
Brief Notes on the new Mexican Pledge Without Transfer of Possession

by Jaime A. Treviño.

On May, 2000, the Mexican General Law of Negotiable Instruments and Credit Transactions, the *Ley General de Títulos y Operaciones de Crédito*, was amended. One of the most important amendments was the inclusion of the Pledge Without Transfer of Possession as a new form of asset-backed guarantee option. In the terms of law, the Pledge Without Transfer of Possession constitutes a right over assets with the purpose of guaranteeing the performance of an obligation and preferential rights for its payment, in which the guarantor maintains possession over the secured asset.

The new Pledge Without Transfer of Possession enhances the options available under Mexican law to structure and formalize asset-backed guarantees, and has become another option to the traditional forms of Mexican guarantees, such as the bonds, *avales*, mortgages and traditional pledges.

In my opinion, the Pledge Without Transfer of Possession will trigger an increase in the business opportunities for global financial firms to participate in the Mexican financing market, particularly in the small and mid-size companies' sector. The structure, generally well-known and adopted as an ordinary form of guarantee in many countries, will ease the structuring efforts for transactions and reduce the costs of preparing tailor-made security agreements enforceable in Mexico, the cost and burden of which made this source of funding out of reach for such smaller companies.

I believe that the Pledge Without Transfer of Possession will, in the mid-term basis, change the way in which financial transactions are guaranteed in Mexico. However, and notwithstanding the benefits that I find in the figure, it is not a perfect instrument. In fact, there are a number of transactions which result better implemented through one of the other "traditional" forms of guarantee. Additionally, and also as a consequence of the recent implementation of this figure, the Mexican legal and business community is still to see how the enforceability of the Pledge Without Transfer of Possession will be ultimately implemented in the day-to-day legal practice by the Mexican courts.

The Pledge Without Transfer of Possession is a valuable instrument, particularly suitable for certain guarantees of a commercial nature and which's guaranteeing assets are variable, undefined or flexible. The proper structuring of the figure may provide a bank or creditor with a first priority pledge over all the personal assets of a business, whether inventory, raw material, accounts receivable, office equipment, cash, rights, intellectual property, or any others. Due to the fact that the possession of the secured assets is maintained by the guarantor, the pledge does not jeopardize the business operations of the guarantor, allowing the business to continue to be run in its ordinary course.

When formalizing a Pledge Without Transfer of Possession, it is advisable that other covenants and agreements become part of the guarantee structure. These ancillary obligations will enable

to creditor to have access to first-hand and timely information on the composition of the pledged assets, its location, and other material information. Such information will be very valuable if at any time the pledge needs to be executed and the pledges assets disposed of for the purposes of satisfying the guaranteed obligation.

The registration of the pledge agreement is required in order for the Pledge Without Transfer of Possession to have effects against other creditors and third parties. It is as a result of the registration process that the creditor gains a priority right over the pledged assets and against any other claims or encumbrances of third parties. Registration fees and costs may be important and vary from state to state; however, there may be alternatives to be explored on a case by case basis in order to make the pledge feasible and effective also from an economic standpoint.

An experienced and professional team of attorneys should advise the parties in the structuring of any security interest, such as the Pledge Without Transfer of Possession. Due to the novelty of this figure, not every legal professional has had the opportunity to deal with these issues in his or her legal practice. Finding an experienced team of attorneys to handle this matter will result to be cost-effective and beneficial for the secured party, particularly during any future enforcement proceedings.

There is no doubt in my mind that the Pledge Without Transfer of Possession will every day play a more active role in the form in which asset-backed guarantees are formalized in Mexico.

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