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Mexico: Trends & Developments

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Trends and Developments

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A Look at Bank Resolution and the Post-COVID Era Concurso Proceedings

Two banks have undergone liquidation since the start of the COVID-19 pandemic. The regulator has stated that these liquidations are not related to the pandemic and that the Mexican financial system is strong and stable. However, these events put the spotlight on the Mexican rules for winding down banks. We will cover some of the main aspects of Mexican regulation for bank resolution, focusing on the liquidation process of these now-liquidated banks.

The airline industry and the non-bank financial intermediaries (NBFi) sector have undergone, or are undergoing, substantial financial workout efforts.

Likewise, the reopening of courts under the worldwide “new normal” has posed very specific challenges for concurso proceedings. These challenges make out-of-court restructurings more appealing in more than one way, and this article will discuss the challenges posed and the actions taken by attorneys to overcome them.

Bank Resolution

Throughout the COVID-19 pandemic, the National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*, or CNBV), in charge of granting and revoking the authorisation to operate as banks, has revoked two banking authorisations: that of Banco Ahorro Famsa (BAF) in June 2020, and that of Accendo Banco (Accendo) in September 2021.

In both instances, the CNBV has emphasised that they are isolated cases and that neither is a sign of a weakening of the banking system. In the case of BAF, the CNBV explicitly stated that the revocation is unrelated to the pandemic. However, when the CNBV revokes two banking authorisations within a little more than a year, the rules and impact of bank resolution become, at least, a topic of interest (prior to that, the most recent case involved *Banco Bicentenario* in mid-2014).

Banco Ahorro Famsa

In the case of BAF, the CNBV had identified regulatory breaches since 2016 in regards to intercompany transactions. In compliance with certain corrective measures CNBV ordered in early 2019, BAF liquidated some of their intercompany transactions and its shareholders made some capital injections.

However, BAF’s capitalisation index (ICAP) continued to sit below the minimum required (8%) because BAF’s intercompany accounts receivable continued to exceed the permissible threshold. Consequently, in June 2020 CNBV issued a statement indicating that BAF’s ICAP was below the minimum required since at least March 2020, and thus revoked BAF’s banking authorisation.

Accendo

CNBV had been continuously requiring Accendo, between March and September 2021, to adjust their accounting records drastically in regard to intercompany transactions. Upon making these accounting adjustments, Accendo’s ICAP fell below the minimum required.

Thereafter, in late September 2021, Accendo filed a statement to CNBV outlining the alternatives it proposed to overcome its financial deterioration. However, the CNBV issued a statement to Accendo informing that its ICAP for August 2021 was below the minimum required and that this event produced the revocation of Accendo's banking authorisation.

Systematically important banks

Before the CNBV issues a revocation of authorisation, the Bank Stability Committee (*Comité de Estabilidad Bancaria*, or CEB) convenes to determine whether a bank is systemically important and the percentage of the bank's non-IPAB-supported liabilities that are susceptible to systemic repercussions (the Institute for Bank Savings Protection is *Instituto para la Protección al Ahorro Bancario*, or IPAB). A bank is systemically important, in short, if failure of such bank to meet its obligations would generate serious negative effects in other banks or other financial entities, or if its failure would jeopardise the functioning of the payment systems.

Non-systemically important banks are subject to revocation of the authorisation and are subject to liquidation. Important banks will systematically undergo a restructuring process. Neither BAF nor Accendo qualified as systemically important banks and, consequently, were subject to revocation and liquidation.

Resolution by liquidation

The purpose of liquidating a bank is to conduct its resolution in an orderly manner.

Upon liquidation, the IPAB, as receiver, will conduct the management of the bank. The IPAB, in turn, will appoint an agent to conduct the process: typically a "turnaround" financial advice firm.

Upon the CNBV issuing the revocation, all managers lose their authority to act as such, all offices and branches shall suspend activities and the bank may no longer grant any other loan or enter into transactions. The receiver may thereafter determine that a certain number of branches and offices be opened to attend the public with respect to certain activities.

The process of collecting what is due is long and troublesome because it involves carrying out several auctions to sale portfolios, substituting the bank as trustee (*fiduciario*) in any trust (*fideicomiso*), and several other actions that will cause an important loss of value. One of the receiver's main duties is to prevent or minimise this loss of value.

Set-offs

Upon liquidation, passive claims will offset against the bank's matured active claims up to the lesser amount of both. The resulting netted-out balance, if against the bank, will be treated as an IPAB-supported claim or as a secured claim (if the pre-netting passive amount derives from a secured transaction).

Ranking of creditors and paying liabilities

The full ranking of priority escapes the scope of this document. It mostly resembles the ranking of typical concurso proceedings. However, one of the main differences is that unsecured claims are divided in three and paid in this order:

- IPAB-supported claims, up to their coverage limit;
- IPAB-supported claims, in excess of their coverage limit; and
- any other regular unsecured claim.

The creditor of the IPAB-supported claims up to the coverage limit is the IPAB, on a subrogation

basis. The creditor of the outstanding amounts will continue to be the client, because the IPAB will not have paid said excess to the client.

Bank restructuring through support or loans

A systemically important bank whose 100% non-IPAB-supported liabilities are susceptible to systemic repercussions will undergo a restructuring through either support or loans. If the bank is operating under a “conditioned operation regime”, it will be subject to restructuring through support, whereas restructuring through loans applies to banks not under this regime.

This regime is an administrative measure available for preventing the further deterioration of the bank’s financial position and is available if a bank’s ICAP sits below the minimum required, but higher than half the minimum required.

A restructuring through loans is similar. However, before any set-off of equity accounts, the IPAB will grant a loan to the bank to the extent required for its ICAP to reach the minimum required. This loan will be secured with the bank’s shares. The payment of this loan shall occur with the proceeds of a capital injection by then-current shareholders.

If the capital increase falls short of the IPAB’s loan amount, the IPAB shall adjudicate the pledged shares at book value. If there still is any amount outstanding, the bank shall immediately repay the loan. Thereafter, the bank will follow, as applicable, the same steps of a restructuring through support.

Bank restructuring through purchase and assumption

If the CEB determines that a bank is systemically important, but that some but not all of its non-IPAB-supported liabilities are susceptible to

systemic repercussions, said bank will be subject to bank restructuring through purchase and assumption.

In this resolution method, the CNBV will revoke the authorisation to act as a bank. Thereafter, the IPAB will conduct the liquidation in a manner similar to that applicable to the non-systemically important bank. However, instead of the bank paying the non-IPAB-supported liabilities, the IPAB will pay them up to the percentage the CEB determined they had systemic repercussions.

Simultaneously, the IPAB shall transfer assets and liabilities to a bridge (temporary) bank created by the IPAB for such purpose or to another bank.

In-court restructuring in the post-COVID-19-era

On 17 March 2020, shortly after the World Health Organization declared the COVID-19 situation a pandemic, the Federal Judicial (*Consejo de la Judicatura Federal* or CJF) issued an order suspending activities throughout the federal judicial branch (excepting those deemed “urgent” under said order). From mid-March to the end of July 2020, courts were almost totally closed.

On 28 July 2020 the Federal Judicial Council issued an order for reopening all courts under a “new normality” regime.

Two aspects of this order stand out: first, it provides a framework for on-site work, stating that vulnerable people (elderly, pregnant women, non-vaccinated people, etc) are relieved from having to perform on-site work. Second, the order provides strict rules for schedule and occupancy, stating that in no case the court may simultaneously hold more than 75% of its personnel.

As it pertains to resuming visits to the court, the order provides for an online platform for making up to four appointments per hour (if so requested, two people may come into the court for each appointment).

Initially, the order was to remain in force for a couple of months. However, the council has extended its duration, whilst increasing or decreasing the percentage of personnel, depending on the pandemic “waves”. The current extension lapses at the end of October 2022. Nonetheless, it is more than likely that the order will remain in force indefinitely.

Under this new normality, the workload keeps increasing as a result of the court system having insufficient personnel working on site. Finding an available time slot for direct discussions with court officers may take more than a week. It is also common that, upon appearing at the court, the specific person in charge of a case file will not be present under the council’s occupancy limit order. Consequently, litigating cases under this new normality poses significant hurdles that, as long as the council’s order remains in force, are probably not going to disappear.

New specialised concurso courts

On 4 March 2022 the Federal Judicial Council issued an order regarding the creation of two concurso courts, the first specialised concurso-exclusive courts. In principle, the creation of these specialised courts is a big step in the right direction. However, it also poses a new challenge: the learning curve of these judges, who were not familiar with bankruptcy matters prior to their appointment.

As a result, reality has fallen significantly short from expectations. IFECOM (*Instituto Federal de Especialistas en Concursos Mercantiles*) has

been trying to provide the concurso courts with the necessary training to close the gap. Attorneys have also collaborated in this effort by having continuous relationship with the court’s personnel, explaining and discussing concepts with the judge or other officers, in an attempt for courts to acquire more sophistication in these matters.

Airline Industry

The airline industry suffered one of the worst hits of the pandemic, placing many airlines under the spotlight of insolvency proceedings. Such was the case of *Aeroméxico*, which entered into Chapter 11 proceedings in 2020 and successfully emerged from them in early 2022 with a reorganisation plan with its creditors. Another case was Avianca Airlines (Colombian airline) which, after a Chapter 11 process of 18 months, recovered from the crisis and completed its financial restructuring in 2021, increasing its liquidity and changing its business model into a more sustainable airline.

In July 2022 LATAM Airlines announced approval for its reorganisation plan under its own Chapter 11 case.

Nevertheless, uncertainty for other airlines remains. While, as according to the newspaper Milenio, Aeromar’s workers have called for a strike to be effective as of mid-October 2020, its obligations with employees keep growing. Aeromar is reported to be making efforts to obtain financing and restructure its debt without having to enter insolvency proceedings.

Interjet entered a concurso proceeding in September 2022 and will attempt to achieve a restructuring agreement with its creditors whilst petitioning the court for a DIP Financing to pro-

vide it with sufficient liquidity during the pendency of the concurso proceedings.

Non-banking Financial Sector

NBFIs have caused much uncertainty about the reliability of this kind of business in recent months.

AlphaCredit, a Mexican multinational NBFI that provides consumer loans for small and medium-sized companies and pay-day loans, was the first large NBFI that ended up in concurso. Whilst some Mexican entities in the AlphaCredit group filed for Mexican concurso, other Mexican and foreign subsidiaries filed for Chapter 11 in the US. The overall restructuring is still ongoing.

Crédito Real, another large Mexican NBFI, defaulted on many bonds and other obligations, triggering a crisis in the confidence of its lenders. Nevertheless, Crédito Real opted to undergo a corporate liquidation (ie, not bankruptcy liquidation) and, in parallel, have this liquidation recognised in the US through Chapter 15 proceedings. Crédito Real's insolvency, plus the sub-ideal road it chose for handling this problem, raised several red flags in the industry. Consequently, Fitch Ratings downgraded Crédito Real rating, from "RD" to "D", placing the company in the last level within the default grade.

A similar case is Unifin. Unifin recently announced it would cease serving its debt, and that it will undergo restructuring negotiations with its creditors. S&P and HR Ratings downgraded the company ratings from "B+" to "D".

Consequently, the NBFI sector in Mexico is facing risk aversion from investors and creditors, even if, in the words of the head of regulators, NBFIs do not represent systemic risk.

Current out-of-court workouts

Out-of-court restructurings are not new in Mexico. Before the pandemic, although most creditors were open to out-of-court negotiations, it was not unusual to see some hostile creditors who refuse to take any type of hit to their claims. However, under the current circumstances, both creditors and debtors are aware of the current burdens of concurso proceedings. Consequently, creditors have become more open to negotiations.

This year there have been a number of major out-of-court restructurings where parties display friendly approaches to reach favourable outcomes. Hostile creditors are becoming more and more the outliers. Stakeholders are conscious of the risk of loss of value they will face in case they do not reach an out-of-court restructuring and creditors show an interest in helping the debtor turn its business around.

The expectation is that, in the aftermath of the pandemic, the experience gained by creditors and debtors in these renewed and broad restructuring efforts will translate, eventually, to the courts. In the meantime, out-of-court workouts remain the clear winner for turning businesses around and preserving value.

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