

# Mind the Gap – Cryptocurrency and its relationship with the Mexican financial system

The financial technology industry in Mexico has been thriving over the last few years, and the regulation that has followed seeks to continue this innovative trend, while protecting the financial system and its users from any potential risks associated with these new technologies.

The Mexican Financial Technology Institutions Law (**Fintech Law**) was published on March 9 2018, in order to build a regulatory framework around the development of innovative financial services and the operation of virtual assets (such as cryptocurrency). The Fintech Law was intended to increase the level of competition and financial inclusion, as well as protecting the wellbeing of innovative financial services consumers, in order to put Mexico at the forefront of the industry.

The provisions written into the Fintech Law mainly focus on regulating the organization, operation, functioning and authorization of companies that offer alternative means of access to finance and investment, the issuance and management of electronic payment funds and the exchange of virtual assets (**Financial Technology Institutions or FTIs**), as well as those providing innovative financial services through a regulatory sandbox. A regulatory sandbox is a special status whereby conventional regulation is not applied in order to test new business models.

The Fintech Law nevertheless provided for secondary regulation to be published by several Mexican government agencies. One of the most anticipated was the piece of regulation regarding virtual assets with which FTIs would be able to operate, as well as the operations they would be able carry out with such assets, including the information that would need to report to financial authorities.

The regulation was required to be released within 12 months of the publication of the Fintech Law. Accordingly, on March 8 2019, the Bank of Mexico (**Banxico**) published a directive containing the “General Provisions applicable to Credit Institutions and Financial Technology Institutions regarding Transactions carried out with Virtual Assets” (**Directive 4/2019**).

The foreword to Directive 4/2019 states that the use of virtual assets in financial services offered to the public can be problematic for its users due to their complexity as well as the difficulty in understanding the factors that determine their price. Moreover, if established financial institutions begin to offer

virtual-asset-related financial products to their clients, it may generate a false sense of security regarding such inherent risks.

The drafting of Directive 4/2019 also considered that the use of virtual assets entails a significant risk regarding money laundering and terrorism finance. This is due to the ease of transferring virtual assets to different countries, as well as the absence of consistent global controls and prevention measures.

With that in mind, the provisions contained within Directive 4/2019 intend to build a healthy gap between the Mexican financial system and virtual assets so that such financial services users are not exposed to their inherent risks or unwittingly aiding illegal activities such as money laundering.

Notwithstanding the above, through Directive 4/2019, Banxico also states that it seeks to encourage and take advantage of new technologies that can promote efficiency or performance. This is as long as these technologies are used in the context of the internal operations of banks and Financial Technology Institutions, and which do not lead to a significant increase in their operational or financial risks.

Therefore, banks and FTIs are permitted to carry out operations involving virtual assets to the extent that they are regarded as internal operations under the provisions of Directive 4/2019. However, financial institutions must at all times prevent the risk from being transmitted directly or indirectly to their clients while carrying out transactions with virtual assets.

Although banks and FTIs are not permitted to provide exchange transmission depository services regarding virtual assets directly to their clients, they might be able to provide such services through indirect means that allows risk to be diverted away from their client base and from the financial system. On the other hand, current regulation does not prevent companies from offering services related to virtual assets, such as buying and selling, as long as such companies are not legally considered financial institutions, such as FTIs, or carry out activities reserved for them.

In any case, the business model for financial institutions would have to be reviewed by the applicable financial authorities. Furthermore, banks and FTIs are required to request authorization before they are permitted to carry out these types of internal operations involving virtual assets. The requirements regarding the application for such authorization are outlined in the provisions and under the terms of Directive 4/2019.

### Final thoughts

The Mexican financial technology ecosystem has flourished over the last few years through innovation, competition and inclusivity. As a result of the new regulations introduced by Banxico, there is confidence that building a healthy gap between the risks associated with virtual assets and financial services users will continue the flow of those same factors that have produced one of the best environments for financial technology in Latin America.

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