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Mexico's Unified Secured Transactions Registry Offers New Opportunities for Secured Lending

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Mexican companies have historically encountered difficulties in attracting secured lending from U.S. and other foreign banks, mainly because of concerns as to the reliability of Mexican laws governing secured transactions and of its systems for filing and perfecting security interests (*garantías reales*) in personal (movable) property or goods (*bienes muebles*). Mexican banks have shared these concerns and have tended to rely on real property collateral in most of their secured lending. As a result, many Mexican companies whose primary assets are inventory, receivables and equipment have lacked access to adequate financing on competitive terms.

In order to encourage lenders to finance the operations of Mexican borrowers, Mexico has enacted significant reforms of its secured transactions laws. Most recently, dramatic steps have been taken to improve its public registry system to make it easier to search for existing liens on a debtor's property and to perfect new security interests.

Mexican Bankruptcy Considerations

The importance to creditors of taking collateral security from Mexican debtors has arguably been increased by certain difficulties in the application of the Mexican Bankruptcy Law (the *Ley de Concursos Mercantiles* or LCM) enacted in 2000 and subsequently amended.¹ As a practical matter, the LCM does not ensure the "cram down" of secured creditors to the extent possible under the U.S. Bankruptcy Code, which allows a debtor, under a reorganization plan, to pay a secured creditor less than its full claim if it is under-collateralized. The secured claim can be "crammed down" to the value of the collateral by paying under the plan, over time, the value of the collateral, with the remainder of the claim being treated as unsecured.²

The LCM provides that a secured creditor may proceed with the enforcement of its collateral security if the reorganization plan does not provide for full payment of the secured debt, or the payment of the value of the collateral.³ On the surface, the latter option suggests the possibility of a cram down, but the absence of clear valuation procedures and criteria in the LCM, combined with the fact that bankruptcy judges often have limited experience with the LCM and few precedents to rely upon, means that it is more difficult than it would be under the U.S. Bankruptcy Code to prevent the secured creditor from proceeding (or threatening to proceed) with an action to enforce



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its collateral. Depending on the importance of the collateral to the future operation of the debtor, any such enforcement action could in effect jeopardize the success of the reorganization plan.

This gives the secured creditor significant negotiating leverage in a restructuring under the LCM, and has implications not only for secured bank lending but also for Mexican corporate bond financings, as to which bond investors may have a strong argument based on the LCM to insist on collateral security when the bonds are issued. If an issuer must provide such collateral, for example to support a high-yield bond offering, it may be less costly for the issuer to provide collateral consisting of personal property than to mortgage its real property, partly because of high mortgage recording costs and the related notarial fees. In order to obtain the advantages of treatment as a secured creditor under the LCM, having personal property collateral is as effective as having real property collateral of comparable value.

Like the U.S. Before the UCC

Mexico has a bewildering variety of personal property security interests, including among others the pledge (*prenda*), the industrial mortgage (*hipoteca industrial*) and the specialized security interests tied to the *crédito refaccionario* and the *crédito de habilitación y avío*, that brings to mind the personal property collateral devices (chattel mortgages, trust receipts etc.) that were commonly used in the U.S. prior to the adoption of the Uniform Commercial Code. Although Mexico has had the advantage of a single Commercial Code (and other federal secured transactions laws) that apply to the entire country, rather than a system of separate State laws as in the U.S., each of the 32 States and the Federal District has its own Civil Code establishing a Public Registry system for real property deeds and mortgages (each such registry is a *Registro Público de la Propiedad*) and, although personal property security filings are governed by the federal Commercial Code, they have previously been required to be made in the commercial registry (*Registro Público de Comercio* or "RPC"), which is normally managed by a unit of the related State or municipal government, in the place of the debtor's domicile. Some of these locally managed commercial registries are less reliable than others, and significant delays are common in searching for existing liens and filing new security interests on collateral of companies domiciled in remote locations.

The Nonpossessory Pledge and the Guaranty Trust

On the substantive side, Mexico has made significant progress since 2000 by amending the Mexican Commercial Code and the General Law of Credit Instruments and Transactions (the *Ley General de Títulos y Operaciones de Crédito* or LGTOC) to permit personal property security interests to be created more easily on a "floating lien" basis. A new type of nonpossessory pledge called the *prenda sin transmisión de posesión* allows a debtor to pledge all of its inventory and receivables, for example, generically described (rather than described by reference to specific items), to a secured party without requiring that possession of the collateral be transferred to the secured party. This pledge can permit the debtor to sell the pledged collateral in the ordinary course of business without obtaining a case-by-case release from the secured party, and can automatically subject newly acquired property to the pledge without any further filing, which effectively results in a floating lien. A similar effect can be achieved through a guaranty trust (*fideicomiso de garantía*) with respect to the same or similar types of property, whereby title to the collateral is transferred to a Mexican trustee (typically a Mexican bank).⁴ Although these new devices resemble a security interest created in the U.S. under Article 9 of the UCC, lenders have remained reluctant to significantly expand their secured lending activities in Mexico because of ongoing concerns about their ability to perfect these security interests against third parties through the public registry system.

UNCITRAL and the OAS Encourage Registry Reforms

Recently, in an attempt to provide guidance for emerging market countries like Mexico that wish to improve access by borrowers to secured lending, the United Nations Commission on International Trade Law (UNCITRAL) has promoted reforms of the bankruptcy laws and secured transactions laws in such countries. Its 2008 Legislative Guide on Secured Transactions indicated the importance of a country having a “registry in which information about the potential existence of security rights in movable assets may be made public.”⁵ In 2010, UNCITRAL decided to expand its work in this field by preparing a “model registry regulation,” which is still in the process of preparation.

The previous efforts of the Organization of American States (OAS) to adopt a Model Inter-American Law on Secured Transactions (the “Model Law”)⁶ appear to have influenced Mexico in its adoption of the nonpossessory pledge concept. The OAS has also been tackling the registry issue; in October 2009, it held its Seventh Inter-American Conference on Private International Law, which approved Model Registry Regulations to “provide the legal foundation for implementing and operating the registry regime contemplated by the Model Law.”⁷ Among other things, the Model Registry Regulations contemplate the adoption of electronic filing systems and acknowledge that most of their features were recommended in UNCITRAL’s 2008 Guide and included in the registry systems recently developed in some Latin American countries, including Mexico, as well as in the U.S. (the UCC), Canada (the Personal Property Security Act) and some European countries.

Mexico’s 2009 Commercial Code Amendments and Creation of the RUG

Mexico has been receptive to the objectives reflected by the UNCITRAL and OAS efforts. Not only did Mexico enact secured transactions law reforms in 2000 and subsequent years to reflect many of the changes contemplated by the OAS’ Model Law, but Mexico’s initiatives with respect to public registry reforms have actually preceded the formal adoption of model rules by UNCITRAL and the OAS. In August 2009, a few months prior to the adoption of the OAS Model Registry Regulations, the Mexican Congress approved amendments to the federal Commercial Code that provide for the establishment of a Unified (or Sole) Registry of Movable Property Collateral (the *Registro Único de Garantías Mobiliarias* or “RUG”).⁸ The new Article 32 bis of the Code provides for the RUG (pronounced “roog”) to be a centralized registry for all types of security interests granted in favor of any creditor that carries out commercial activities (a *comerciante*) in personal property. The RUG will be a section of the PRC under the supervision of the Ministry of Economy (*Secretaría de Economía*), in which all filings are to be carried out electronically, through the RUG website, www.rug.gob.mx.

The stated Congressional purpose of the RUG is to strengthen the system for personal property secured transactions “as an effective tool for access to credit.” Its main functions are to create a mechanism that allows public disclosure of security interests created on personal property and to establish priority rules for secured creditors. Filings through the RUG have immediate effect, without requiring any approval by any authority. Such filings can be made by financial institutions, public officials, public notaries (*notarios públicos*) or brokers (*corredores públicos*) and others authorized by the Ministry of Economy. Under Article 32 bis 4 of the amended Commercial Code, a debtor is generally deemed to have authorized any secured party creditor that is *acomerciante* to file evidence of the applicable security interest in the RUG. Article 32 bis 7 allows “any interested party” to request the issuance of a certification as to the filings that have been made in the RUG with respect to any debtor.

New Registry Regulations

On September 23, 2010, an executive decree was issued by Mexican President Felipe Calderón implementing the 2009 Commercial Code amendments by amending the Regulations governing the PRC to provide specifically for the inclusion of the RUG as a section of the overall PRC.⁹ The amendments clarify how the RUG will operate through the electronic system called the Integrated System of Registry Procedures (*Sistema Integral de Gestión Registral* or SIGER) and the procedures to be followed for the use of the RUG by those who wish to (i) search it for the existence of existing security interests and (ii) perfect their own security interests as against third parties by filing notices.

Anyone who registers with the RUG can initiate a search, but filings of security interests directly by an institutional creditor can only be done if the creditor entity has arranged to utilize an electronic signature for this purpose which satisfies the technical requirements contemplated by the Commercial Code¹⁰. Otherwise the security interest must be filed on the creditor's behalf by someone else authorized under the RUG to do so.

The provisions of the amended Regulations (the "Amended Registry Regulations") impose certain formalities which do not seem to be contemplated by the new Article 32 bis of the Commercial Code and may contravene the policy guidelines recommended by the OAS and UNCITRAL. For example, Article 10 of the Amended Registry Regulations provides for the RUG registrar or officer to verify that a filing has been properly made "in accordance with applicable legal and regulatory provisions," which would seem to prevent the filing from becoming immediate and automatic, as provided in Article 32 bis 4 of the amended Commercial Code. Also, Article 10 bis of the Amended Registry Regulations specify that filings can only occur through a public authenticating officer (*fedatario*), i.e. a public notary (*notario público*) or broker (*corredor público*), although Article 30 bis seems to permit others, including financial entities, to make filings without using a *fedatario*. As a practical matter, until changes are made in Article 10 bis to allow filings to be made otherwise, it seems advisable to use a *fedatario* to carry out the filing. A number of law firms in Mexico employ *fedatarios*, so this should not be a significant impediment to the filing process or impose a significant additional cost.

The use of a *fedatario* has the advantage of avoiding the requirement under Article 10 that the RUG registrar or officer verify the propriety of the filing; under Article 10 bis a filing by a *fedatario* has immediate effect.

Preventive Filings

Prior to the closing of a secured lending transaction, the proposed lender may wish to have the comfort that there will be no last-minute filings by other lenders of security interests that would have priority (based on time of filing) over any security interest to be filed to secure the transaction in favor of the proposed lender. To obtain such comfort, Articles 32 bis 5 of the Commercial Code amendments and 33 bis of the Amended Registry Regulations permit the proposed lender to make a filing prior to the scheduled closing, which will have the effect of preventing any other lender from making a filing that would have priority over the later definitive filing by the proposed lender of its own security interest. If the closing does not take place, the debtor need not seek removal of the preventive filing from the records of the RUG, because such filing would automatically cease to be effective after the passage of a specified period, normally two weeks.

Information to be Provided in Filings through the RUG

Article 33 Bis 2 of the Amended Registry Regulations provides that the information that must be provided in the filing of the security interest will be (i) the name of the debtor or debtors granting the security interest, (ii) the name of the creditor or secured party, (iii) the type of security device utilized to create the security interest, (iv) the personal property securing the relevant obligations, (v) the secured

obligations, (vi) the term or time frame during which the filing will be effective, and (vii) anything else contemplated by Article 33 of such regulations, i.e. anything else that may be required by the forms to be used in order to effect such filings, which are to be specified in a publication in the official Gazette (*Diario Oficial*) of the Republic.

Using the RUG

As contemplated by the Amended Registry Regulations, to provide further guidance on using the RUG, the Ministry of Economy published a User's Guide (*Guía de Usuario*) in Spanish providing additional guidance as to how the search and filing processes will operate.¹¹ The User's Guide shows how (i) a user can become registered with the RUG, (ii) searches can be performed, (iii) search certificates can be obtained, (iv) secured party creditors (whether organized or resident within or outside of Mexico) can be registered and (v) the creditor's representatives can be registered in order to be entitled to submit filings on behalf of the creditor.

Mexican creditors can be registered online by including their Mexican tax ID numbers in the creditor information they provide. In the case of foreign creditors not having such numbers, the registration may be carried out at one of the designated offices of the Ministry or through a *fedatario*. Foreign creditors that wish to avoid delays at the closing of a secured loan may wish to become pre-registered before the closing. For cases involving multiple creditors, such as a syndicated loan, there is a separate procedure for entering the names of the additional creditors. As for the debtor, the filing form contemplated by the User's Guide mandates that it be filed electronically in such a way that the debtor's name is accompanied by an indication of whether the debtor is an individual or an entity and his or its nationality, registration file (*folio*) number and taxpayer ID or CURP number. A debtor that is an individual may be registered by a *fedatario* at the time of the filing of the security interest, but a debtor that is a company or other entity will have to have been registered in the PRC prior to the time of filing.

According to the User's Guide, the filing of a security interest is to be effected by making entries in the electronic equivalent of a document akin to a UCC financing statement, which should specify

- (i) the name and address of the person requesting the registration of the security interest,
- (ii) a description of the type of property subject to the security interest, such as "machinery and equipment" (the applicable type is to be selected from alternatives that appear on the screen),
- (iii) the type of security document under which the security interest was created, i.e. whether it was a nonpossessory pledge, guaranty trust etc. (again, the selection is from the types indicated on the screen),
- (iv) the date of the relevant security agreement,
- (v) the maximum amount secured, specifying the applicable currency,
- (vi) a more detailed description of the property subject to the security interest,
- (vii) a description of the public deed issued before the *fedatario* which formalized the security agreement,
- (viii) a description of the agreement under which the secured obligation arose,

(ix) optionally, any terms and conditions established by the documents, and

(x) the period of time for which the filing is to remain effective.

The User's Guide provides examples of entries that are to be made in the online "financing statement," and indicates how the electronic signature is to be applied to the document in order to affect its filing.

The User's Guide includes similar instructions for related procedures, such as amendments, assignments, renewals or reductions of the effective term of the filing, corrections of errors, cancellations and "annotations" (*anotaciones*). The annotations might include information on any enforcement action with respect to the security interest, and would be made pursuant to instructions from a court or other authority. An annotation might result from a debtor challenging the propriety of the filing.

Effect of the Reforms: Better than the UCC?

The RUG is now the exclusive method in Mexico for perfecting security interests in inventory, receivables, equipment and many other types of personal property, whether created through a possessory or nonpossessory pledge, guaranty trust or other device, superseding all of the local public registries. However, security interests previously filed in the local registries will continue to be effective, so lenders must undertake searches as to any debtor in the locally-managed public registry responsible for such debtor's domicile until such time as the previously filed security interests are no longer effective (for example, because they have been released or the related debt has been repaid), or otherwise satisfy themselves that no such filings have occurred (for example, by obtaining representations and warranties from the debtor to this effect).

Similar transition issues were encountered in the U.S. during the implementation of the UCC and its associated filing systems.

Two features are present in the Mexican situation which did not exist in the case of the adoption of the UCC. First, the RUG will be the sole registry in Mexico for filing security interests in personal property, unlike the separate filing systems in the 50 States of the U.S. and in the District of Columbia, and many local filing places such as the offices of County Clerks. Thus, the sometimes thorny question in the U.S. of where to file will not apply in Mexico. Secondly, the RUG is exclusively electronic, as opposed to the recordation systems in the U.S., which initially relied entirely on paper filings and have only recently begun to transition to electronic systems, gradually, on a State by State basis.

It will still be necessary to comply with the relevant requirements for creating security interests, which in Mexico often requires that the security agreement or pledge agreement be formalized by the preparation by *afedatario* of a formal deed (*escritura*).

Instead of being recorded in the locally managed public registry, such deed should now be recorded in the RUG. Filings as to some types of collateral, such as vessels and aircraft, will continue to be made in specialized registries. Also, some of the enforcement remedies available under the UCC are not available under Mexican law, and the enforcement process in Mexico is likely to be more time-consuming than it is in the U.S.

But with those exceptions, and despite some uncertainty created by the amended Regulations, the establishment of the RUG represents a huge step forward by Mexico in making secured lending an attractive option for borrowers and lenders alike. Even a lender that remains skeptical about the enforcement of security interests in Mexico may be persuaded that it is worth perfecting security interests pursuant to a filing in the RUG in order to obtain the important practical advantages under the Mexican bankruptcy law of being a secured lender.

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¹ Published in the *Diario Oficial de la Federación* (the "D.O.F.") on May 12, 2000. Amendments to the LCM were published in the D.O.F. on December 27, 2007.

² 11 U.S.C. § 1129(b)(2)(A).

³ See LCM Articles 158, 160.

⁴ Published in the D.O.F. on May 23, 2000, with amendments published in the D.O.F. on June 13, 2003.

⁵ Legislative Guide on Secured Transactions of the United Nations Commission on International Trade Law, GA Res. 63/121, UN GAOR, 63rd Sess., 17 December 2008.

⁶ Adopted on February 8, 2002, by the Sixth Inter-American Specialized Conference on Private International Law (known as "CIDIP-VI", for its Spanish acronym) [CIDIP-VI, Final Act 3(f), OEA/Ser.K/XXI.6/ CIDIP-VI/doc.24/02 rev.3 (March 5, 2002)].

⁷ Approved by the Seventh Inter-American Specialized Conference on Private International Law (CIDIP-VII) at its second plenary session of October 9, 2009; quoted language appears in the Introduction.

⁸ Published in the D.O.F. on August 27, 2009.

⁹ Published in the D.O.F. on September 23, 2010.

¹⁰ Art. 11 of the Amended Registry Regulations.

¹¹ See <http://www.rug.gob.mx/Rug/resources/pdf/guia%20de%20usuario/Manual%20de%20Usuario%20RUG.pdf>.

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