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Recent developments in Mexican securitization

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Creel García-Cuéllar y Müggenburg
Mexico City

Significant efforts have been made for quite some time now to set the stage for the creation and development of a public asset-backed securities market in Mexico. Starting with the first public mortgage-backed securitization in 2003, the Mexican assets securitization market has seen many significant developments in the recent past.

Setting the stage

Non-consolidation and bankruptcy remoteness

The 2000 and 2003 amendments to federal laws governing Mexican trusts provided clarity and legal certainty on two fundamental principles for securitization: true sale and asset segregation. These amendments, coupled with the enactment of the new Mexican insolvency statute in 2000, created the legal framework necessary for the delivery of true sale and non-consolidation opinions in terms comparable to those of the most developed global securitization markets.

Evolution of securities laws and regulations

Key amendments to securities laws and regulations came into effect in 2001 to introduce new types of securities and to accommodate more streamlined structures for asset securitization. A significant contribution was the creation of the *certificado bursátil*, a more versatile security instrument which has taken over the securities market as the debt instrument of choice, and may be issued by corporate issuers and by securitization and other conduit issuers.

Certificados bursátiles represented more than 95% of new issuances of fixed income securities in the domestic market in 2004,

according to a statistical report by the Mexican securities exchange. A new and fully revamped securities market statute, enacted in December 2005 and effective since mid-2006, has contributed further to the development and modernization of the Mexican securities market.

Emergence of domestic institutional investors

The creation of the Mexican private pension fund system in 1996 gave birth to the primary institutional investor base for the domestic debt capital markets generally. Mexican pension funds, known as *siefores*, held in 2005 approximately 35% of all domestic fixed-income securities placed by private issuers in the Mexican market. In addition, Mexican insurance companies and in particular investment funds known as *sociedades de inversión* have also become important participants in the domestic capital markets.

Contribution of other market participants

Other market participants, such as the Mexican state-owned *Sociedad Hipotecaria Federal* (SHF), a mortgage development bank, have played key roles in the development of the market. The SHF was created in 2001 to serve as a catalyst for the development of the primary and secondary mortgage market in Mexico and to provide funding and credit enhancement to low-income and mid-residential housing originators.

It has played a leading role in promoting standardization in documentation and underwriting guidelines, creating benchmark requirements for securitized products and otherwise making valuable contributions to the development of the housing industry and mortgage securitization market. The SHF has been focusing on the development of mono-line mortgage insurance in Mexico, and is in the process of exploring the expansion of its own activities to mortgage insurance.

Important amendments to Mexican insurance laws and regulations incorporated for the first time financial guaranty insurance and

mortgage insurance as new, mono-line insurance products. These products had already found their way into Mexican assets securitization on a cross-border basis, and are fast becoming a common feature in Mexican mortgage, auto loan and sub-sovereign public securitizations. Various international market participants have shown interest in setting up these specialized insurance operations in Mexico.

Investment banks, partial guaranty providers, liquidity providers, rating agencies and multilateral institutions have also played an important role in introducing healthy practices into the Mexican asset securitization market. These contributions have translated into the adoption of industry standards that have greatly facilitated the origination, standardization, pooling and securitization of various asset classes.

The future is now

Leveraging off these important developments, the market seems to be ready to take the next steps towards a deeper and more sophisticated era. 2006 and the first half of 2007 saw many innovative transactions including the first-ever covered bond, the first-ever cross-border residential mortgage loan securitization, the first-ever domestic securitization with a full wrap, the first-ever residential mortgage securitization with mortgage insurance, the first-ever securitization with a prefunding feature, the first-ever securitization with a retapping feature and the first ever repackaging securitization. Also, the first-ever asset-backed commercial paper conduit is in the process of being created and should be operational in the very near future.

It seems that the time has finally come for Mexico to reap the benefits of a mature and developed asset securitization market.

Banking and capital markets

Recommended firms

Tier 1

Creel García-Cuéllar y Müggenburg
Galicia y Robles
Mijares Angoitia Cortés y Fuentes
Ritch Mueller
White & Case

Tier 2

Jáuregui Navarrete y Nadar
Kuri Breña Sánchez Ugarte Corcuera y Aznar
Martínez Algaba Estrella de Haro y Galván-Duque
Santamarina y Steta

Tier 3

Baker & McKenzie
Bello Gallardo Morales y Tsuru
Berdeja Abogados
González Calvillo
Holland & Knight – Gallastegui y Lozano
Romo Paillés Guzmán

Mergers and acquisitions

Recommended firms

Tier 1

Creel García-Cuéllar y Müggenburg
Galicia y Robles
Mijares Angoitia Cortés y Fuentes
White & Case

Tier 2

Jáuregui Navarrete y Nadar
Kuri Breña Sánchez Ugarte Corcuera y Aznar
Ritch Mueller
Santamarina y Steta

Tier 3

Baker & McKenzie
Basham Ringe y Correa
González Calvillo
Goodrich Riquelme y Asociados
Holland & Knight – Gallastegui y Lozano
Von Wobeser y Sierra

Project finance

Recommended firms

Tier 1

Galicia y Robles
Ritch Mueller
White & Case

Tier 2

Creel García-Cuéllar y Müggenburg
Mijares Angoitia Cortés y Fuentes

Tier 3

Jáuregui Navarrete y Nadar
Kuri Breña Sánchez Ugarte Corcuera y Aznar
López Velarde Heftye y Soria
Martínez Algaba Estrella de Haro y Galván-Duque
Santamarina y Steta
Von Wobeser y Sierra

After a fiercely contested election in 2006, Felipe Calderón took office as president of Mexico in January 2007. The slim victory margin ensures few radical changes, suggesting stability for the country's financial markets. Calderón also offers a sense of continuity with the previous administration, and what some market experts say is a "more professional, more sophisticated government" – pleasing for investors to hear.

The economic picture is positive, with unemployment mostly under control. Currency fluctuations are minimal, offering a measure of predictability to the export markets. The country is experiencing a period of growth, although a modest one by the standards of Latin America's emerging markets.

The big question is how the country moves forward. There are experts who would like to see Pemex, the state-owned oil company, opened to at least some privatization. This would be difficult, as it would overturn a 70-year old monopoly. Some hope that this administration can begin to create efficiencies that would increase revenue by introducing reforms to a vital industry.

Change has come, at least to the country's banking industry. The central bank authorized more than a dozen new banking licences in 2006, including one to Wal-Mart that allowed the country's largest retailer to offer bank products. Mexico only had about 40 commercial banks previously, so this is a material change in the banking industry. It is also a sign of a definitive effort to reach new customers that have typically been overlooked by traditional (mostly foreign-owned) banks.

Meanwhile, Mexican financial institutions have created enormous funds that are looking for institutional products to buy. The markets are creating structured finance deals, credit-enhancements, asset-backed obligations – sophisticated instruments that demonstrate

the maturation of the local markets, and offer Mexican companies the ability to finance themselves through the domestic markets. Mortgage-backed securities are particularly in demand by investors, and there is an appetite for securitizations. Credit card receivables, sales receivables – these markets should grow in the short-term future.

The equity markets are not as mature, so there is only a limited placement of shares and initial public offerings (IPOs) are infrequent. Market experts state that Mexican companies need to create a more mature corporate governance area in order for the equity markets to be as relevant as the debt markets.

Investment funds looking for new investment opportunities have become important to M&A activity. Mexico's relative stability makes the country a safer bet than other Latin American markets, particularly the emerging ones. Multinational corporations are always a big factor in Mexican M&A. They acquire mature family-owned companies, or those publicly traded ones without much movement in share price, as an easy entry into Mexican industries.

Banking has been the hottest industry all over Latin America; Mexico is no exception. Scotiabank and Banorte will not want to be left behind after recent activities by HSBC, Banamex (Citibank) and Santander, so further consolidations are expected. Consumer goods, packaging, rubber, telecoms and cable TV are also in demand.

There hasn't been a lot of activity in project finance but that should change soon. Energy, oil, natural gas distribution and petrochemicals all need significant investments. Mexico is also lagging behind in its infrastructure development. New toll roads and highways, a new passenger airport and an alternate cargo airport for Mexico City are being considered or put up for bids. Still, it will take some time to get these projects going. The previous administration did not undertake significant new projects, and the new administration has only just come into office.

Creel García-Cuéllar y Müggenburg

The 71-year-old firm of Creel García-Cuéllar y Müggenburg, one of Mexico's leading M&A firms, won *IFLR's* award for the Mexican law firm of the year. This year Creel received unanimous recommendations from its colleagues to be ranked in the top tier for capital markets and banking. In a typical comment, one competitor said: "To be fair, Creel should be in tier one – they are close to Credit Suisse and Deutsche Bank. They do so much work in asset-backed securities, equity IPOs, and cross-border debt deals."

Indeed, Creel represented the Citibank-Accival team in a secondary round of a public offering by the Mexican government. The government wanted to divest itself of a 49% stake in Grupo Aeroportuario del Centro Norte, operator of 13 airports across Mexico. The November 2006 offering totalled \$375 million. The IPO was the first Latin American privatization for Nasdaq and one of the largest listings in Mexico for 2006.

In another deal placed both locally and on the international markets, the firm represented Citibank and Mexican bank Accival, which were underwriters for a \$260 million equity offering for Grupo Simec. The February 2007 offering for the Mexican steel manufacturer was placed in the Mexican Bolsa de Valores and also internationally through Rule 144A/Regulation S.

But the deal that really placed Creel in the top ranks was the IPO of airport operator Grupo Aeroportuario del Pacífico. The firm advised underwriters Credit Suisse and Acciones y Valores in Mexico on the worldwide offering. The \$962 million flotation was the country's largest privatization in more than a decade and the biggest IPO in Latin America in 2006.

Jean Michel Enriquez and Carlos Aiza are the two partners singled out for their work in this practice area. A veteran partner at a leading firm said: "Jean Michel Enriquez and Carlos Aiza are two young lawyers with a lot of punch."

The firm is also highly rated by the market for its work in mergers and acquisitions.

In August 2006, Creel advised client Brown-Forman in its acquisition of tequila producer Grupo Herradura, owned by the Romo family. Carlos Creel Carrera led the team advising the acquirers in the \$776 million deal. Not only was this one of the largest M&A deals of the year, but the involvement of the culturally important tequila industry ensured it was a high-profile one as well.

Leading lawyers

Carlos Aiza
Carlos Creel Carrera
Jean Michel Enriquez Dahlhaus
Javier Gallardo Guzmán
Samuel García-Cuéller

Galicia y Robles

The 12-partner, 25-associate firm of Galicia y Robles is one of two firms ranked in the top tier for all areas. A peer said: "Galicia is a good firm with a top-tier reputation. They typically participate in the important transactions."

Despite little activity in the IPO market, Galicia y Robles participated in the deal that took Grupo Famsa public on the Mexican

Stock Exchange and internationally through Rule 144A/Regulation S. The firm represented Credit Suisse and Bancomer and the underwriting syndicate in the May 2006 deal which raised \$230 million for the country's largest specialty retailer.

The firm is especially respected in the project finance area. Partners Carlos de María and Francisco Fernández Cueto were particularly noted for their accomplishments in the field. One leading attorney said: "We have done a lot of projects with them, and if I had a conflict of interest in a project finance deal, I'd recommend Galicia first."

Galicia y Robles uses its association with the eminent Spanish law firm Uría Menéndez to expand beyond the local markets. The Uría Menéndez network offers the Mexican firm the ability to assist its clients on international matters. It also provides the firm with access to deals in Europe, the US and South America.

Leading lawyers

Francisco Fernández Cueto
Manuel Galicia
Carlos de María
Rafael Robles Miaja

Mijares Angoitia Cortés y Fuentes

A past winner of the *IFLR's* award for Mexican law firm of the year, the firm of Mijares Angoitia Cortés y Fuentes maintains its high level of work for its clients. Other top-ranked firms cite Mijares as a firm they "always see on the other side of the table". But it should be noted that senior partner Jaime Cortés Rocha left the firm on amicable terms in June 2007 to work at his son's law firm.

The firm had another successful year in the capital markets, for both equity and debt transactions. In May 2006, the firm represented Grupo Famsa when the country's largest specialty retailer issued its IPO. Shares were placed on the Mexican Stock Exchange, as well as internationally through Rule 144A/Regulation S. The deal raised \$230 million for the country's largest specialty retailer, and also allowed the company to expand its efforts in banking. This is important to Famsa's customers, who tend to be those that do not always have credit made available to them.

November 2006 saw the firm advise the Mexican government, sellers of its stake in Grupo Aeroportuario del Centro Norte, which operates thirteen airports across Mexico. The offering totalled \$375 million, and was listed in the US on Nasdaq's Global Select Market, which has one of the strictest

placement standards. The company now has a market value of more than \$1 billion.

MACF's largest equity markets deal was the \$468 initial public offering for microfinance lender Banco Compartamos. The firm represented the underwriting syndicate, led by Credit Suisse, Acciones y Valores and Banorte. Companies like Banco Compartamos are becoming vital to the Mexican economy, providing loans to smaller businesses that would typically be overlooked by traditional lenders. This deal was unique in that the bank's shares trade directly on the stock exchange, rather than through a holding company as is customary.

Innovation is nothing new to Mijares, as the firm seems to specialize in unique offerings. Patricio Trad Cepeda and his banking team advised shopping mall operator Grupo Acosta Verde in a peso-denominated asset-backed security. The cash flow was maintained by commercial leases for this \$100 million security issuance.

In the lending area, Mijares was able to provide counsel to several high-profile clients. The firm advised a syndicate led by Bank of America, Institución de Banca Múltiple, and Grupo Financiero in arranging a revolving warehousing credit facility to Patrimonio, the country's oldest specialized housing finance company. The \$51 million facility was meant for mortgage originations.

The firm also represented Standard Bank in structuring a December 2006 credit agreement for Baja Ferries. The \$43 million agreement was for the purchase of a new vessel for its services on the Sea of Cortez.

M&A is another strong point for the firm. The most important deal was the August 2006 \$760 million purchase of Tequila Herradura (owned by Grupo Herradura) by the firm's American client, Brown-Foreman. The combined stock and asset deal was one of the largest of the year. The deal's importance was not about its size, however – the tequila industry is part of the country's identity, so the acquisition by a non-Mexican company attracted a lot of local attention.

Mexican M&A deals tend to be well below the \$1 billion mark, so anything more than \$400 million is considered very large. Mijares found itself in yet another very large deal when the firm's telecoms client Axtel acquired another provider, Avantel. The \$500 million consolidation closed in December 2006, and transformed Axtel into the second-largest fixed line telecoms company in Mexico.

Although the firm is not recognized for its prowess in project finance – the top three firms in this area have a virtual lock on important deals – MACF was able to participate in one important financing. Mijares advised lending syndicate led by BBVA Bancomer in a

\$333 million loan, including a \$102 million additional loan facility, to the Spanish construction company OHL. The financing was necessary to allow continuing development of the national Eastern Toll Road System.

Leading lawyers

Horacio de Uriate Flores
Francisco Fuentes Ostos
Pablo Mijares Ortega
José Raz-Guzmán
Patricio Trad Cepeda

Ritch Mueller

The 31-lawyer firm of Ritch Mueller impresses its peers for its work in financial legal markets. It is considered to be well staffed and is a consistent participant in the most important deals.

Ritch Mueller enhanced its reputation in the capital markets when it participated in Latin America's largest IPO of 2006, and one of the biggest privatizations in nearly two decades in Mexico. The firm advised the Mexican government in the divestiture of its 85% stake in Grupo Aeroportuario del Pacífico, an airport operators in the Pacific region (including second-city Guadalajara). The worldwide placement raised \$960 million in the March 2006 offering.

The firm has been quite active working with real-estate deals. Ritch Mueller advised GMAC Commercial Mortgage in a \$425 million securitized loan to the Ty Warner Group. The loan was securitized in the US, and involved the Los Cabos luxury resort of Las Ventanas al Paraíso, along with four American resorts.

It's not just high-end real-estate clients for the firm. Affordable housing builders Consorcio ARA needed to raise capital, and turned to a syndicate led by Merrill Lynch and BBVA Bancomer. Ritch Mueller advised the syndicate in a \$230 million global secondary shares offering.

In the debt markets, Ritch Mueller was kept busy, mostly advising underwriters. In its largest deal, however, it advised Cemex as the issuer of €730 million debentures. The financing was to be used for the cement company's hostile takeover bid of Australia's Rinker Group.

The firm also represented Grupo Televisa in a Ps4.5 billion (\$413 million) 8.49% 30-year senior notes offering. The media company was conducting a straight refinancing of its debt of similar coupon and maturity.

Citibank provided the firm with plenty of work. John Farah led the Ritch Mueller team that advised Citi in a syndicate for a \$3 billion loan to Teléfonos de México, and a \$297 million syndicated financing to Comunicaciones Nextel.

The firm also advised Citibank in two acquisition financing loans. Citi, Standard Bank and HSBC provided a \$550 million facility to aluminium distributor Tenedora Nemark for its acquisition of Hydro Castings and production facilities from TK Aluminum. The firm also advised Citi on its \$190 million acquisition financing to retailer Grupo Milano for its acquisition of women's apparel maker Grupo Melody. The financing was also used to refinance Milano's outstanding debt.

While Ritch Mueller has an excellent reputation in banking and capital markets work, its M&A work is a bit under-rated. Not as active as other top-tier firms, Ritch Mueller nonetheless participated in a key cross-border acquisition. The firm represented Latin American steel supplier Ternium (majority-owned by Argentine conglomerate Techint) in its acquisition of Grupo Imsa. By taking over the Mexican company in a \$1.7 billion deal, Ternium was able to significantly expand its North American operations.

As one of the top firms in project finance, Ritch Mueller participates in the most important deals in the country. The one name that is always mentioned for project finance work is partner Thomas Mueller. Working on projects as diverse as gas infrastructure to toll road development, Mueller advised clients in several project finance transactions this year. But it was partner Federico Santacruz who led the firm's largest deal – advising the syndicate financing a \$148 million oil pipeline construction in the Gulf of Mexico. Mueller led the team advising Nord/LB as lead arranger for financing of the development of a gas pipeline and compression project in the central state of Querétaro. In the same state of Querétaro, the firm advised Banco Santander in the Ps558 million financing to Concesionaria Irapuato-La Piedad, a company owned by ICA, the largest construction company in Mexico. ICA is meant to use the financing for the Irapuato-La Piedad project, a 74km road in central Mexico, for general purposes related to construction and maintenance of the highway.

The firm mostly represents international financiers such as Goldman Sachs, Morgan Stanley and the aforementioned companies, but there are industrial companies on Ritch Mueller's client list: Telefónica Móviles, brewers Femsá Cerveza, TEVA Pharmaceuticals, and credit card acquirers First Data Merchant Services are some of the non-banks advised by the firm.

Leading lawyers

Thomas Mueller-Gastell
Luis Nicolau
Guillermo Pérez Santiago
James Ritch

White & Case

The only other firm to sit with Galicia & Robles in the top tier in all three areas, White & Case has been uniquely able to integrate itself into the Mexican financial legal community. A partner at a leading competing firm said: "Interestingly enough, as a US firm, White & Case are probably the only ones that have done a good job in Mexico in terms of market recognition."

That recognition is only one of the reasons the 11-partner firm is ranked so highly in the financial practice areas. The firm's ability to put together sophisticated transactions also helps boost its reputation. White & Case partners Thomas Heather and Juan Antonio Martin represented HSBC in the issuance of a \$227 million series of mortgage-backed securities originated by the bank. This was the largest mortgage-backed obligations the bank had issued in Mexico.

White & Case represented Grupo Aeroportuario del Centro Norte (OMA), operators of thirteen airports across Mexico when the company went public late in 2006. OMA was able to list shares when the Mexican government sold off its stake in the company. The November 2006 IPO totalled \$375 million and was listed on the Mexico and New York stock exchanges. It was also one of the largest IPOs in Mexico of the year.

The ever-important tequila industry saw some consolidation last year, and the firm represented Tequilera Cielito Lindo (TCL) in its sale of shares to American spirits distributors William Grant & Sons. The distributors acquired a 31% stake in the Mexican tequila maker, with an option to fully acquire the company. This deal allows William Grant to distribute TCL's products worldwide.

Microfinance is becoming important to the Mexican economy as an alternative financing medium for smaller businesses. HSBC moved into this area when it purchased a stake worth nearly 20% of microfinancier Financiera Independencia for an amount estimated to be at least \$100 million. This allows HSBC access to Independencia's 200,000 sub-prime credit customers.

The firm also advised Wal-Mart in all regulatory matters regarding the establishment of the retailer's banking operations. This is one of only 13 banking licences presented by the Mexican banking authorities, and considering the retailer's customers, it could be a cost-effective move. Traditional banks typically do not cater to Mexico's poorer citizens, and this could create enormous credit lending opportunities for Wal-Mart.

Project finance is clearly a strong suit for White & Case, partly through its representation of ICA. One market insider said: "They are good and have done a lot. They represent

Mexico's biggest construction company ICA – if you're in project finance, you have to deal with ICA." This relationship was most clearly demonstrated in the firm's representation of the construction company to obtain concessions for the construction and renovation of the Irapuato-La Piedad toll road in the central state of Querétaro. The firm also represented ICA in obtaining Ps580 million financing from Banco Santander.

The firm's signature deal for the moment, however, is its role in the restructuring of Satélites Mexicanos (Satmex), followed by an auction sale of the company's shares. All aspects of the restructuring were handled successfully by the firm over the past three years. Thomas Heather led the team that restructured nearly \$800 million of debt for the satellite service provider; the restructured program was implemented in November 2006. This allowed Satmex to proceed with plans to launch another satellite. With a cleaner balance sheet and potential new revenue opportunities, White & Case then began the process of auctioning the company to qualified bidders. By no means is the auction a done deal – the minimum price of \$500 million and relatively small satellite fleet conspire to undermine Satmex's attractiveness – but pulling the company out of bankruptcy was a test of the firm's abilities.

Leading lawyers

Vicente Corta
Thomas Heather
Rodrigo Orozco
Juan Pablo Rico
Alberto Sepúlveda Cosío

Other notable firms

The young firm – no attorney is even 40 yet – of **Bello Gallardo Morales y Tsuru** debuted in last year's rankings, and returns this year with more experience under its belt. In a rare equity markets offering, the firm advised the International Finance Corporation (IFC) on the sale of its stake in Banco Compartamos in the bank's IPO. The offering raised \$468 million, and IFC was also able to lower its ownership stake from nearly 11% to less than 8% in this April 2007 deal. Microfinanciers are becoming important in Mexico, as lenders to small-business owners who cannot get financing from commercial banks. In another IFC deal, the firm represented the international agency when the agency agreed to purchase a 19% stake in Grupo Financiero IXE. The shares purchase would raise \$70 million for the commercial bank holding company. Other companies that have used the firm's services include Bank of Tokyo-Mitsubishi, HSBC, ING and Banco Santander.