Business Loans in Mexico

by John H. Baker

Mexico has taken tremendous strides to improve its economy in the past few years. Now it is working equally hard to make its laws more friendly to investment in Mexico. In the Spring of 2000, Mexico passed two laws that are sure to entice lenders to make more business loans into Mexico. One of these laws allows the broader use of personal property as collateral for loans, and the other speeds up the bankruptcy process.

Before the passage of these laws, Mexico had very stringent rules about what property could be used as collateral for a loan. This led to some interesting twists in order to make the existing laws on secured lending work in modern day transactions.

For instance, in the United States, a pledge of personal property as collateral for a loan requires that the borrower physically give the pledged property to the lender for the duration of the loan. Pledge agreements do not work well in the United States if the borrower often needs access to the pledged collateral, such as a borrower's raw material inventory.

Because there were so few methods available in Mexico for collateralizing loans prior to these new laws, lenders and borrowers became very creative. One fiction they would create when using a pledge would be to have the borrower's president become the lender's agent and hold the borrower's raw material inventory on behalf of the lender. The raw material might be put in a cage on the borrower's premises, and the president might be the only one with a key to the cage. Fundamentally, however, the borrower would retain possession of the pledged collateral. The threat that the president might be jailed for breach of his position of trust as the bank's agent became a far greater motivation for compliance than the threat that the bank might foreclose on the collateral.

Under the new law, the non-possessory pledge was officially recognized. Any kind of commercial obligation may be secured with the non-possessory pledge, and any kind of personal property (as opposed to real estate) may be used as collateral. Now it is even possible to use accounts receivable, inventory and trademarks as collateral for a non-possessory pledge.

The non-possessory pledge can be used with goods that are continually used and replenished ("floating liens"), without having to file new non-possessory pledge agreements each time pledged materials are used or replenished. Moreover, the parties can agree that the pledge follows the raw materials as they are transformed first into parts, then into finished goods and then into money when the finished goods are sold. The lender does not lose its secured position as this metamorphosis takes place.

The parties can determine the amount of the lien in the beginning or after a default, and the pledge can cover existing personal property or property acquired in the future. This now allows a borrower to arrange credit in advance of actually buying the goods that will be used as the collateral. In addition, the law now authorizes the accrual of interest even after default or the debtor's bankruptcy.

A lender can now take all of the debtor's personal property as collateral (a "blanket lien"), and can describe the property generically. Before, each piece of property had to be described with excruciating specificity. Even though one lender may have a blanket lien, a debtor may still give a security interest in newly acquired property (a "purchase money security interest"), provided that the property can be distinguished from the other secured property. This purchase money security interest will have priority over the blanket lien.

The law provides for registration of the non-possessory pledges. Only one non-possessory pledge may be placed on the same personal property. A borrower cannot sell pledged goods to his family, officers of the business or other insiders without first obtaining the lender's consent.

If the proceeds from a foreclosure sale are insufficient to pay the balance of the debt, the borrower is nonetheless relieved from having to pay the deficiency. While some lenders may complain about this rule, it should promote safer lending practices. Lenders will only lend that which they can safely recover on foreclosure. Borrowers will be protected if there is a sudden devaluation, as there was in 1994, and the property becomes worth less than the loan balance.

All lenders and most borrowers in Mexico will welcome both these laws. Up until now, little credit has been available to small and medium sized businesses, and what credit was available was loaned at very high interest rates. Large businesses obtained credit in the international market, not from Mexico's banks. These new laws will create more opportunities for borrowers of all sizes to be able to expand their businesses because more credit will become available to these borrowers.