitucionalidad is a constitutional proceeding brought in the Mexican court system that challenges the constitutional validity of either a given legislative enactment that has already been passed and published in the Diario Oficial, or a legislative bill that is in the process of being discussed by Congress.
protection against default from the issuer and seek to impose as many restrictions as possible on the issuer in order to protect their interests in a potential conflict.

In my experience, in every structure and securities transaction, a negotiation is carried out between the issuer and the underwriter in order to offer reasonable terms and conditions to the investors that reflect the market conditions in other similar transactions.

Risk and Ratings

Pursuant to Mexican laws and regulations, the issuer is obliged to disclose any known risk related to the offering of the Certificados Bursátiles and is required to obtain a rating by an authorized rating agency.\(^\text{13}\) The issuer discloses every possible or imaginable risk. For the purposes of this paper I would like to focus on two types of risk. The first one is applicable to either private or public securitizations and consists of the quality of the issuer and the correct assignment or isolation of the assets that are being securitized in order to ensure that in the event of a conflict with the issuer the investors will have access to and control of the receivables. Even though in Mexico a legal opinion is required from the external counsel of the issuer in order to obtain approval from the CNBV to issue Certificados Bursátiles, such opinion is limited to the legal incorporation of the issuer, the authority of its representative, and the legality and enforceability of the transaction documents.\(^\text{14}\) The ratings provided by the rating agencies (e.g., Standard & Poors, Moody's or Fitch) evaluate, among other things, the liquidity of the issuer, preventive reserves in the event of deterioration of the securitized receivables, access to and control of the receivables by a third party other than the issuer if an event of default occurs, and feasibility of acceleration or prepayment. Therefore, the rating agency should be carefully considered by investors before acquiring any security.

The second risk is known in the market as the "political risk" involved in transactions made by countries, states or provinces, counties or municipalities and/or their corresponding public entities. It is quite difficult to define the risk exactly, but it can range from economic crisis to the reputation of the issuer, its credit history, or other criteria not necessarily related to the transaction.

The risks involved with Certificados Bursátiles issued by a state and/or municipality are related to the applicable constitutional restrictions that we have previously discussed, and in long-term transactions, future authorizations that may be required from other authorities (e.g., annual approval by the local legislative body of the Income Act and Expenditures Budget). Since infrastructure normally involves licenses and/or concessions from the Mexican government, either federal or local, it should be considered that political risk is always present. The ability of the holder of the license or concession to comply with the requirements established therein should also be considered.

\(^{13}\) Authorized for such purposes by the CNBV.

4. CONCLUSIONS

Since their origin, Certificados Bursátiles were meant to be negotiable instruments that combine the versatility and flexibility of Pagarés with the ability of Obligaciones to establish terms and conditions of the credit and protection clauses for the investors. Certificados Bursátiles can be issued by private and public issuers, and due to their characteristics have become one of the most used debt securities in the Mexican market over the last couple of years.

With approval from the CNBV, Certificados Bursátiles can be issued either through a program or in specific transactions without many formal requirements, and are “ideal” for infrastructure finance. There are certain constitutional restrictions on Mexican states and municipalities regarding financing through Certificados Bursátiles to be acquired by foreign investors. The Supreme Court of Mexico has not yet decided if such restrictions are applicable to structured finance transactions. There are further constitutional restrictions on Mexican states and municipalities regarding the destiny of funds obtained through the issuance of Certificados Bursátiles. The Supreme Court of Mexico has not yet defined if such restrictions include restructure transactions or not.

In any public transaction, issuers, underwriters and investors have common and conflicting interests. In practice, terms and conditions offered to the investors should reflect the market conditions in similar transactions. In order to make an accurate evaluation of the risks involved, investors must rely on ratings offered by renowned rating agencies and make their own analysis of the quality of the product, the issuer, the underwriter and, if applicable, the political risk involved in the transactions.