International Lawyer

Volume 33
Number 3 *Foreign Law Year in Review: 1998*

Article 8

1999

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I. Introduction

Beginning with the December 1994 devaluation of the Mexican peso, an extended controversy over the role of FOBAPROA in connection with the Mexican banking crisis dominated the Mexican financial sector. FOBAPROA is the *Fondo Bancario para la Protección al Ahorro* or Bank Fund for the Protection of Savings, a trust administered by Banco de México (the Mexican central bank). It was created initially to protect Mexican bank deposits but beginning in early 1995 it was also called upon to assume control of over $40 billion of Mexican bank loans, most of them past-due or otherwise of doubtful value. FOBAPROA acquired problem-loan portfolios from some banks in exchange for notes issued by it to such banks. The entity also assumed the task of administering a number of failed banks, in the process assuming control of all such bank loans, both good and bad.

Since the banking crisis began, FOBAPROA played an important role in the rescue or takeover of a number of troubled Mexican banks, but eventually it became controversial due to largely unproven claims of favoritism to some bankers and debtors and questions raised as to the legal basis for its role. In early 1998, the Zedillo administration introduced legislation to reform the country's banking system; to improve the process of supervising the banks; to address the problem loan issue; and to convert the FOBAPROA notes to full-faith-and-credit obligations of the Mexican federal government. Because of the large total amount of loans for which the federal government would become directly liable if the proposed conversion of FOBAPROA notes to public debt became effective, a firestorm of controversy that lasted throughout the year engulfed the administration's proposed legislation.

On December 11, 1998, after a long and intense struggle between opposing parties in the Mexican Congress, the *Ley de Protección al Ahorro Bancario* or Bank Savings Protection Law (Bank Savings Law) was approved. The Bank Savings Law subsequently was approved by the president and published in the Official Gazette on January 19, 1999.

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A. Purpose of the Bank Savings Law and the Deposit Protection System

The purpose of the Bank Savings Law is to create a new entity, in place of the FOBAPROA, to insure Mexican bank deposits, and to provide for financial assistance to be provided by the new entity to Mexican banks that are having difficulty. The new entity is to be called the *Instituto para la Protección al Ahorro Bancario* or Bank Savings Protection Institute (Institute). The Bank Savings Law creates a system, to be administered by the Institute, to protect bank deposits or savings of persons who carry out guaranteed transactions. Also, the new law provides for certain types of financial support to be made available by the Institute to Mexican commercial banks with a view to protecting bank deposits, and the law contains general provisions for the organization and operation of the Institute. Ordinary bank deposits will immediately become eligible for the protection of the new system, and other categories will be phased in gradually.

B. Guaranteed and Unguaranteed Obligations

The new system guarantees money deposits of any kind, as well as loans and credits in which banks are obligors, but the new system does not guarantee the following obligations: (i) obligations in favor of financial entities; (ii) obligations in favor of any member of the financial group of which the respective bank is also a member; (iii) liabilities that are evidenced by negotiable instruments or instruments issued to bearer; (iv) obligations or deposits in favor of shareholders, members of the board and officers at the two highest management levels of the bank, as well as any agent with powers of administration and any general manager of the bank; and (v) unlawful transactions, transactions that violate banking practices, bad faith transactions and those related to money laundering.

C. Payment of Guaranteed Obligations

The maximum amount the Institute will guarantee will be 400,000 UDIs per person, per bank, regardless of the number and type of obligations. The UDI is a unit of account that is inflation-adjusted. Any person who effects a guaranteed transaction with a bank shall, in order to recover on a guarantee thereof, file an application for payment within sixty days after the Institute publishes the resolution as to the liquidation, suspension of payments, or bankruptcy of the bank. The guaranteed obligation shall be paid within ninety days after the date on which the liquidator or receiver of the bank took possession. After payment of a guaranteed obligation has been made, the Institute will be subrogated as to the collection rights that originally belonged to the person to whom the payment was made.

D. Dues Payable to the Institute

The Board of Governors of the Institute (Board) may establish ordinary dues or fees to be payable by the banks in differing amounts depending on the risk exposure determined to be applicable to the respective bank. Such dues or fees shall not be less than four pesos for each 1,000 pesos of the total amount of the bank's transactions creating liabilities on the part of the bank. Extraordinary fees may be established for special circumstances.

E. Financial Support for Troubled Banks

The Institute may grant financial support to a bank for the purpose of ensuring the liquidity and soundness of the bank. The Institute may grant support through the subscription of shares and debentures, the granting of credits, the assumption of obligations, the acquisition of real property of the bank, or the purchase from the bank of the payment flows with respect to its problem loans. Such support may be provided when: (i) a technical study has been issued that justifies the viability and suitability of the support; (ii) the Institute determines that it is more appropriate for the bank to remain in operation than for it to be liquidated; (iii) a program to reestablish the soundness of the bank has been prepared; (iv) collateral security for the financial support is obtained by the Institute from the bank or its shareholders, on terms that require the shareholders to assume the cost of the support; and (v) the Board otherwise authorizes such support. The bank shall pledge its outstanding voting shares to the Institute to secure the payment of any financial support from the Institute. If the Institute is unable to perform its obligations under the financial support measures, the Congress must take the necessary measures in order to pay the guaranteed obligations and any loans obtained by the Institute.

In case there is an emergency that affects the solvency of a bank, the Board must inform the executive branch, so that financing may be obtained for an amount during each three-year period, not greater than six percent of the total liabilities of the banking system, as published by the National Banking and Securities Commission, *Comisión Nacional Bancaria y de Valores* (CNBV), in the preceding month. The Chamber of Deputies of the Congress shall establish in a specific section of the federal budget the corresponding allocation of funds required by the Institute.

F. Preventive Administration, Dissolution, Etc.

The Bank Savings Law provides for preventive administration which, in the event of default of the financial support obligations, allows the Institute to take over the administration of the bank as sole administrator, replacing the shareholders and the board of directors. In addition, the Institute may seek the dissolution, liquidation, suspension of payments, or bankruptcy of a bank, and the Institute may act as liquidator or receiver. The Institute may acquire, directly or through a trust, any of the real property of banks that are the subject of financial support and may administer and sell the property, obtaining the maximum value. Real property shall be sold through public auction unless the Board considers that such procedure is not the best method of achieving the maximum economic result.

G. The Institute's Authority and Assets

The Institute has the authority to: (i) administer the financial support programs; (ii) assume or pay the guaranteed obligations; (iii) receive and assign the economic resources that were authorized in the federal budget; (iv) subscribe and acquire shares, debentures, and other negotiable instruments issued by the banks; and (v) grant loans to the banks. The assets of the Institute shall comprise: (i) the fees paid to it by the banks; (ii) monies and other property obtained by reason of its operations, including interest; (iii) interest and other profit derived from its investments; (iv) economic resources obtained through financing; (v) all real property acquired for the accomplishment of its purpose; (vi) funds allocated through the federal budgets; and (vii) any rights and obligations acquired or assumed pursuant to applicable law.

H. Governance of the Institute

The Institute will have a Board of Governors made up of the Minister of Finance and Public Credit, the Governor of the Central Bank, the President of the CNBV, and four members designated by the Executive Power and approved by the Senate. The first three shall designate their alternates. The Institute shall also have an executive secretary who will be in charge of the administration and representation of the Institute, and will be responsible for carrying out the resolutions of the Board.

I. Transitional Provisions

The Bank Savings Law will become effective as of the day of its publication in the Official Gazette. Any person who was Minister of Finance and Public Credit, Governor of the Central Bank or President of the CNBV and, as such, a member of the Technical Committee of FOBAPROA between 1995 and 1997, will not be eligible to be a member of the Board or act as the Institute's executive secretary.

The Executive branch and the Chamber of Deputies will be required to take the necessary measures so that the recently appointed auditors of FOBAPROA conclude their work within six months after the Bank Savings Law becomes effective. During the conduct of such audits, any liabilities that are detected shall be reported. Once the audits are concluded, the banks may choose to terminate their contracts with FOBAPROA, in which case they shall return all the instruments issued by the fund, and seek to enter into a new arrangement with the Institute. Such banks may be motivated to terminate their FOBAPROA contracts by a concern that a gradually disappearing FOBAPROA will not pay its obligations, but they may first wish to ensure that they will qualify for equivalent financial support from the Institute. The Institute will assume the credits granted by the Central Bank to FOBAPROA and to the Securities Market Support Fund (FAMEVAL).

The conversion to public debt of the debts of such funds, which was requested by the Zedillo administration in its original draft legislation, was not approved by the Congress. The Institute is to finish the FOBAPROA financial support transactions that have not yet been concluded, presumably meaning that the Institute will assume the administration of intervened banks previously administered by FOBAPROA. Although ordinary bank deposits will become subject to the new guaranteed obligations regime immediately, such regime will not be fully effective until December 31, 2005. Prior to this date, the Institute shall determine the additional categories of guaranteed obligations entitled to the protection of the system and publish them in December of each year. Article 122 of the Credit Institutions Law, the legal basis for FOBAPROA, and Article 89 of the Securities Market Law, the basis for FAMEVAL, are repealed by the Bank Savings Law.

J. Other Developments Affecting Financial Institutions

In addition to approving the Bank Savings Law, Congress also amended a number of related laws. The Credit Institutions Law, Securities Markets Law, and Financial Groups Law were amended to eliminate the remaining limitations on foreign investment in Mexican commercial banks, securities firms and financial groups, and related amendments to such laws were approved which will eliminate the need for such institutions to have class A and B shares. Instead, each institution will have series O shares that may be freely held by investors located either within or outside of Mexico. A majority of the members of the board of directors of each such institution shall be either Mexican citizens or residents of Mexico. The Congress also amended the Credit Institutions Law to provide that a failure by a bank to pay its dues to the Institute can be a ground for revoking the bank's charter.

The special provisions of each of the laws mentioned in the preceding paragraph that govern Mexican affiliates of foreign financial institutions were also amended to specify that the series B shares thereof will be eligible to be acquired by foreign as well as domestic investors.