C A D W A L A D E R

Mexican Capital Call Facilities

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By **Wes Misson**
Partner | Fund Finance

In honor of Cinco de Mayo, we decided to go south of the border this week and give a brief overview of Mexican facilities.

While nearly all of the current bank lending and investor base is local, this market has the potential to make a spicy impact on the U.S. market soon. In fact, U.S.-based sponsors Blackstone, BlackRock, KKR and Lexington, to name a few, have already publicly registered Mexican trusts.

Why the recent interest? Think large amounts of institutional and pension money looking to invest cross-border in private funds. Mexican pension fund managers (*administradora de fondos para el retiro* – AFOREs) reportedly have more than $240 billion in assets under management. AFOREs are actively deploying pension capital to invest in infrastructure projects, energy, real estate, private equity and private debt via investment in Mexican trust co-investment vehicles called CDKs (*certificados bursátiles fiduciarios de desarrollo*) and CERPIs (*certificados bursátiles fiduciarios de proyectos de inversión*).

While each vehicle is a publicly registered and regulated trust that permits AFOREs and other institutional investors to invest in a manner akin to traditional private equity investment, the CERPIs have become more the vehicle of choice over the last couple of years. CERPIs provide more discretion to the investment manager and also permit foreign investment in non-Mexican projects (so long as at least 10% of commitments are invested locally in Mexico). As you can imagine, this distinction has been attractive for U.S.-based sponsors.

Our direct experience in the Mexican subscription finance market is limited, but we understand that, as available funds have grown, the market has become quite established and sophisticated over the last decade. To date, most of the per se Mexican subscription lending has been completed solely by local banks in Mexico. Now given the growing popularity of the CERPIs, we are seeing some material cross-over via the joinder of such vehicles to U.S.-based facilities.

While the CERPIs make great sense to AFOREs and the fund managers attracting capital, they present some unique challenges to lenders. Even though prefunded commitments are technically possible with a CERPI, they have all been structured via capital call mechanics that are governed by Mexican law and regulated by the Mexican National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores* – the CNBV). Per CNBV rules, investors are required to initially fund 20% of their commitment amount. Funding of the remaining amount is then subject to traditional call mechanics on a five-to-ten day basis but on a “soft” commitment basis given that regulated pension funds in Mexico cannot legally acquire liabilities.

Lenders are certainly able to give credit and underwrite prefunded cash held in a controlled account, but how does one get comfortable with a “soft” commitment to fund the remainder? Punitive dilution and skin-in-the-game: the funded portion coupled with draconian dilution penalties (*e.g.*, 50% of an investor’s interest that can be taken from defaulting investors and allocated to non-defaulting investors) are the key. While this is a far leap from the enforceable commitment structure that U.S. lenders rely upon, we are told by our friends in Mexico that track record is another compelling reason – there have been no known defaults. Presumably also, the local banks are comfortable taking local public fund risk.

So, as you enjoy your next margarita, ponder whether lending to these vehicles will continue to gain traction as sponsors raise more Mexican pension money. Will U.S. lenders ever gain enough comfort to provide borrowing base credit? Only time will tell.

Happy Cinco de Mayo from all of us at Cadwalader, and special thanks to our colleague Gabriel del Valle at the Mexico City law firm of Ritch Mueller for his assistance with this article.