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# Mexico

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## Introduction

Mexico's economy started decelerating in 2019 and, in 2020, ultimately faced an 8.8% contraction.

On the one hand, the administration of Mexico's President Andrés Manuel López Obrador ("AMLO") has continued to set protectionist policies that have detracted foreign and local investments in our country. This administration is now going into its third year in office, with interim federal elections happening in June of 2021, in which the political future of our country is expected to be defined.

On the other hand, the COVID-19 pandemic has generated adverse economic conditions in Mexico and abroad, the long-term effects of which are yet to be seen.

Crisis aside, a considerable part of our country's population remains unable to access banking and financial services (in particular the lower and middle classes) and, as a consequence, financings. Considering Mexico has one of the biggest lower- and middle-class populations in Latin America, alternative and new non-banking financial products have arisen and developed in our market and are starting to fill out a demand of an immense amount of the population that has caught the attention of several players and represents a material opportunity for growth in our country.

Some traditional banks have realised and understood the potential opportunities that come from such an unattended market and the current digitalisation trends that derive from them and other financial intermediaries offering similar products to those that have been developing in the non-banking financial sector, such as neobanks (*i.e.* banks that offer banking services via digital means exclusively). One example is the recent joint venture between Rappi (a Colombian powerhouse in the online retail sector and the first Unicorn in Latin America) and Banorte (Mexico's second-largest bank), which will ultimately result in a purely digital bank that will seek to provide financial services to all, purely through a technological platform. Moreover, the so-called "new normal" resulting from COVID-19 is expected to accelerate these digitalisation trends, given that traditional banking services – which in several cases imply an actual visit to a branch – are currently out of reach for a large section of the population, and have simply become impractical and extremely burdensome on clients.

As part of the efforts and trends targeting financial inclusion, Mexico was the first Latin American country to regulate financial technology by the enactment of the Law to Regulate Financial Technology Institutions (*Ley para Regular las Instituciones de Tecnología Financiera*, or "Fintech Law"). The Fintech Law mainly regulates the rendering of financial services through technological platforms and innovative instruments, such as crowdfunding,

electronic payment mechanisms, cryptocurrencies and a regulatory sandbox for innovative technologies in the financial sector. Furthermore, financial technology entities (including electronic payment entities and electronic funding entities) are now considered part of the financial system and are thus supervised by Mexico's main regulator in the banking and securities sectors, the National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*, or "CNBV").

With respect to the regulators, significant reductions in government salaries and budgets have been enacted, which have clearly affected the quality of the banking and credit regulators, such as the Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*, or "SHCP") and the CNBV. Except for its sanctioning area, the CNBV has not been in the government's priorities; thus, it is foreseeable that such agency continues to suffer regular budget cuts within this administration, hence negatively affecting the overall quality of this regulator, as well as its general function and operations.

Also, it is important to mention that some fractions within the MORENA group have been trying to push certain amendments to the financial system, including recent initiatives aiming to modify the Mexican Central Bank (*Banco de México*, or "BANXICO") policy on exchange and purchase of foreign currency, which could impact the autonomous nature of BANXICO granted by Mexico's Federal Constitution and the business of banking and financial institutions in our jurisdiction.

On Mexico's economy in general, while the country has profited so far from the trade wars between the USA, China and Europe and a successful renegotiation of the North American Free Trade Agreement in the form of the United States–Mexico–Canada Agreement ("USMCA" or "TMEC", the latter for its acronym in Spanish), significant concerns about Mexico's current administration's public policies have been increasing throughout foreign governments, and local and foreign investors; particularly due to the current "war" that AMLO's administration has initiated against the already existing participation of private money in the energy sector, and a labour reform that seeks to significantly increase costs for investors that do business in our country. It is expected that under President Biden's new administration, additional pressure on dropping the foregoing protectionist energy policies will be put on AMLO's agenda.

### **Regulatory architecture: Overview of banking regulators and key regulations**

Mexico has a complex banking regulatory architecture, comprising several federal agencies and diverse legislative and executive regulations.

Mexican regulators have different functions and attributions when it comes to regulating the financial sector and, in particular, the banking industry. The main banking regulators in Mexico are the SHCP and the CNBV. The CNBV is an independent agency of the SHCP. Among their many roles and functions, they serve as the primary supervisory authorities over banking activities and regulate the organisation and operation, among others, of the following entities:

- 1) Financial groups (*grupos financieros*).
- 2) Banking or credit institutions (*instituciones de crédito*).
- 3) Brokerage and trading firms (*casas de bolsa*).
- 4) Investment funds (*fondos de inversión*).
- 5) Issuers of securities and publicly listed companies (*emisoras bursátiles*).
- 6) Non-bank banks (*sociedades financieras de objeto múltiple*).
- 7) Credit auxiliary entities (*sociedades auxiliares de crédito*).

- 8) Savings and loans institutions (*sociedades de ahorro y crédito popular*).
- 9) Rating agencies (*agencias calificadoras*).
- 10) Fintech institutions (*instituciones de tecnología financiera*) and related firms.

In addition to the CNBV, other relevant regulators in the Mexican banking sector are:

- a) The Institute for the Protection of Bank Savings (*Instituto para la Protección del Ahorro Bancario*, or “IPAB”), which is the main supervisory authority in the protection of bank savings.
- b) The National Commission for the Protection and Defense of Financial Services’ Users (*Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros*, or “CONDUSEF”), which mainly protects financial services customers.
- c) The National Insurance and Bonds Commission (*Comisión Nacional de Seguros y Fianzas*), which is responsible for the operation, organisation and supervision of insurance companies and bonds activities.
- d) The National Commission of the Retirement Savings System (*Comisión Nacional del Sistema de Ahorro para el Retiro*), which is in charge of regulating the Mexican retirement savings system.

Further to the federal agencies aforementioned, which are all dependent of the executive branch, another relevant player amongst Mexico’s banking regulation bodies is BANXICO. BANXICO is an autonomous body created by constitutional mandate, whose main purpose is to provide Mexico’s economy with its national currency (Mexican Peso), to procure the purchasing power of such currency and to promote the healthy development of the financial system, including a proper functioning of the payment systems within Mexico.

With respect to the main legislation governing the banking sector, Mexico’s legal framework comprises the following principal statutes (among others less relevant):

- i) *Ley de Instituciones de Crédito* (“LIC”), which mainly regulates banking services and the organisation and operation of banking institutions.
- ii) *Ley del Mercado de Valores*, which mainly regulates the securities market.
- iii) *Ley para Regular las Agrupaciones Financieras*, which mainly regulates the organisation and operation of financial groups.
- iv) *Ley para la Transparencia y Ordenamiento de los Servicios Financieros*, which mainly regulates transparency in financial services, particularly with respect to commissions and fees charged by financial entities.
- v) *Ley General de Organizaciones y Actividades Auxiliares de Crédito*, which mainly regulates the organisation and operation of services and activities ancillary to financial services.
- vi) *Ley de Transparencia y de Fomento a la Competencia en el Crédito Garantizado*, which mainly regulates transparency in financial services competition and secured credit.
- vii) *Ley para Regular las Sociedades de Información Crediticia*, which mainly regulates the organisation and operation of credit bureaus and credit scores.
- viii) *Ley de Sistemas de Pagos*, which mainly regulates the operation of payment systems.
- ix) *Ley de Sistemas de Ahorro para el Retiro*, which mainly regulates financial services related to retirement.
- x) *Ley de Ahorro y Crédito Popular*, which mainly regulates the protection of bank savings of the underserved gap of the population.
- xi) *Ley de Fondos de Inversión*, which mainly regulates investment funds.
- xii) *Ley de Uniones de Crédito*, which mainly regulates the organisation and operation of credit unions.

- xiii) *Ley para Regular las Instituciones de Tecnología Financiera* (the Fintech Law), which mainly regulates the financial services provided by financial technology institutions and firms.
- xiv) *Ley de Protección y Defensa al Usuario de Servicios Financieros*, which mainly regulates the financial services customer protection.
- xv) *Ley General de Títulos y Operaciones de Crédito*, which mainly regulates negotiable instruments and certain special credit transactions.
- xvi) *Ley General de Sociedades Mercantiles*, which in general regulates commercial and business entities (and applies to private banking institutions).

As indicated above, in addition to the main legislation provided above, there is also a large body of secondary regulations, which sets forth supplementary and more specific provisions. The main comprehensive collection of secondary provisions applicable to banking institutions is contained within the *Disposiciones de Carácter General Aplicables a las Instituciones de Crédito*, known in Mexico as the *Circular Única de Bancos*, or “CUB”.

### Recent regulatory themes and key regulatory developments in Mexico

Mexico’s GDP has fallen at a record rate, the fastest in over a decade, and even though GDP contracted at a softer annual pace in the last two quarters of 2020 in comparison to Q2, mostly due to a solid recovery in exports, such instability has raised significant concerns for local and foreign investors.

The USMCA was approved and ratified and is expected to significantly increase economic activity in Mexico, and thus create a positive effect on the banking and financial industries.

Moreover, Mexican banking regulators have tried to align to international standards, mainly after the issuance of the Basel Accords. Part of such efforts includes taking relevant steps towards the implementation of a consolidated supervision model (e.g. rebalancing and redistribution of certain functions and authorities among the different regulators). Mexico was one of the first countries to subscribe to Basel III and to gradually implement it into its financial system. In line with this, Mexico was granted the grade of “compliant” by the Basel Committee on Banking Supervision in March 2015.

In 2019, through a joint effort by BANXICO, the SHCP and the CNBV, a new electronic payment system was implemented through the use of “QR codes”. This system, known as CoDi (Digital Collection), represents an important effort by Mexican regulators to increase financial inclusion and reduce cash economy. Likewise, there has also been a rise in non-banking financing alternatives and inclusion, specifically in the fintech sector, resulting in Mexico becoming a pioneer in the Latin American Region for fintech regulation. In March 2018, the Fintech Law was enacted and, in the past year, most of the relevant secondary regulations, mainly regulating operative matters of fintech institutions, have also been enacted, which has allowed several smaller corporations to provide financing to both entities and individuals. The Fintech Law arises with the objective of regulating financial services provided by financial technology institutions; the purpose of the regulations is to supervise transactions made through technological platforms and promote financial inclusion and innovation via new technologies to provide financial services to more people in easier ways than those of traditional banking. The main areas regulated and covered by the Fintech Law are, among others:

- a) Means of payment and transfers.
- b) Financial services’ infrastructure (including customer and risk profile assessment, fraud prevention, identity verification, banking APIs, and payment method aggregators, among others).

- c) Financial software solutions (accounting, invoicing and financial management).
- d) Blockchain developers, intermediaries and digital asset markets.
- e) Disruptive financial institutions.
- f) Crowdfunding web platforms.

As a consequence of the enactment of the Fintech Law and most of its secondary rules, the regulators (particularly the CNBV) are facing a new operational challenge in its due implementation amongst the existing financial services platforms, affecting the already saturated workforce of the CNBV. That said, many fintech institutions and firms have faced significant delays in their applications before the CNBV for obtaining certain authorisations to provide financial services in terms of such Fintech Law.

Furthermore, Mexican regulators and authorities (mostly through the SHCP, the *Servicio de Administración Tributaria* and the *Unidad de Inteligencia Financiera*) have been increasing their focus on new mechanisms and initiatives to combat money laundering and tax evasion. In the last year, significant reforms to tax and criminal laws have been passed in order to tighten regulations on tax compliance and criminal liability to individuals and entities that have implemented schemes aiming to evade taxation for any purpose. In contrast to such efforts, some recent initiatives are currently being discussed aiming to modify BANXICO's policy on exchange and purchase of foreign currency, which, according to experts, could create a fertile environment for money laundering and other illegal activities. Experts have also warned that in case such initiative to BANXICO's policy is passed, in addition to the implications in our financial system and the potential breach of international treaties to which Mexico is a party, the country's sovereign rating could also suffer additional downgrades in addition to those confirmed this year by the three major rating agencies (Moody's, Standard & Poor's, and Fitch).

Last but not least, in November 2020, AMLO filed before the Congress a decree to amend several labour, social security and tax laws and regulations, aiming to ban insourcing and outsourcing structures in Mexico. Even though it is expected that such amendment decree will undergo modifications during the legislative process, in the event it is accepted under its current terms, the insourcing and outsourcing structures that several companies have implemented will have to be reviewed and modified, as the specific case may require. The private sector has shown particular concern on this matter, given the implications it would have on the competitiveness of firms and the administrative burden it represents in the midst of one of the most severe financial crises that the country has seen in the last decades.

### **Bank governance and internal controls**

Rules governing corporate governance and internal control matters applicable to private banking institutions in Mexico are mostly provided by the LIC and the CUB.

In general, banking institutions' capital structures are divided into two series of shares: Series "O"; and Series "L". Subject to the specific bank, Series "O" shares will have full corporate and economic rights, while Series "L" shares will have limited corporate rights (e.g. voting restricted to certain specific matters like mergers, spin-offs, transformations, dissolutions, etc.) but may also grant preferential dividends to their holders.

With respect to governance matters, such rules are mostly focused on the integration and authority of the board of directors and committees, as well as on the appointment and authority of the chief executive officer ("CEO") and other officers.

Regarding the board of directors, applicable rules provide that: (i) such corporate body must be composed of five to 15 members, of which at least 25% must qualify as independent; and

(ii) its members must have acceptable technical aptitudes, trustworthiness and a satisfactory credit score. Likewise, there are statutory mechanisms that preclude certain persons from acting as directors of banking institutions (e.g. convicted felons for financial crimes), or that prohibit certain directors from voting when they have a conflict of interest. Also, the board of directors is responsible for approving the objectives, guidelines and policies regarding loan origination and management, which must be consistent, compatible and complementary with those set forth for the process to identify, measure, control, reveal and manage risk. The board of directors of banking institutions has all the necessary powers and authorities to represent the bank and lead its business. On a related note, the board of directors is liable to the shareholders' meeting as the supreme corporate body of the banking institution, and the statutory auditors are in charge of evaluating the performance of the internal control system of the banking institution.

Management of banks is also entrusted to a CEO, who must be an individual who resides in Mexico for tax purposes, with a recognised moral reputation and at least five years' experience in senior decision-making positions. The CEO is in charge of the elaboration and presentation of policies for the correct application and utilisation of the human and material resources of the entity, including the consideration of their efficient use, restrictions on misuse, oversight and control mechanisms. The individual performance of the CEO is overseen by the board of directors, and it is required for the CEO to provide all exact information and data to assist such body in the making of relevant decisions.

Internal auditing functions of retail banking institutions in Mexico fall firstly on a statutory body comprising at least two statutory inspectors (*comisarios*), each of which shall be appointed by the shareholders. Such committee is responsible for general surveillance matters, such as:

- i) Requesting monthly reports from the board of directors, including financial information.
- ii) Overseeing the entity's operations.
- iii) Submitting its annual report to the shareholders' meeting, which includes its opinion on accounting and information policies, as well as the sufficiency and adequacy of certain criteria.

The statutory inspectors must comply with certain requirements, such as technical aptitudes, trustworthiness and a satisfactory credit score, as well as ample knowledge and experience in financial, accounting, legal and administrative matters.

In addition to the board of directors, the CEO and the statutory inspectors, the management of Mexican banking institutions is aided by an audit committee for consultation purposes. As with the statutory inspectors, the members of the audit committee must be selected for their aptitudes, experience and professional prestige, and at least one of its members must have experience in the fields of auditing and internal control. The members of the aforementioned committee will be selected by the board from amongst the specific banking institution's directors by nomination of the chairman. Such committee must comprise at least three members, of which a majority must be independent. The rights, obligations, and authorities of the audit committee are contained in the CUB.

Likewise, banking institutions have a risk committee whose purpose is the management and assessment of the risks to which they are exposed, as well as to ensure that the operations of the bank comply with the applicable internal regulations and statutes.

Finally, banking institutions must engage an external auditor for the purposes of auditing and certifying financial information (mainly financial statements). External auditors must



be independent, must hold a degree in public accounting and must be partners in the auditing firm engaged by the banking institution, among other requirements. Engagement of external auditors, their requirements and the nature of the services to be rendered are governed by the *Disposiciones de Carácter General Aplicables a las Entidades y Emisoras Supervisadas*, also known as the *Circular Única de Auditores Externos*, issued by the CNBV.

The CNBV is entitled to order the removal or suspension of any board members or relevant officers in certain particular cases.

Regarding compensations of banking institution's officers and employees, applicable laws and regulations provide for ordinary and extraordinary types of compensation. The ordinary comprises their salary, benefits and fixed remunerations, while the extraordinary comprises other kinds of variable compensation, based on results. Mexican law does not provide limits or maximums with respect to compensation of banking officers and employees. Banking institutions may also have a compensation committee, which is the body responsible for overseeing the compliance of these compensations pursuant to Mexican law.

### **Bank capital requirements**

Banking institutions in Mexico are subject to minimum capitalisation requirements depending on the specific activities they perform. Mexican full-service banking institutions are required to subscribe and pay a minimum fixed-capital stock of 90 million investment units (*unidades de inversion*, or “UDIs”), which amounts to approximately US\$30 million. In the case of private banks that limit their purpose to a shorter scope of activities, the relevant requirement is of 54 million UDIs, which currently amounts to approximately US\$18 million. This allows for the existence of smaller, so-called “niche” banks specialised in particular sectors (*e.g.* trustee services).

The CNBV has discretionary authority pursuant to Mexican law to grant or deny licences to any banking institution based on their service nature and capitalisation requirements.

In addition to the minimum capitalisation requirements applicable to banking institutions in Mexico, such entities must have a fixed corporate capital. Having a fixed corporate capital obliges banking institutions to submit and approve all corporate capital variations by means of a shareholders' meeting or resolution with much stricter standards, implying in addition an amendment to its corporate by-laws that need to be formalised before a local notary public.

### Liquidity requirements

The liquidity requirements applicable to retail banking institutions are mainly set forth in the *Disposiciones de Carácter General sobre los Requerimientos de Liquidez para las Instituciones de Banca Múltiple*. The foregoing statute sets forth the different rules to calculate the applicable liquidity coverage ratio which, subject to specifics, is calculated as computable liquid assets (*activos líquidos computables*) over total net outward cash flow (*flujo neto total de salida de efectivo*). The purpose of this ratio is to require banking institutions to have sufficient liquid assets to cover the outward cash flow for a specific period of time – similar to the requirement of Basel III. In calculating the aforementioned ratio, banks must include, among others, all transactions (individually and on a consolidated basis), including those carried out by financial subsidiaries, all transactions registered in the balance sheet, and the expected cash flow arising from transactions with derivatives. The foregoing requirement also promotes transparency in the financial sector given that retail banking institutions must report their liquidity coverage ratio to BANXICO.

### Leverage ratio

Required leverage ratio in Mexico is 3%. Such ratio must be calculated as basic capital over adjusted assets, without considering subsidiaries or special purpose vehicles, and considering operations within Mexico and abroad, in terms of the formulas set forth in the aforementioned statute.

### Capital adequacy

Pursuant to the LIC, retail banking institutions must evaluate, at least on a yearly basis, whether their capital would be enough to counterattack potential losses derived from the risks to which such institutions are subject under different scenarios, including those arising from adverse economic conditions. Banking institutions that do not pass the relevant tests must present an action plan with the capital forecasts that would, as applicable, allow them to cover such losses.

## **Rules governing banks' relationships with their customers and other third parties**

### Deposit-taking activities

Pursuant to Mexican law, only banking institutions and certain popular financial entities (*Sociedades Financieras Populares*, or “SOFIPOS”) are allowed to receive cash deposits from the general public for depositing into checking accounts. While other financial intermediaries and issuers of registered securities are allowed to receive funds from the general public on a professional or on its ordinary course of business and to promote the same via massive communication tools, cash deposit-taking for checking accounts remains exclusively for banking institutions and certain SOFIPOS.

### Lending activities

As mentioned before, general lending activities in Mexico are not a regulated matter under applicable law and can be carried out by any person within the Mexican territory. However, and as previously discussed, certain financing activities are regulated in Mexico, which would require certain registrations and/or authorisations from Mexican financial regulators and will be subject to the supervision of such regulators.

### Investment services

Mexican banking institutions are allowed to perform and provide fiduciary and investment advisory services, as well as to offer limited securities brokerage services to their customers (please refer to the “*Proprietary trading activities*” section below).

### Proprietary trading activities

Pursuant to Mexican law, banking institutions are allowed to transact with securities, subject to the limitations provided by the LIC and the Securities Market Law of Mexico (*Ley del Mercado de Valores*). Nonetheless, banking institutions are not authorised to underwrite in securities and have limited authority to provide brokerage services to their clients, which are typically provided by a broker-dealer affiliate entity called *Casa de Bolsa*. This role must be organised and authorised by the CNBV.

### Protection and defence of users and transparency of financial services

By means of *Ley de Protección y Defensa a los Usuarios de Servicios Financieros* and the creation of the CONDUSEF, the Mexican legal framework seeks to promote, assess, protect and defend the rights and interests of users of financial services before the financial entities, act as a neutral arbitrator and provide a fair field in the relationship between them.

Some of the CONDUSEF's main functions are the following:

- a) attend consultations from users and financial entities;
- b) perform conciliatory procedures between users and institutions;
- c) perform arbitrations;
- d) provide legal orientation and assessment for the users of financial services;
- e) issue recommendations to the executive branch; and
- f) review and, if applicable, modify the forms of agreements used by financial institutions with their customers.

Furthermore, pursuant to *Ley para la Transparencia y Ordenamiento de los Servicios Financieros*, Mexican law provides: (i) rules for the commissions and fees charged by financial institutions for purposes of clarity and transparency and to protect the interests of the public; (ii) additional requirements to the forms of agreements used by the financial entities with their customers; and (iii) the need to disclose the annual and total cost of financing of any credit, loan or finance product offered by a financial entity (known as *Costo Anual Total*).

#### Protection to bank savings

In addition, by means of *Ley de Protección al Ahorro Bancario* and the creation of the IPAB, Mexican law provides a system for the protection of bank savings to any person that carries out “*secured transactions*” within a banking institution. Per the applicable regulations, the IPAB acts as joint obligor of the banking institutions with respect to deposits and loans received from the public for up to an amount of 400,000 UDIs, which amounts to approximately US\$134,000. Such obligation from the IPAB is also applicable in the event of liquidation, suspension of payments or bankruptcy of a banking institution.

#### Regulatory framework on anti-money laundering

The Mexican legal framework provides for specific rules applicable to banking institutions in order to prevent transactions aiming to finance terrorism and money laundering.

The LIC and other secondary provisions set forth the means and procedures to prevent and detect acts, omissions or transactions that could favour, help or cooperate with any of the aforementioned activities, which are also listed as criminal activities pursuant to the Federal Criminal Code (*Código Penal Federal*). Some of the standard requirements include know-your-customer obligations, suspicious activity reporting to the SHCP and the CNBV, training and capacitation of banking institution staff, the use of automatised systems and the establishment of internal structures for compliance purposes within banking institutions.

#### Outsourcing (third-party providers)

Banking institutions are allowed to hire third-party services that are required for their operations. In the last two decades, different amendments have been passed in the applicable legal framework with respect to the hiring of third parties, providing additional authority to the CNBV to order the complete or partial suspension of any such services. In addition, the CNBV is entitled to request, through the relevant banking institution, information and documents regarding the services to be provided and to perform inspections and audits, as well as to order additional measures deemed necessary to secure the continuity of the services that banking institutions render to their customers.

Any operations carried out by third parties must be done on behalf of the banking institutions, who will be deemed responsible before their customers for any operations performed by such service providers.

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