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VIII Investment framework

Over the last several years, Mexico has removed significant foreign investment barriers as part of an ambitious economic development plan that aims to achieve, and sustain, industrial development and expansion. The government has recognized that substantial private capital is needed to create additional employment and to increase industrial output, which also results in attracting an influx of modern technology, management techniques, and financing.

Consistent with NAFTA, Mexico enacted a Foreign Investment Law (FIL), effective as of December 1993, and amended on December 1997, which abolished restrictions on foreign investment in most areas. FIL repealed several statutes that strictly regulated the participation of foreign investors in certain activities. The Foreign Investment Commission is the exclusive authority for the application of FIL.

On September 1998, new Regulations were published for the FIL and the Foreign Investment Registry to further relax requirements and filings. Lately, further amendments were published on July 2006 same that removed several restrictions to foreign investment in Mexico.

A. Foreign investment law

FIL establishes, as a general rule, that foreign investors may hold 100 percent of the capital stock of any Mexican corporation or partnership, except in those few areas expressly subject to limitations under the FIL. The repealed law stated, as a general rule, that foreign investment was limited to 49 percent unless expressly authorized to exceed this percentage. FIL grants all investors from NAFTA and non-NAFTA countries the same investment treatment in Mexico. In certain activities limited by FIL, investors from NAFTA, EU and EFTA countries enjoy greater access, as provided in NAFTA, MUEFTA and the Free Trade Agreement with EFTA member states (MEFTA-FTA). There has been dynamic liberalization of previous restrictions in FIL by modification of various specific laws, applicable generally, as well as to specific provisions in these free trade agreements applicable to their Parties. To attract further flows of capital and allow even greater foreign capital participation, there have been accelerated changes in certain areas such as railroad services, ports, airports, telecommunications, and in certain financial services.

The following are the major categories of limitations on foreign investment contained in FIL. Where applicable, NAFTA, MEUFTA and MEFTA-FTA provisions relevant to each sector are noted as well.

1. Activities reserved for the State

The constitutionally-defined "strategic activities" continuing to be reserved exclusively for the State are the following, as per Article 5 of FIL:

- a) Oil production and oil refining;
- b) Basic petrochemical production;
- c) Electricity;
- d) Nuclear power generation;
- e) Radioactive minerals;
- f) Telegraph and radiotelegraph services;
- g) Local postal service;
- h) Bill issuance and coin minting; and
- i) Control, supervision and surveillance of ports, airports and heliports.

Consistent with FIL, Mexico has reserved these activities from NAFTA, MEUFTA and MEFTA-FTA application.

2. Activities reserved for Mexican investors

Article 6 of FIL reserves the following activities of the Mexican economy for national investors:

- a) Domestic land transportation of passengers, tourists and cargo, not including passenger or package delivery services;
- b) Retail gasoline sale and distribution of liquefied petroleum gas;
- c) Radio broadcasting and television services (except cable television, where foreign participation may reach up to 49 percent);
- d) Credit Unions were deleted from the law in 2008 as the New Law of Credit Unions was enacted 8DOF 20/08/08).

The Law of Credit Unions establishes a maximum of 10% of foreign investment either directly or indirectly (art. 21 LUC)

- e) Development banks;
- f) Professional and technical services expressly defined by the applicable legal provisions;
- g) As of December 1995, a rule included activities of international land transportation of passengers, tourists, and cargo, between points in Mexican territory, as well as services of administration of central stations for passenger and auxiliary auto motive service vehicles. As of January 2004, foreign investment may participate up to 100 percent in the capital stock of Mexican companies engaged in this type of activities.

3. Activities subject to specific participation percentage

Article 7 of FIL establishes the following three categories where foreign investment is authorized up to 10 percent, 25 percent, and 49 percent:

- a) 10 percent in cooperative production companies;
- b) 25 percent in domestic and specialized air transportation and air shuttle services;
- c) 49 percent, which is the most extensive category, includes the following activities:
 - i) Insurance and bonding institutions, currency exchange houses, general deposit warehouses, companies mentioned in article 12-Bis of the Securities Market Law which handle security portfolios in the name of third parties, investment companies' fixed capital and companies operating investment companies; in some of these cases, financial companies from NAFTA, MEUFTA and MEFTA-FTA may invest up to 100 % in an affiliate established in Mexico. As of July 2006, foreign investment up to 100% is allowed in financial leasing, factoring, and special purpose financial companies.
 - ii) Manufacture and commercialization of explosives, firearms, cartridges, munitions and fireworks, excluding their acquisition and use for industrial or extractive activities, or for the production of explosive mixtures for use in these activities;
 - iii) Printing and publication of newspapers for circulation exclusively in Mexico;
 - iv) Ownership of series "T" shares of companies that own agricultural, cattle-raising or timber land;
 - v) Fishing in fresh water, along the coast and in the exclusive economic zone, except aquaculture;
 - vi) Integral port administration, pilotage, shipping companies commercially operating vessels engaged in coastal trade and navigation in internal waters, except for tourist cruise ships and dredges, and naval artifacts for port construction, conservation and operation;
 - vii) Supply of fuel and lubricants for ships, aircraft and railway equipment; and
 - viii) As of January 1999, 100 percent foreign investment is allowed in the manufacture and assembly of auto parts for the automotive industry without the requirement of prior authorization.

4. Majority interest upon approval

Finally, article 8 of FIL establishes categories of activities in which foreign investors may hold greater than a 49 percent interest, subject to approval of the Foreign Investment Commission. These activities include the following:

- a)* Port services such as towage, launching and line handling;
- b)* Shipping companies using vessels exclusively for high-seas traffic;
- c)* Administration of air terminals;
- d)* Private educational services;
- e)* Legal services;
- f)* Credit information companies;
- g)* Institutions for categorization of securities;
- h)* Insurance agencies;
- i)* Cellular telephone services;
- j)* Construction of pipelines for transportation of petroleum and derivatives thereof. As of May 1995, 100 percent participation is permitted by special law without specific authorization;
- k)* Oil and gas well drilling;
- l)* Erection, construction and installation of public works.

5. Acquisition of existing Mexican companies

Except as above provided, foreign investors may acquire up to 100 percent of the shares of any company. However, a resolution from the Foreign Investment Commission is required when foreign investors wish to acquire more than 49 percent of the capital stock of existing Mexican companies, when the value of the involved companies' assets exceeds the threshold fixed by the Foreign Investment Commission. Such threshold is fixed annually.

On this respect, it is noteworthy that NAFTA provides phasing for NAFTA parties.

6. Real estate

The Mexican Constitution establishes a "restricted zone" (100 kilometers wide from the borders and 50 kilometers wide from the coastal shores) in which direct foreign ownership is prohibited.

However, FIL authorizes foreign participation in a Mexican company owning real estate within the restricted zone for non-residential purposes and requires only a notification to the Ministry of Foreign Affairs; if for residential purposes, title of the real estate must be held through a trust by a trustee, which must be a Mexican bank. Approval of the Ministry of Foreign Affairs is required. Long term leases of real estate are no longer prohibited.

7. Neutral investment

Neutral investment is a carryover from the 1989 Regulations to the 1993 Foreign Investment Law. FIL regulates the mechanism to allow foreigners to hold greater percentages of the capital of Mexican companies in restricted areas. Neutral investment may be done either through Mexican companies or in authorized trusts, as follows:

- a)* The Ministry of Economy may authorize companies to issue special series of shares with limited or no voting rights.
- b)* Banks acting as trustees may be authorized by the Ministry of Economy to issue instruments of neutral investment that grant holders economic and limited voting rights, with the restriction that no voting rights may be granted for ordinary shareholders or partners meetings.
- c)* The Foreign Investment Commission may authorize neutral investment in the capital

stock of Mexican companies by international development financial companies.

The Ministry of Economy has 35 working days to issue or deny the aforementioned authorizations. Otherwise, authorization will be granted automatically.

B. Privatization

In 1982, during the term of former President Miguel de la Madrid, the Mexican government started a privatization process of government-owned enterprises. However, it was not until 1988 during the administration of President Carlos Salinas that this process was intensified. Both, the Zedillo and the Fox administrations continued the process and further broke down other taboo areas. It is expected that the Calderón government will continue this trend.

For over two decades many government-owned enterprises were privatized, including hotels, airlines, all of the banks, the telephone company (TELMEX), mining (Minera Cananea), TV stations (TV Azteca), theaters, sugar mills, fishing companies, automobile assembly, steel companies, and other companies covering a wide range of activities.

The privatization process is part of the policy to liberalize the economy, while simultaneously allowing foreign participation in most economic activities. For example, the banking system, which until 1982 was owned by Mexican investors, was expropriated by the government and in 1990, privatized to Mexicans, and now allows foreign participation and control.

Another example is TELMEX, which was privatized in 1990 with foreign participation in special series of shares, bringing in over US\$7 billion. Foreign participation was permitted in the telecommunications industry in 1997 when Mexico opened long-distance telephone markets.

Special rules in the bidding process are applied depending upon the specific characteristics of the government-owned company in process of privatization. Each privatization requires the approval of the Intersecretarial Committee on Privatization, created on April 1995, and consisting of the Ministers of Finance, Economy, Transport and Communications, Energy, General Comptroller and Labor, with the participation of the president of the Competition Commission.

Outsourcing part or all of the activities of the entity without changing its ownership is another form of privatization (sometimes referred to as "indirect privatization"), without the necessity of direct ownership of the outsourcing company.

Privatization in this form opens a whole new vast area of business opportunities to national and foreign enterprises. Such contracting may occur for operations to be performed separately from the facilities of the government-owned entity or may occur within the facility (i.e., maintenance contracts, statistical processing, management of production, and operating computer systems).

C. Monetary and financial system

1. Normative Framework

Money, foreign exchange, and financial services, are regulated by a series of laws, regulations and circular letters from the Ministry of Finance, the Bank of Mexico, National Banking and Securities Commission (NBSC), and the National Insurance and Bonding Commission (NIBC).

2. Currency

The unit of currency is the peso. The only legal currency circulating are paper bills issued by the central bank, and coins of various values and characteristics. Foreign money is not legal currency in Mexico. Obligations denominated in foreign currency for payment in Mexico may be paid by delivery of the equivalent amount in pesos at the exchange rate in

effect on the date of payment, as established in the Monetary Law. The Official Federal Gazette publishes the V.S. dollar exchange rate determined by the central bank for payment of obligations. The parties may agree to make payments in foreign currency outside of Mexico, in which case, the Monetary Law would not be applicable. The exchange rates for other foreign currencies are calculated according to the exchange rates of those currencies with the V.S. dollar in international markets. The exchange rates of most foreign currencies are available at banks in Mexico.

Mexican monetary law provisions may not be waived and any contractual stipulation to the contrary is null.

3. Investment Units (UDIs)

Upon the 1995 financial crisis and to offset inflationary pressures, the Mexican government created the Unit of Investment (UDI), which is a unit of account that may be used to express the value of investments, credits or commercial transactions. The Bank of Mexico is in charge of calculating the value of the UDI on a daily basis, which is based on the National Consumer Price Index. (The value of one UDI was equal to \$1.00 peso on April, 1995, the date of enactment of the corresponding decree).

UDIs may be used to denominate the value of obligations in credit instruments, excluding checks. Its use is voluntary and when due, payment must be made in pesos. Payment is calculated by multiplying the peso value of the UDIs on the payment date, by the number of UDIs owed.

Relatively few private investments or commercial transactions are denominated in UDIs, principally because of the relative stability of the exchange rate of the peso and attractive interest rates in pesos.

4. The Central Bank and foreign exchange

The Bank of Mexico operates as the country's central bank. The purpose of the Bank of Mexico is to provide legal currency for the economy, and its goals include achieving stability in the purchasing power of the peso, as well as promoting the healthy development of the financial system, and providing an effective payment system.

The Bank of Mexico maintains foreign reserves for the purpose of supporting the purchasing power of the peso. The Bank supports the peso's purchasing power by compensating for disparities between the inflow and outflow of foreign currencies in the country. The Bank of Mexico is well respected both inside Mexico and in international financial circles.

Mexico has complete freedom regarding monetary exchange. This free peso exchange policy has been a constant in the financial history of Mexico, except for a short period between September 1982 and December 1982, when strict exchange controls were enforced. After December 1982, the few remaining controls were liberalized considerably, and were removed completely on November 1991.

Mexico uses a floating exchange rate system. Foreign currency may be sold or purchased in authorized currency exchange houses and in commercial banks. Furthermore, peso futures markets operate in Chicago, U.S.A., and in Mexico City. Although there is no exchange control, bank accounts may not be denominated in foreign currency. However, there are exceptions for companies and for individuals residing in the Mexican border zone. There are some discussions regarding the allowance of dollar bank accounts more generally; this being related to monetary policy.

5. Affiliates of foreign financial entities

The law defines as affiliates a Mexican corporation, authorized to operate as a type of

financial institution, whose capital stock is owned by a "foreign financial institution." A "foreign financial institution" is an institution legally established as such in a foreign country. In addition, the "foreign financial institution" must be from a country with which Mexico has entered into a treaty that provides for the establishment of foreign affiliates in Mexican territory. Similarly, an affiliate holding company, is defined as a Mexican corporation, organized and authorized to operate as a holding company of a financial institution or institutions, in which a "foreign financial institution" holds at least 51 percent of the capital stock. As such, under the financial laws, and as these terms are used herein, an affiliate, a foreign financial entity or institution, and an affiliate holding company are terms that apply to vehicles related to foreign investment by an entity in a NAFTA, MEUFTA or EFTA country.

Since 1994, by virtue of amendments to the respective laws governing various financial institutions, foreign financial entities may establish affiliates with the prior approval of the Ministry of Finance. NAFTA, MEUFTA and MEFTA-FTA contemplate the establishment of foreign financial affiliates, including market participation limits, individual and aggregate, which have now been liberalized.

In order to have an affiliate, foreign financial institutions must perform in their countries of origin, the same activities authorized for the affiliate in Mexico. Mexican legislation regulates affiliate operations.

The capital stock of foreign financial affiliates engaged in activities of credit institutions, holding companies of financial groups, bonding companies, auxiliary institutions, exchange houses, special purpose financial companies, and brokerage houses, can be represented only by "F" and "B" shares. "F" shares must represent at least 51 percent of the capital stock and may be held only by an affiliate holding company or foreign financial institution. "B" shares are free of ownership restrictions, and are regulated by the provisions for "O" series, contained in the corresponding laws.

In the case of affiliates of foreign insurance companies, the capital stock shall be represented by "E" and "M" shares. "E" shares must represent at least 51 percent of the capital stock and may be held only by an affiliate holding company or a foreign financial institution. "M" shares are free of ownership restrictions, but are subject to certain restrictions according to the Law of Insurance Institutions and of Mutual Insurance Companies regarding holdings permitted to a single stockholder.

In the case of affiliate investment companies or companies operating investment companies, up to 99 percent of the fixed capital stock may be held by an affiliate holding company or a foreign financial institution.

It should be noted that an affiliate of a foreign financial institution is a Mexican entity and is not considered as foreigner or foreign entity.

6. Credit institutions

Banking institutions fall into two categories in Mexico: development banks and commercial banks.

The Mexican legal denomination for commercial banks is "Instituciones de Banca Múltiple" (the literal translation of which is "multiple bank institutions"). This denomination expresses the change in the range of services of commercial banks, as banks are now permitted by law to perform all kinds of banking services, and are not solely restricted to certain types of services, as they were in the past (i.e., deposit banks, mortgage banks, medium and long term financing banks, savings banks, trustee banks, etc.). Article 46 of the Law of Credit Institutions contains the detailed list of services that development banks can also perform.

The essential difference between development banks and commercial banks is that development banks are governmental entities and commercial banks are privately owned. The different services they offer result more from the practice than from legal provisions.

a) Developments banks

Development banks are established by their respective organic laws for special objectives, such as promotion of foreign trade, financing public utilities, housing, and industrial and agricultural development, among other areas. Some examples of development banks include Nacional Financiera, S.N.C., which operates as the principal government bank for promotion of industry in Mexico, and Banco Nacional de Comercio Exterior, S.N.C., which promotes exports and pre-exportation activities. Foreigners may not participate in the equity of development banks.

b) Commercial banks

To operate as commercial banks, authorization from the Ministry of Finance and opinions from the Bank of Mexico and the NBSC are required. The authorizations are nontransferable.

The ordinary capital stock of commercial banks must be represented by series "O" shares.

The law allows commercial banks to issue special series "L" shares representing contribution of "additional" capital. "L" shares have limited voting rights, and a preferred and cumulative dividend, which can be greater, but not less than, the dividend on common stock. These shares may be issued for up to an amount equal to 40 percent of the ordinary capital stock. "O" shares must be held by Mexicans, including affiliates of foreign financial entities, provided there are no restrictions governing their particular area of activity. Foreign government entities cannot hold stock of commercial banks.

No person or entity may hold more than 5 percent of the capital stock, but may hold up to 20 percent with prior authorization from the Ministry of Finance. Exceptions to such limitations on holdings of ordinary capital stock are listed in article 17 of the Law of Credit Institutions, and include the federal government, certain institutional investors, holding companies of financial groups, shareholders of banks participating in a merger program approved by the Ministry of Finance, and other banks and foreign financial institutions and their Mexican affiliates when participating in programs approved by the Ministry of Finance.

Except for the period between 1982 and 1992, historically, most Mexican commercial banks have been privately owned. Today, four large banks (Banamex-Citibank, BBVA-Bancomer, Santander-Serfin, and HSBC Mexico) operating through thousands of branches throughout the country, dominate this sector of the economy.

7. Special purpose financial entities ("non-bank banks")

The Law of Credit Institutions expressly prohibits any entity other than credit institutions from rendering banking services, with few exceptions. One such exception includes the so-called "non-bank banks," which may obtain resources from the placement of securities registered in the National Registry of Securities and Intermediaries, and grant credits for determined activities or sectors. Foreigners may now participate up to 100 percent of the capital stock of such entities, except affiliates of foreign financial institutions, provided there are no restrictions governing their particular area of activity.

8. Auxiliary credit organizations and activities

The General Law of Auxiliary Credit Organizations and Activities considers the following as auxiliary credit organizations: general deposit warehouses, financial leasing companies, savings and lending companies, credit unions, and financial factoring companies, as well as others considered as such by any other law. The law also considers the purchase and sale of currencies as an auxiliary credit activity. As such, this law regulates the operation of

currency exchange houses.

The above institutions are subject to authorization of the Ministry of Finance, with the exception of credit unions, which are subject to authorization of NBSC. All of the institutions, except the savings and lending companies, must be incorporated as corporations and have capital requirements established by the Ministry of Finance.

Auxiliary credit institutions and exchange houses, except savings and lending companies whose capital is represented by social parts rather than shares, may issue preferential, limited vote, or no-par-value shares.

Foreign government entities, as well as bonding and mutual insurance companies, may not participate in the capital stock of auxiliary credit institutions or exchange houses. Other auxiliary credit institutions and exchange houses may hold capital stock in auxiliary credit institutions and exchange houses when participating in merger programs approved by the Ministry of Finance.

No person or entity may hold more than 10 percent of the paid-in capital stock of these organizations, except for the federal government, credit institutions, insurance companies, stock brokerage houses and financial group holding companies, shareholders of auxiliary credit organizations and exchange houses, or those institutions participating in a merger program approved by the Ministry of Finance. The Ministry of Finance or the NBSC, in special cases, may authorize the purchase of more than the 10 percent limit to persons or entities with no connection to other shareholders of the respective company, provided that such approval does not create an undue concentration of share ownership.

As per the FIL, foreigners may participate with up to 49 percent in the paid-in capital stock of general deposit warehouses and currency exchange houses. In these cases, financial companies from NAFTA, MEUFTA and MEFTA-FTA may invest up to 100 percent in an affiliate established in Mexico.

9. Stock exchange operations sector

a) The Mexican stock exchange

Stock exchanges are principally regulated by the Securities Exchange Law and the circular letters issued by the NBSC. Although the Law contemplates the possibility of a stock exchange in any city, currently, the only authorized stock exchange is the Mexican Stock Exchange located in Mexico City. The Mexican Stock Exchange is operated by a corporation whose shareholders are brokerage houses or stock specialists. The Mexican Stock Exchange has an auction hall divided into two trading floors; one floor for capital markets, including a derivatives market for trading of futures, warrants and options, and the other floor for the money market for trading of debt instruments. However, since 1999 the trading is performed electronically from the brokers' offices.

In December 1998, the Derivatives Market initiated operations. Mexican companies have been authorized by Mexican authorities to place securities in foreign markets. Similarly, foreign securities have been authorized to register in the Mexican market since July, 2003.

b) New Market Securities Law

Mexico has enacted a New Securities Market Law, published on December 2005 and enforceable 180 calendar days after said publication. The new law aims to develop a more efficient and transparent securities market so the interests of investors are duly protected. A paramount objective of the new law is to assure access of medium-sized companies to the securities market through the implementation of good corporate governance practices and regulations.

The features introduced by this law are the new types of legal entities: Sociedades Anónimas Promotoras de Inversión (SAPIs), Sociedad Anónima Promotora de Inversión

Bursátil (SAPIB), and Sociedad Anónima Bursátil (SAB). SAPIs are stock corporations aimed to promote domestic and foreign investment by providing certain protections not contemplated in general Mexican corporate laws: for example, SAPIs are not subject to the supervision of the National Banking and Securities Commission. Minority shareholders also have additional protection, such as the right to appoint a director and an examiner, the right to call a meeting having only a 10 per cent stake of the equity, and other rights, such as puts, calls, tag alongs, drag alongs, and others. SAPIBs are similar to SAPIs, but they are to become publicly traded companies in no more than three years - a transition vehicle to transform into a Sociedad Anónima Bursátil (SAB) as explained below. As such, they must have at least one independent director and provide a program for the progressive adoption of the regime applicable to SABs; they can also trade shares with or without public offer, subject to certain conditions. SAPIBs are the middle option between SAPIs and SABs. The third type of corporation introduced is the SAB, which is a different corporation to the common publicly-held entity. This corporation is identified by the introduction of certain new concepts such as the duty of care and duty of loyalty for members of the board of directors.

c) Brokerage houses

Brokerage houses are considered in the Securities Exchange Law as intermediaries in the stock market and may perform intermediation activities such as: (i) activities with the purpose of creating supply and demand of securities; (ii) operations with securities on behalf of third parties, acting as agents or legal representatives; and (iii) negotiating securities either publicly or with other intermediaries acting of third parties. Brokerage houses must be registered in the Intermediaries Section of the National Registry of Securities and Intermediaries.

The Law refers to the limitations on holdings of shares and types of shares to be issued, which are essentially the same as those discussed in Section 6 above (i.e., "O" shares and "L" shares).

Brokerage houses, stock specialists, foreign governmental agencies, credit institutions, insurance or bonding companies, auxiliary credit institutions, currency exchange houses, investment societies or companies and any other person or entity that could have a conflict of interest may not participate in the capital stock of brokerage houses or stock specialists.

d) Investment Advisors

Investment advisors are individuals who, without being intermediaries in the stock market, provide management services on a stock portfolio, making investment decisions on behalf of third parties, and providing financial counsel. In order to provide this kind of service, the advisors shall have a mandate which allows them to draw instructions to perform operations on behalf of the clients and register the client's name on operations performed on his behalf. Investment advisors are not supervised by the NSBC.

e) Institutions for the deposit of securities

Institutions for the deposit of securities operate through a concession granted by the Ministry of Finance, and are used to hold for safekeeping, ad ministering, compensating, liquidating, and transferring securities. The shareholders may be only the Bank of Mexico, brokerage houses, stock exchanges, credit institutions, insurance and bonding companies, retirement funds administrators, investment companies, corporations operating investment companies, and holding companies of financial groups.

10. Institute for the Protection of Bank Savings (IPAB)

The Law for the Protection of Bank Savings went into effect on January 1999, for the purpose of establishing a guaranty system for people who have bank deposits, or who have been given loans or credits from financial institutions, and for regulating the supports given to financial institutions for the protection of depositors.

The system established by the aforementioned law is administered by a decentralized agency of the government called the Institute for the Protection of Bank Savings, known by its Spanish acronym as the IPAB. The IPAB has its own budget and its own legal capacity, and operates under a Board of Directors, formed by the Bank of Mexico, the Ministry of Finance and the NBSC, and a General Secretary.

The IPAB is the entity that replaced the Banking Fund for Savings Protection, known in Mexico as FOBAPROA dating from July 1990. The FOBAPROA was a trust set up by the federal government and managed by the central bank in a fiduciary capacity, which during its term had similar objectives to those of IPAB.

IPAB sets the groundwork for more solid and well-supervised financial institutions through the promotion of market discipline and the efficiency, transparency, and capitalization of the banking system.

The law establishes that whenever a financial institution is liquidated, enters into suspension of payments under bankruptcy law, or enters into bankruptcy, IPAB will assume and pay the guaranteed liquid obligations due according to procedures specified in the law. It also manages the deposit insurance sale of assets through its banking support system.

IPAB does not guarantee the following:

- a) Operations for the benefit of domestic or foreign financial institutions;
- b) Operations for the benefit of any company that forms part of a financial group to which the financial institution in liquidation or bankruptcy belongs;
- c) Debt denominated in negotiable instruments or bearer instruments;
- d) Obligations or deposits for the benefit of shareholders, advisors, high officers, attorneys-in-fact holding powers of administration, and general managers of the financial institution being liquidated or in bankruptcy;
- e) Any operations not conforming to the applicable legal or administrative requirements, as well as to sound banking practices; any banking operations in which bad faith exists on the part of the obligation creditor; and any operations related to illegal transactions or acts.

Financial institutions are required to pay ordinary and extraordinary fees established by the IPAB Board to fund the objectives of the law. In any year, such fees may not exceed eight-one thousandths of the total of the financial institution's operating liabilities.

11. Insurance and bonding sector

a) Insurance companies

Insurance companies are regulated by the Law of Insurance Institutions and of Mutual Insurance Companies and the circular letters issued by the NIBC.

The following institutions may not participate in the capital stock of Mexican-controlled insurance companies: credit institutions, mutual insurance companies, brokerage houses, auxiliary credit organizations, non-bank banks, currency exchange houses, pension fund administration companies, and companies operating investment companies. A mutual insurance company is one in which the policyholders are the owners of the company. It is a rarely-used vehicle in Mexico.

Only insurance companies authorized by the Ministry of Finance may engage in any of the following insurance or reinsurance activities: (i) life; (ii) personal injury, medical expenses and health; and (iii) damage in any of the following areas, among others: civil liability and professional risks, maritime and transport, fire, agriculture and animals,

automobiles, credit, earthquake and other catastrophes

Insurance companies must have a minimum paid-in capital stock expressed in UDIs for each of the aforementioned operations determined by the Ministry of Finance during the first quarter of each year. If the insurance company has variable capital, shares representing the minimum capital required by the Ministry of Finance may not be voluntarily withdrawn whether or not any of such shares represent the variable portion of the capital.

Foreign financial institutions may acquire Mexican insurance companies under programs approved by the Ministry of Finance. The Mexican company must then become an affiliate of the foreign financial institution.

Foreign insurance companies may only enter into insurance contracts in Mexico, with prior authorization from the Ministry of Finance, when: (i) the risks covered are in countries where the companies are authorized to act as such, and (ii) no Mexican insurance company is able or deems it beneficial to enter into the relevant insurance contract. For this purpose, Mexican insurance companies may act as commission agents of the foreign insurance companies.

b) Reinsurance intermediaries

Insurance companies engaged in reinsurance operations may use the services of reinsurance intermediaries residing in Mexico. Reinsurance intermediaries residing in Mexico must be authorized by the NIBC.

c) Foreign re-insurers

To participate in reinsurance operations, foreign re-insurers must be registered in the General Registry of Foreign Re-insurers of the Ministry of Finance. Foreign reinsurers may open representative offices in Mexico with prior authorization from the Ministry of Finance, which may only accept or assign reinsurance liabilities in the name of their main offices.

d) Insurance agents

Insurance agents may be individuals or legal entities regulated by the Regulations for Insurance and Bonding Agents, and in the case of legal entities, also by the Law of Insurance Institutions and Mutual Insurance Companies. This law defines insurance agents as all persons or legal entities intervening in the contracting of insurance through the exchange of offers and acceptances, as well as advising regarding execution, preservation or modification of insurance policies or coverage, for which authorization from the NIBC is needed.

Mexican and foreign individuals may be insurance agents. Legal entities must be incorporated as corporations and may be 100 percent foreign owned, subject to authorization from the Foreign Investment Commission.

Individuals or entities not authorized as insurance agents may intervene in the contracting of most adhesion contracts, with the prior registration with the NIBC of their respective service agreements with the insurance companies.

e) Bonding companies

Bonding companies are regulated by the Federal Law of Bonding Institutions. Incorporation is subject to authorization from the Ministry of Finance. The capital stock of bonding companies may be controlled by foreign financial institutions, which may own up to 49 percent of affiliate holding companies, which may own up to 100 percent of the capital stock (affiliates), or may be controlled by Mexicans who must own at least 51 percent of the capital stock thereof, as per the FIL.

Mexican investment must always maintain the faculty to determine the administration and control of the bonding companies. The control of a bonding company is obtained in the following cases: (i) when 33 percent of the capital stock is acquired, (ii) when any

shareholder(s) have the possibility to designate the members of the Board of Directors, or (iii) by any other means by which the bond company could be controlled. Companies that are in control of a bonding company are subject to the inspection and vigilance of the NIBC.

The following institutions may not participate in the capital stock of bonding companies: credit institutions, mutual insurance companies, brokerage houses, auxiliary credit organizations, and companies operating investment companies.

In those cases in which no Mexican bonding company can or deems it beneficial to grant a requested bond, bonds may be acquired from foreign bonding institutions, with prior authorization from the Ministry of Finance, Mexican bonding companies may acquire "back-up" bonds from foreign bonding institutions, which are duly registered in the registry created by the Ministry of Finance for that purpose.

12. Investments companies

Investment companies are entities incorporated for the purpose of purchasing securities and documents selected in accordance with risk diversification criteria, and use funds obtained from the public placement of shares representing their capital stock.

Incorporation of investment companies is subject to authorization by the NBSC, and may be divided into: (i) common investment companies, which operate exclusively with fixed and variable interest rate instruments; (ii) debt instrument investment companies, which operate exclusively with fixed interest rate instruments; and (iii) capital investment companies, which operate with securities and instruments issued by companies requiring long-term funding.

Companies operating investment companies, brokerage houses, and credit institutions, may engage in the management of investment companies, as well as the purchase and distribution of Investment Company shares.

The FIL limits foreign participation on the fixed capital stock to 49 percent. This limitation does not apply to affiliates of foreign financial entities.

Individual participation in the capital stock is limited to 10 percent, except for: (i) founding members and those purchasing shares during a six-month term from the date of incorporation, who must resell their shares in accordance with the investment plans approved by NBSC; (ii) brokerage houses, credit institutions, companies operating investment companies, and shareholders of capital investment companies; and (iii) any other person authorized by NBSC.

13. Financial groups

Financial groups are governed by the Law of Financial Groups, and are formed in one of three ways:

1. With a holding company along with any of the following financial entities: general deposit warehouse, leasing company, financial factoring company, currency exchange house, bonding company, insurance company, non-bank bank, brokerage house, commercial bank, company operating investment companies, and pension fund administration companies.

2. Without a holding company, but including at least two of the following: a commercial bank, a brokerage house, or an insurance company.

3. Without a holding company, but including at least three of the financial entities mentioned in part 1 above, not including companies operating investment companies or retirement fund administration companies.

The Ministry of Finance may authorize the participation of other institutions. To establish and operate a financial group, authorization from the Ministry of Finance is required. Each of the financial institutions that form part of the financial group must also receive authorization from various authorities, such as the Ministry of Finance, Bank of Mexico, NBSC, or NIBC.

The holding company must own at least 51 percent of the paid-in capital stock with the voting rights of each of the financial institutions forming the group, and its corporate purpose must be the acquisition and administration of the shares issued by the financial institutions. The holding company may never engage in the activities of each of the financial institutions. Since liberalization of the Foreign Investment Law, foreign investors no longer have to form an affiliate holding company. Stock of a regular holding company (as distinguished from a foreign affiliate holding company) may be subscribed freely, which means there are no restrictions on foreign ownership.

The Law for the Protection and Defense of Users of Financial Services (Ley de Protección y Defensa al Usuario de Servicios Financieros "LPDUSF"). was published on January 1999. This law was enacted to protect and defend the rights and interests of users of financial services. Such services include those provided by public, private, and approved social institutions. The law also regulates the organization, procedures and function of the National Commission for the Protection and Defense of Users of Financial Service (Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros "CONDUSEF").

In accordance with Article 11 of the LPDUSF, CONDUSEF has authority to:

1. Assist users and resolve the issues submitted by Users of the Financial Services ("Users"), the financial authorities, and the proper institution (i.e., the kind of product and/or services offered by the financial institutions in the country).

2. Assist and resolve the claims filed by Users when the Users contracted the services or acquired the product from the financial institution by means of an adhesion agreement, and such product or services at the beginning of the assumed commitment, is different from the agreed upon product or service.

3. Assist and resolve the claims when, in the judgment of the User, the financial institution has acted in an undue manner, or when the institution has defaulted on the provisions contained in the agreements executed with the User.

CONDUSEF may not assist Users or render attention to claims arising from:

1. Disputes among the settlor and beneficiary or vice versa.

2. Claims submitted for variation of interest rates agreed upon between the User and the financial institution, when said variation is a direct consequence of general terms observed in the markets.

3. Claims submitted one year after the fact that gave rise to the claim.

4. Claims brought before the Commission where the User did not justify his absence from the Conciliation Hearing, and therefore his claim was dismissed.

5. Claims brought before CONDUSEF or the Supervising Domestic Commissions regarding the same issue (same parties and same facts) and User rights have been kept harmless during the Conciliation Hearing.

6. When an issue is before CONDUSEF as arbiter or external arbiter (of the same parties and by the same facts),

7. When the judiciary has declared a judgment or an administrative authority has issued a ruling on a matter concerning the same facts and parties.

14. Credit information companies

Credit information companies are regulated by article 33 of the Law of Financial Groups and by the General Rules Applicable to Credit Information Companies effective as of February 1995, and as modified on December 1997, and September 1998. The purpose of these companies is to render information services on credit and analogous operations performed by financial entities. Their operation is subject to authorization from the Ministry of Finance with the opinion of the Bank of Mexico and NBSC. As per the FIL, foreign participation in the paid-in capital stock may exceed 49 percent with prior approval from the Foreign Investment Commission.

D. Exchange controls

1. Repatriation and exchange controls

Repatriation is not restricted in Mexico and with exception of a relatively short period, was never controlled. Additionally, it does not generate any special tax or require any special exchange rate. No requirements exist to pay dividends or to repatriate capital investments or loans and interest.

2. Capitalization and payment of dividends

Apart from the general capitalization requirements discussed in Section XIII no capitalization requirements apply before a dividend may be repatriated.

Dividends to non-resident shareholders are not taxed and the so-called dividend tax at the corporate level, which is sometimes applicable to the corporation, will not be levied if the dividend is paid from the net taxed profit account. There are no imposed limitations on capital remittances when operations are terminated.