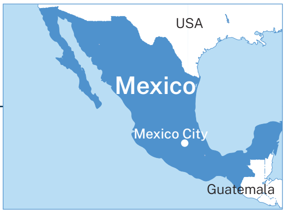
MEXICO



Law and Practice

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Ritch Mueller

Contents

Ritch Mueller is a top-tier multidisciplinary transactional firm committed to offering high value-added legal advice to national and international clients in the structuring, development and financing of their private businesses and public sector projects in Mexico. Its work encompasses transactions within the financial, industrial, infrastructure, energy, retail and services sectors, among others. The firm has a staff of more than 100 professionals who seek to add value to clients by means of an efficient and in-depth service combined with high levels of expertise and experience.

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1. Multilateral and Regional Regimes

1.1 Multilateral Climate Change Legal Regime

Mexico has actively engaged in the multilateral climate change legal regime since its inception. The country's commitment is evident through its participation in various international instruments and initiatives:

1. Mexico participates in the Intergovernmental Panel on Climate Change established by the United Nations Environment Programme and the World Meteorological Organization.

2. Mexico is party to several key international agreements related to climate change:

- The United Nations Framework Convention on Climate Change (UNFCCC) was signed on 13 June 1992 and ratified on 11 March 1993;
- The Kyoto Protocol to the UNFCCC was signed on 9 June 1998 and ratified on 7 September 2000. Mexico also accepted the Doha Amendment to the Kyoto Protocol on 23 September 2014;
- In 2015, Mexico adopted the United Nations Sustainable Development Goals, giving particular emphasis to Goal 13 related to climate action; and
- The Paris Agreement was signed on 22 April 2016 and ratified on 21 September 2016.

3. Mexico has consistently demonstrated its commitment through proactive reporting and contributions:

- Mexico was among the first developing countries to submit its initial and second national communications to the UNFCCC in 1977 and 2001, respectively.
- The country submitted its first Nationally Determined Contribution (NDC) under the UNFCCC in 2015. A second NDC was submitted on 29 December 2020, with an update in November 2022.
- Mexico's third national communication under the UNFCCC was submitted in 2006, presenting an updated emissions inventory up to 2002 and reporting on the developments carried out regarding the climate change institutional framework, such as the creation of the Inter-Ministerial Commission on Climate Change and the execution of a collaboration agreement with the Ministry of Energy (*Secretaría de Energía*, SENER) to create a climate change committee for the energy sector, in February of 2005.

- Through its fourth national communication, Mexico reported on the following actions relevant to adaptation to climate change: (i) advising federal entities and municipalities to consider adaptation concepts in their planning and zoning strategies, and (ii) upgrading urban development programmes in order to take into account risks and population vulnerabilities in the context of climate change events. This communication also included mitigation actions taken in the energy sector as energy-saving programmes.
- Mexico submitted its sixth national communication to the UNFCCC in 2018 and began internal preparations for its seventh national communication as of 23 January 2024, according to information from the Ministry of Environment and Natural Resources (*Secretaría del Medio Ambiente y Recursos Naturales*, SEMARNAT).

1.2 Regional Climate Change Legal Regimes

Mexico engages in regional climate change efforts through various initiatives and partnerships.

Organization of American States

Mexico is a member of the Organization of American States (OAS). While the OAS has not yet developed a specific legal regime for climate change in the North American and Caribbean region, Mexico actively participates in regional initiatives led by the OAS.

Mexico particularly emphasises implementing mandates from the ninth Summit of the Americas, held in Los Angeles in 2022. These mandates include actions to advance commitments from the Glasgow Leader's Declaration on Forest and Land Use, focusing on national deforestation and conservation efforts.

Mexico collaborates in regional efforts aimed at halting and reversing deforestation and reducing greenhouse gas (GHG) emissions from sectors such as agriculture, forestry and mining.

North American Climate, Clean Energy, and Environment Partnership

Mexico participates in the North American Climate, Clean Energy, and Environment Partnership Action Plan with the United States and Canada. This partnership focuses on collaborative actions to address climate change, promote clean energy and protect the environment.

2. National Policy and Legal Regime (Overview)

2.1 National Climate Change Policy

Mexico's approach to national climate change policy is deeply informed by and aligned with international climate change regimes, particularly under the UNFCCC and the Paris Agreement.

Legal Framework and Policy Development

Mexico's national climate change policy is anchored in the General Law on Climate Change (*Ley General de Cambio Climático*, GLCC), enacted on 6 June 2012. This law mandates the formulation and implementation of comprehensive policies including national adaptation and mitigation strategies, the establishment of a national climate change system, and various planning instruments such as the national strategy and national programme.

These policy instruments are intricately linked to Mexico's commitments under the international climate change legal regime, including the submission of national communications and NDCs to the UNFCCC.

Evolution of Mexico's NDCs

Mexico has submitted two NDCs to date: the first in 2015 and the second in 2020, with an update in November 2022.

Primary objectives

The NDCs encompass both mitigation and adaptation measures. They are designed to align with Mexico's broader sustainable development goals and address vulnerabilities across various sectors.

Differences between NDCs

The 2020 NDC introduced non-conditioned commitments and included additional feasible actions. It emphasises synergies between mitigation, adaptation and the Sustainable Development Goals (SDGs). Specific attention is given to vulnerable population sectors, which were less emphasised in the 2015 NDC. The 2020 NDC also strengthened the focus on gender and human rights, cultural heritage, islands and forced migration issues.

Updated goals

In its 2022 update, Mexico increased its GHG reduction targets for 2030 from 22% to 35%, with a conditional target of up to 40% pending increased international financing, innovation and technology transfer.

The updated NDC also outlines plans to implement strategies for emissions reduction from deforestation and forest degradation and aims to expand clean energy production to 40 GW.

2.2 National Climate Change Legal Regime

Mexico's approach to addressing climate change is primarily governed by the GLCC. This law serves as the foundational legislation to combat the adverse effects of climate change within the country.

Constitutional and Legal Framework

The Political Constitution of the United Mexican States does not contain specific provisions directly addressing climate change. Instead, climate change matters are primarily regulated through the GLCC.

The GLCC is categorised as a general law within Mexico's legal framework. It holds authority below the Constitution and international treaties ratified by Mexico, and above local legislation and municipal regulations.

This law grants jurisdiction over climate change matters to authorities at all three levels of government: federal, state or local, and municipal.

Federal-Level Regulations

Alongside the GLCC, specific federal regulations, such as those governing the national emissions registry, have been enacted to support its implementation and enforcement.

State and Local Legislation

Mexico consists of 32 states (entities), out of which 30 have enacted their own local laws on climate change. These laws align with the GLCC and address specific regional climate challenges and priorities.

Complementary legal instruments

Various complementary legal and planning instruments have been amended or created at both federal and local levels to incorporate climate change considerations. These include:

- Local development plans
- Climate change plans

- Inter-Ministerial Climate Change Commissions
- Climate change funds
- Climate change evaluation mechanisms
- Air quality management programmes
- Emissions inventories
- Waste management laws
- Ecological territorial planning programmes
- Risk assessments
- Urban development regulations
- Mobility programmes

2.3 Bilateral/Multilateral Co-operation

Mexico engages in international co-operation under the Paris Agreement, primarily focusing on enhancing climate action and achieving its NDCs. While Mexico actively participates in discussions concerning Article 6, a specific framework for action under this provision has yet to be established or implemented. Additionally, Mexico has not established a Designated National Authority as stipulated in Article 6.4.

Article 6.2 International Co-operation and Activities

Article 6.2 of the Paris Agreement allows voluntary co-operation between Parties through the use of "internationally transferred mitigation outcomes" (ITMOs). Mexico participates in discussions and initiatives related to this provision, including involvement with the Partnership for Market Readiness (PMR).

Mexico collaborates with PMR countries to explore potential co-operation mechanisms under Article 6.2, aimed at enhancing market-based approaches to climate mitigation.

Other International Co-operation and Activities Under the Paris Agreement

While specific frameworks under Article 6.2 are not yet fully established, Mexico actively participates in various co-operative efforts and bilateral agreements fostering climate action. Examples of these actions include:

Bilateral, regional and international agreements

- **North American Climate, Clean Energy, and Environment Partnership Action Plan**: Mexico, alongside Canada and the United States, participates in this partnership focused on advancing clean energy, reducing climate pollutants and enhancing climate resilience in the North American region.
- **Latin American and Caribbean Initiatives**: Mexico contributes to the Latin American and Caribbean Initiative for Sustainable Development (ILAC) and engages in Climate Action Plans within the Pacific Alliance (Chile, Colombia, Mexico, Peru). These initiatives aim to strengthen climate resilience, promote renewable energy and reduce GHG emissions.
- **Kunming-Montreal Global Biodiversity Framework**: Mexico has adopted this framework to co-operate towards the global effort to address biodiversity loss, which is essential for the health of ecosystems, human well-being and achieving sustainable development goals worldwide. Its adoption and effective implementation are seen as crucial steps in safeguarding the planet's biodiversity for future generations.

Technology transfer and capacity building

Mexico collaborates with international partners on technology transfer and capacity building initiatives. For instance, partnerships with organisations such as the German Agency for International Cooperation (GIZ) support Mexico's renewable energy projects and improve energy efficiency measures.

International climate finance

Mexico receives financial and technical support from global institutions such as the World Bank and the International Monetary Fund, and bilateral aid from countries such as Germany and the United Kingdom. These funds assist Mexico in implementing climate initiatives and meeting its NDC targets.

2.4 Key Policy/Regulatory Authorities

The GLCC establishes the obligation of Mexican federal authorities to formulate and direct the climate change national policy, including a national adaptation policy and a mitigation adaptation policy, from which derives the climate change national strategy and the climate change national programme, as well as local climate change programmes.

On the other hand, the climate change national system composed of the government levels (federal, local and municipal), whose purpose is to act as a permanent mechanism devoted to the application of the climate change national policy, is co-ordinated by SEMARNAT.

Key Mexican Authorities on Climate Change

Considering that under the GLCC climate change is a matter which requires the concurrent action of all three government levels, the GLCC created the following key authorities:

1. **Inter-Ministerial Climate Change Commission**: This commission is permanent and will be presided over by SEMARNAT and composed of all the federal ministries connected with climate change matters.

2. **Climate change council**: This organism will be the permanent consultation and advisory body of the Inter-Ministerial Climate Change Commission and will be formed of 15 members from the social, private and academic sectors as designated by the president of the commission.

3. **SEMARNAT**: This is the federal Ministry of Environment and Natural Resources in charge of the co-ordination and application of the climate change national policy and presides over the Inter-Ministerial Climate Change Commission.

4. **National Institute of Ecology and Climate Change (INECC)**: The INECC will co-ordinate, promote and develop the scientific and technological research related to the climate change national policy. The Director of the INECC will also preside over the Evaluation Co-ordination.

5. **Evaluation Co-ordination**: Composed of the Director of the INECC and six independent members, this will oversee the co-ordination of the evaluation of how climate change policy is applied. The evaluation itself will be carried out by independent entities such as educational, research or non-profit organisations.

Similar structures are replicated by the local and municipal authorities according to the corresponding local legislation and municipal regulations.

3. National Policy and Legal Regime (Mitigation)

3.1 Policy/Regulatory Instruments and Spheres of Government/Sectors

The national strategy on climate change, issued by SEMARNAT on 3 June 2013, includes a comprehensive mitigation policy aimed at implementing cost-effective emissions reduction actions that yield environmental benefits, such as:

- accelerating the transition to clean energy sources and reducing energy intensity;
- enhancing energy efficiency through responsible consumption and efficiency schemes;
- promoting sustainable urban models to improve mobility systems, comprehensive waste management, and construction of low-carbon-footprint buildings;
- supporting improved agricultural and forestry practices; and
- reducing emissions of short-lived climate pollutants.

In alignment with this strategy, SEMARNAT published the 2021-2024 Climate Change Special Programme on 8 November 2021. This programme prioritises mitigation efforts, particularly Objective No. 2, which focuses on reducing GHG emissions and other compounds to foster socio-economic development, with a low carbon footprint and ozone layer protection, based on the latest scientific knowledge.

Mexico has traditionally required entities to obtain emissions permits in order to release pollutants into the atmosphere, with specific annual emission caps established. Any modifications to production processes necessitate obtaining new permits. In addition to such emissions permits, the legal framework on environmental and climate change matters also includes the submission each year of an annual operating schedule (*Cédula de operación Anual*), through which the emissions generators inform the environmental authorities of the amount of emissions generated during the prior year in order to create the national emissions inventory.

4. National Policy and Legal Regime (Adaptation)

4.1 Policy/Regulatory Instruments and Spheres of Government/Sectors

Despite the obligation stipulated by the GLCC for federal authorities to develop a national adaptation policy, such a policy has not been enacted to date. However, Mexico's climate change national strategy includes a primary objective focused on adaptation measures. These measures aim to reduce vulnerability among the population and key sectors, while enhancing the resilience of strategic infrastructure through improved risk management and territorial planning.

An example of Mexico's adaptation efforts is the successful implementation of a pilot project in 2017, which focused on adapting coastal wetlands in the Gulf of Mexico. This project, supported by the Global Environment Facility, was carried out in three wetland areas across the states of Veracruz, Tabasco and Quintana Roo.

On 28 February 2022, Mexico issued its first adaptation communication under the Paris Agreement.

5. Responses to International Developments

5.1 Carbon Markets

Mexico's Implementation of Article 6.4 of the Paris Agreement

Article 6.4 of the Paris Agreement establishes a framework for a carbon credit market, facilitating the international transfer of GHG reductions or removals. This centralised approach differs from that of Article 6.2, whereby countries establish their own bilateral arrangements for transferring ITMOs. Project developers approved under

Article 6.4 by the supervisory body can obtain credits known as "A6.4ERs" for GHG emission reductions or removals, similar to the Clean Development Mechanism under the Kyoto Protocol. These credits can be traded internationally or utilised for other climate change mitigation purposes.

While Mexico has yet to announce specific measures regarding Article 6.4 and has not established a Designated National Authority, the nation's broader commitment to climate change mitigation suggests potential engagement with Article 6.4 as part of its climate strategy.

The national strategy on climate change, derived from the GLCC, highlights economic mechanisms, including those related to taxation and markets, as primary strategies for Mexican climate policy. The following sections detail relevant economic mechanisms implemented by Mexico.

Carbon Markets

Mexican Emissions Trading System

The 2018 amendment to the GLCC introduced a mandatory Emissions Trading System (ETS) designed to regulate GHG emissions. A pilot phase of the ETS has been completed ("Pilot Programme"), and the publication of rules for its operative phase is pending. The following are basic principles presented by the Pilot Programme:

- The Pilot Programme targeted projects in the energy and industrial sectors emitting 100,000 tons or more of direct CO2 annually from stationary sources per installation. Regulated entities were allotted a fixed number of allowances under this programme, with the option to offset any shortfall with offset credits (*Créditos de Compensación*).
- In accordance with the Resolution establishing the preliminary guidelines for the Emissions Trading System Pilot Programme (*Acuerdo por el que se establecen las bases preliminares del Programa de Prueba del Sistema de Comercio de Emisiones*, the "Pilot Programme Rules"), SEMARNAT is authorised to issue offset credits. These credits represent the reduction or absorption of one ton of CO2 equivalent, or emissions of the same amount that have been avoided, resulting from eligible mitigation projects or activities not covered by the Pilot Programme.
- The Pilot Programme Rules also consider the potential transfer of offset credits, which may include those from Article 6, to the ETS as external compensatory credits to meet allowances. However, certain conditions must be met: the offsets must originate from projects not regulated by the ETS, the initial credits must be cancelled upon issuance of the external offset credit, and the offsets must fulfil SEMARNAT's specified conditions, which have not been published as of the time of writing.

Voluntary carbon market

Mexico has initiated a voluntary carbon market, providing individuals, businesses and organisations with the opportunity to voluntarily purchase carbon credits or offsets to mitigate their carbon footprint and support climate action initiatives. Managed by MEXICO2, a subsidiary of the Mexican Stock Exchange's SIF ICAP, this market is currently in its trial phase. During the 2023 Mexico Carbon Forum, the Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Publico*) announced the ongoing drafting of rules for the Mexican Voluntary Carbon Market, which are expected to be presented for discussion in 2024.

It should be noted that access to the platform of the ETS and the voluntary carbon market is not public during the respective trial periods; access is restricted to participants.

Carbon Tax

In Mexico, carbon taxes and/or GHG emissions taxes have been implemented at the federal level through the Special Tax on Production and Services (*Impuesto Especial Sobre Producción y Servicios*, IEPS) and at the state level through GHG emissions tax.

- **Federal level**: The federal carbon tax primarily targets the upstream and some midstream processes of the hydrocarbons sector. Implemented in 2014, this tax is calculated based on the carbon content of fuels rather than the direct emissions from their use. IEPS applies to the production, importation and disposal of fossil fuels intended for combustion processes, excluding natural gas and other fuels not used for combustion. Different rates are applied to each fossil fuel based on its carbon dioxide content.
- **State level**: State-level taxes focus on downstream processes, allowing for the taxation of GHG physically released into the atmosphere. This tax covers activities beyond fossil fuel combustion and includes GHGs other than CO2.

Currently, only eight out of Mexico's 32 states have operational taxes on atmospheric emissions: State of Mexico, Guanajuato, Nuevo León, Oaxaca, San Luis Potosí, Tamaulipas, Yucatán and Zacatecas. However, Querétaro is the only state that allows the use of offsets as a flexibility mechanism.

5.2 European Union Carbon Border Adjustment Mechanism (CBAM)

The Carbon Border Adjustment Mechanism (CBAM) is a European Union (EU) policy aimed at equitably pricing the carbon emissions involved in producing carbon-intensive goods imported into the EU. By verifying that a carbon cost has been paid for the emissions embedded in these imported goods, the CBAM will equalise the carbon pricing between imports and domestic products.

The CBAM will not be mandatory for Mexico; however, as the second-strongest economy in Latin America, Mexico holds an important trade relationship with the EU. While specific effects are uncertain and will need to be studied along with the progressive implementation of the CBAM, it is likely to have the following effects on Mexico.

Trade relations with the EU

The primary impact concerns Mexico's trade connections with the EU. In 2020, Mexico stood as the second-largest export market for the EU. Significant imports include machinery and appliances, transportation equipment, optical/photographic instruments and mineral products. The CBAM could affect the competitiveness of Mexican exports to the EU market, especially in sectors with high carbon intensity.

Industries exhibiting notable carbon intensity, such as steel, cement and select chemical sectors, might face elevated expenses due to the CBAM. Mexican exporters operating within these realms could encounter additional prerequisites or expenditures linked to carbon emissions, potentially influencing their competitiveness in the EU market.

Impact on domestic policies

It is a well-known fact that Mexico's policies are significantly shaped by regulations from its trade partners. Along these lines, it is probable that Mexico's internal carbon pricing policies and climate commitments could be influenced by the CBAM. To mitigate any negative impacts on Mexico's exports to the EU, the country will need to reinvigorate its emphasis on clean energy sources and strengthen its carbon pricing mechanisms or emissions reduction targets. Accomplishing this could better equip the country to meet CBAM requirements and mitigate trade-related risks.

Adaptation measures

Not only will the CBAM influence policies, but it will also shape decisions made by Mexican industries in their day-to-day operations. Strategies to adapt and mitigate potential CBAM impacts may involve investing in cleaner technologies, improving energy efficiency and diversifying export markets to reduce reliance on the EU.

6. Liability for Climate Change and ESG Reporting

6.1 Task Force on Climate-Related Financial Disclosures (TCFD)

The TFCD's Influence on National Policy

The Task Force on Climate-Related Financial Disclosures (TCFD) has had a considerable influence on global practices concerning climate-related financial reporting, and its impact is starting to increase in Mexico. The following sections describe the extents to which TCFD has influenced Mexico's policy and regulatory positions.

Adoption by financial institutions and corporations

Leading national financial institutions such as BBVA Bancomer S.A., Institución de Banca Múltiple, Grupo Financiero BBVA Bancomer (BBVA México) and Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte (Banorte), and corporations such as Cemex, S.A.B. de C.V. (CEMEX) and Orbia Advance Corporation, S.A.B. de C.V. (Orbia), have adopted TCFD recommendations voluntarily. This includes disclosing climate-related risks and opportunities in their financial reports, which helps in aligning with international best practices. Grupo Financiero Citibanamex, S.A. de C.V. (Citibanamex) was the first Latin American pension fund to participate in the pilot trial of the TCFD.

Stock exchange initiatives

The Mexican Stock Exchange (*Bolsa Mexicana de Valores*, BMV) encourages listed companies to improve their environmental, social and governance (ESG) disclosures, and TCFD guidelines are increasingly seen as a benchmark for best practices. The BMV has also published environmental reports aligned with TCFD guidelines.

Governmental and regulatory engagement

Although the Mexican government has not mandated TCFD-aligned disclosures yet, there is increasing awareness and consideration of these recommendations in policy discussions. SEMARNAT and other regulatory bodies are progressively acknowledging the importance of climate-related financial disclosures.

Civil Society Influence

Civil society's influence on climate change policy, regulatory positions and corporate behaviour in Mexico is steadily increasing. Civil society organisations play a crucial role in shaping public discourse, raising awareness and advocating for stronger climate change actions.

An historic example was when Greenpeace filed an Amparo against the Mexican Government challenging Mexico's revised NDC), arguing that the NDC failed to respect the principle of non-regression in human rights law. Despite the case being dismissed, it not only set a precedent for the non-regression principle in climate targets but also pressured Mexico to voluntarily issue a revised version of the challenged NDC.

6.2 Directors' Climate Change Liability

The Mexican environmental and climate change legal framework does not explicitly include provisions establishing specific liability related to climate change matters, except for entities or individuals found in breach of their emissions reporting obligations through traditional enforcement channels. Failure to comply with emissions reporting requirements may result in fines of up to MXN325,710 (approximately USD1,845). If false information is submitted, fines can increase to MXN1,085,700 (approximately USD170,000).

6.3 Shareholder or Parent Company Liability

As mentioned above, no specific liability provisions are regulated under the Mexican climate change legal framework for shareholders or parent companies, except for the corporate liability regulated by commercial and civil laws. Please note that under environmental legislation, in the event that a company or other similar entity is involved in causing environmental damage or breaching an environmental law or obligation, the liable party will be the company or entity involved, being obliged to respond with its own assets. It is uncommon for shareholders or parent companies to be involved in these matters.

6.4 ESG Reporting and Climate Change

ESG reporting is becoming increasingly important globally, and Mexico is no exception. ESG reporting currently is not a mandatory regulatory requirement for all companies in Mexico. However, numerous initiatives and regulations encourage or indirectly mandate such disclosures, particularly for publicly listed companies and financial institutions. Below are examples of voluntary and mandatory ESG disclosures in Mexico:

Voluntary Disclosures

BMV Guidelines

The BMV has issued the BMV Guidelines for Strengthening Corporate Sustainability in Mexico (*Guía de la BMV para el fortalecimiento de la sostenibilidad empresarial en México*). These guidelines encourage listed companies to disclose their sustainability practices though voluntary international frameworks including the Global Reporting Initiative, Sustainability Accounting Standards Board, TCFD, SDG Impact Standards, International Integrated Reporting Council, Carbon Disclosure Project and International Financial Reporting Standards (IFRS). These instruments encompass ESG disclosures, including those related to climate change.

ISSB and SBT initiative

As companies and investors are increasingly seeking standardised and credible frameworks for sustainability reporting, the work of the International Sustainability Standards Board (ISSB) and the Science Based Targets initiative is playing the role of indicative guidelines for ESG reporting in Mexico. Adopting these standards and targets provides Mexican companies with transparency, investor confidence, regulatory preparedness and alignment with global sustainability practices.

Mandatory Disclosures

Retirement Savings Systems

Retirement Savings Systems (*Sistemas de Ahorro Para el Retiro,* SIEFOREs) are required to include in their investment prospectus how their investment strategy incorporates ESG factors and how these factors are applied to risk management. While specific climate ESG components are not explicitly announced, they are traditionally considered within the ESG disclosure spectrum.

Annual report

Specific security issuers are required to make ESG disclosures in their annual report filed before the National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*, CNBV). The environmental component of these disclosures includes:

- risk factors related to changes in environmental regulations and those related to ESG risks;
- relevant actual or potential impact of climate change and related regulations;
- existence of environmental policy, environmental management system, or environmental certificates or recognitions; and
- disclosure of activities that pose significant environmental risks and any environmental measures affecting significant fixed assets of the issuer and its subsidiaries.

It should be noted that pursuant to a 2023 amendment to the Securities Market Law (*Ley del Mercado de Valores*), subject to a prior opinion of the CNBV and the Banco de México, the Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*, SHCP) can issue general provisions regarding sustainable development. These provisions are aimed at promoting, informing about and evaluating the adoption of best practices in this area by issuers and other participants in the securities market.

Financial Reporting and Sustainability Standards

On 13 May 2024, the Mexican Financial Reporting and Sustainability Standards Board (*Consejo Mexicano de Normas de Información Financiera y Sostenibilidad*, CINIF) issued the Financial Reporting and Sustainability Standards (*Normas de Información Financiera y Sostenibilidad*, NIS):

- **Applicability**: NIS will be mandatory as of 1 January 2025 for entities that prepare financial statements in accordance with the Financial Reporting Standards of CINIF. The NIS aim to enhance the disclosure of useful information to improve entities' resilience to sustainability challenges and support sustainable growth decision-making.
- **Connection with IFRS**: CINIF has announced its commitment to align the NIS with the IFRS of ISSB, and considers NIS as an initial step in such direction. Although NIS are not fully converged with IFRS, CINIF plans, as part of its strategy, to issue specific NIS on sustainability topics, beginning with climate-related financial disclosure requirements.
- **NIS series**: The initial publication of the NIS includes two series: NIS A-1 Conceptual Framework for NIS (*Marco Conceptual de NIS*) and NIS B-1 Core Sustainability Indicators (*Indicadores Básicos de Sostenibilidad*, IBSOs):
  - (a) NIS A-1 Conceptual Framework for NIS establishes the foundational principles for the application of NIS and outlines quality requirements that disclosures must meet.
  - (b) NIS B-1 Core Sustainability Indicators requires the determination and disclosure of 30 IBSOs in financial statements, which are universally applicable metrics provid-

ing entities with a clearer understanding of their sustainability status. IBSOs related to climate change include GHG emissions, energy consumption, sustainable investment, water usage and waste generation.

7. Transactions

7.1 Due Diligence

Climate change due diligence in Mexico is increasingly becoming a critical component of M&A, finance and property transactions, especially as global awareness and regulatory frameworks evolve. While mandatory ESG regulations in Mexico do not yet exist, companies and investors are recognising the importance of incorporating the assessment of climate-related risks and opportunities into decision-making processes. Key areas of focus in climate change due diligence include regulatory compliance, risk assessment, financial impacts, and disclosures and reporting (voluntary and mandatory).

8. Climate-Friendly Investment Support

8.1 Renewable Energy

Mexico provides various forms of policy, regulatory and other support to encourage the uptake of renewable energy technologies, including the following:

Electric Industry Law (Ley de la Industria Eléctrica)

Clean Energy Certificate (CEL)

CELs are tradable certificates issued to generators of clean energy, providing financial incentives for renewable energy generation, indistinctive of the technology. Certain regulated parties including Suppliers, Qualified Market Participant Users (*Usuarios Calificados Participantes del Mercado*), and End Users (*Usuarios Finales*) that are supplied by isolated supply (*abasto aislado*) are required to acquire a certain percentage of their power from renewable sources or purchase CELs to comply with clean energy targets.

Net metering, net billing and complete sale policies

The Energy Regulatory Commission issued a resolution outlining the general administrative provisions, the model contracts, the methodology for calculating the consideration and the general technical specifications applicable to contract models, the methodology for calculating the compensation and the general technical specifications applicable to distributed generation and clean distributed generation power plants (*Resolución de la Comisión Reguladora de Energía por la que expide las disposiciones administrativas de carácter general, los modelos de contrato, la metodología de cálculo de contraprestación y las especificaciones técnicas generales, aplicables a las centrales eléctricas de generación distribuida y generación limpia distribuida*).

Under these regulations, residential, commercial and industrial customers of the Federal Electricity Comission (*Comisión Federal de Electricidad*, CFE) can install renewable energy systems, such as rooftop solar panels. If connected to the national electricity grid, customers can receive compensation for excess electricity generated. The applicable provisions outline three different schemes for customers:

1. **Net metering**: The customer consumes and generates energy under the same supply contract. Generated energy is subtracted from the customer's energy consumption.

2. **Net billing**: The energy consumed that CFE delivers to the customer is independent of the energy that the customer generates and sells to CFE; it is not subtracted from the customer's consumption.

3. **Complete sale**: The customer sells to CFE all the generated energy. There is no supply contract between the customer and CFE.

These schemes promote distributed generation and encourage investment in renewable energy by reducing electricity bills and providing a revenue stream for surplus energy. Further information can be found here.

Income Tax Law (Ley del Impuesto Sobre la Renta)

Investments in machinery and equipment for the generation of renewable energy or for co-generation systems are 100% tax deductible.

8.2 Other Support

Mexico provides policy, regulatory and other forms of support for distinct types of climate-friendly investments beyond renewable energy. These supports encompass areas such as energy efficiency, sustainable transportation, waste management and sustainable agriculture. Some specific examples are as follows.

Tax Incentives for Electric Vehicles

Diverse federal and local tax regulations provide financial incentives such as tax exemptions, rebates and subsidies for the purchase and use of electric vehicles. Some states and municipalities also offer additional incentives such as reduced registration fees and access to high-occupancy vehicle lanes. As an example, the Federal Law of New Motor Vehicles Tax (*Ley Federal del Impuesto Sobre Vehiculos Automóviles Nuevos*) exempts the sale or importation of electric vehicles from such tax.

Sustainable Agriculture

Through diverse programmes, Mexico provides financial incentives and technical support to farmers for the adoption of sustainable agricultural practices such as organic farming, conservation tillage, use of water and integrated pest management. An example of such programme is the Sectoral Programme of Agriculture and Rural Development 2020-2024 (*Programa Sectorial de Agricultura y Desarrollo Rural 2020-2024*).

Green Bonds

Mexico has actively participated in the issuance of green bonds, which are financial instruments designed to fund projects with positive environmental impacts. These projects typically focus on renewable energy, energy efficiency, sustainable waste management and water resource management. Green bonds have been issued both by banks such as Nacional Financiera, S.N.C. (NAFIN) and Banco Nacional de Obras y Servicios Públicos, S.N.C., (BANOBRAS), and by private sector entities such as Coca-Cola Femsa, S.A.B. de C.V. (KOF).

These instruments are issued under the Securities Market Law, similarly to other bonds. To qualify as a green bond, certification from an independent third party validating the environmental benefits of the project is required, following internationally recognised standards such as the ICMA Green Bond Principles and the Climate Bonds Initiative.

Sustainable Financing Mobilisation Strategy by SHCP (Estrategia de Movilización de

Financiamiento Sostenible por Parte de SHCP)

This strategy includes a series of actions and policies designed to promote investment in projects and activities that contribute to the sustainable development of the country. Its main objectives are: fundraising for sustainable projects, promotion of sustainable investments, integration of ESG criteria into financial policies, and ensuring financial transparency and accountability.

Sustainable investments can be identified through the Sustainable Taxonomy (*Taxonomía Sostenible*) issued by the SHCP in 2023, which provides tools to identify such investments and facilitate financial flows towards projects that positively impact environmental and social goals. The overarching goal of the taxonomy is to provide reliable market information, mitigate greenwashing risks, and enhance transparency and certainty in markets.

Payment for Environmental Forestry Services

The National Forestry Commission (*Comisión Nacional Forestal*, CONAFOR) implemented a public policy called Payment for Environmental Services (*Pago por Servicios Ambientales*, PSA). This programme seeks to actively conserve the country's forests, jungles, arid zones and mangroves through economic incentives for forest landowners that carry out good management practices. It is divided into three schemes:

PSA

This scheme supports forest landowners in areas with high environmental value and good ecosystem conservation. Payments are based on vegetation type and deforestation pressure index. Support is granted for five years, with beneficiaries required to reinvest at least 50% of the funds in conservation, protection, management, organisation, governance and eco-friendly projects. A successful case is the Ejido Cañón de los Encinos y San Antonio Necúa in Ensenada, Baja California.

Local mechanisms for PSA through concurrent funds

These are collaboration agreements between CONAFOR and public or private actors, formalised for two to five years. They aim to pool resources and form alliances for paying for environmental services to forest landowners. Areas are selected based on watershed, biological corridor vision or conservation interests of partners. CONAFOR contributes up to 50% of the total fund, with the remaining amount provided by partners, with no set limit on their contributions.

Biodiversity Heritage Fund

This long-term PSA (over 20 years) focuses on globally important high-biodiversity areas, promoting ecosystem connectivity through biological corridors and integrated land management. It aims to enhance the impact of the PSA by synergising with other conservation instruments. Currently, 47,395 hectares are conserved in Jalisco, Nayarit and Durango. Economic incentives are provided through renewable five-year agreements, financed by the Mexican Forestry Fund, Global Environment Facility donations and federal government contributions.

Trends and Developments

Contributed by:
Brenda Rogel, Javier Camacho and Carolina Villaseñor
Ritch Mueller

Ritch Mueller is a top-tier multidisciplinary transactional firm committed to offering high value-added legal advice to national and international clients in the structuring, development and financing of their private businesses and public sector projects in Mexico. Its work encompasses transactions within the financial, industrial, infrastructure, energy, retail and services sectors, among others. The firm has a staff of more than 100 professionals who seek to add value to clients by means of an efficient and in-depth service combined with high levels of expertise and experience.

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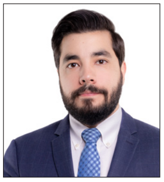
Brenda Rogel joined Ritch Mueller and was named partner in 2023. She has experience in the practice of environmental and regulatory law, assisting a wide range of industries and companies in managing the environmental and regulatory risks associated with business start-ups, acquisitions, operations, expansions and divestitures. She is an expert in the management of contaminated sites and environmental emergencies, as well as in the formulation of sustainability and climate change strategies, permit analysis, regularisation and compliance programmes. Brenda also has engaged in strategic investigations and litigation to protect the environment, advance climate change adaptation and promote the inclusion of women and minority rights.



Javier Camacho joined Ritch Mueller in 2023. He has experience advising national and international clients on matters mainly related to environmental impact and risk, national waters use, wastewater discharge, air emissions, climate change, waste management and circular economy, forestland use and wildlife, as well as ESG matters. His experience includes legal analysis and consulting, as well as administrative litigation and counselling in administrative proceedings at local and federal levels. Additionally, he has participated in multiple investment projects and M&A transactions, accompanying clients in identifying and addressing key environmental risks and issues.

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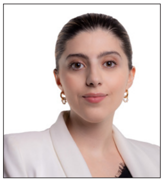

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Climate Change-Driven Regulatory Changes on Sustainable Financing in Mexico

Introduction

Mexico, as a major emerging economy, has made significant strides in promoting sustainable development and integrating environmental and sustainability considerations into its financial sector.

This comes as the result of ambitious goals in its Nationally Determined Contribution (NDC) and overall commitments to minimise its greenhouse gas (GHG) emissions and mitigate the effects of climate change that have been slow to become apparent.

Efforts in other areas have not yet revealed a significant benefit in terms of direct reduction of GHG emissions and achieving the NDC, namely, the creation and implementation of green taxes as a source of resources to combat climate change, and the test run of the Mexican carbon emissions trading system.

As a result, Mexican policymakers have turned their head towards the steady growth in environmental, sustainability and climate change-focused requirements from financial institutions as both eligibility and preference criteria for project funding.

This new approach to sustainability has triggered the creation of new tools and guidelines, and the modification or adjustment of existing regulation.

Mexican sustainable taxonomy

In March 2023, the Ministry of Finance and Public Credit, with the support of the Ministry of Environment and Natural Resources, launched the sustainable taxonomy as a reliable, unified and science-based classification tool that allows the identification of sustainable economic activities.

The sustainable taxonomy has three main goals: climate change adaptation and mitigation, gender equality, and access to basic services related to sustainable cities.

Regarding climate change in particular, technical evaluation criteria are presented for activities related to climate change mitigation. These include 124 eligible activities across six economic sectors, along with their respective metrics, thresholds and criteria for avoiding significant harm.

The six economic sectors considered under the sustainable taxonomy are:

1. **Agriculture**: Farming and animal husbandry, as well as forestry utilisation. This includes various types of food and non-food crops, greenhouses and other protected agricultural structures.

2. **Generation**: Transmission, distribution and commercialisation of electricity, as well as water supply. This encompasses the collection, treatment and supply of water carried out by either the public or private sector.

3. **Construction**: Includes the construction of single-family homes, multifamily dwellings, warehouses, industrial plants, and commercial and service buildings, as well as other infrastructure projects.

4. **Manufacturing industries**: Includes the production of cement, steel complexes, industrial gases, and other basic organic and inorganic chemical products.

5. **Transport**: Covers transportation by rail or inland waterways, for both passengers and goods. It includes long-distance transportation by road of construction materials, hazardous materials and refrigerated goods, and urban and suburban public transport, among others.

6. **Waste management and remediation services**: Includes the collection of non-hazardous waste by the public and private sectors, and the treatment and final disposal of non-hazardous waste by either the public or private sector, as well as waste recovery, among other services.

These sectors were chosen for their significant impact on Mexico's financial development and their direct link to GHG emissions and climate change. The sustainable taxonomy defines specific criteria, standards and best practices for each activity to qualify as sustainable.

In terms of climate adaptation, the sustainable taxonomy recognises Mexico's exposure to diverse climate and environmental risks that impact different sectors of the economy to varying degrees. Economic activities are intended to substantially contribute not only to climate change mitigation but also to adaptation.

By incorporating climate adaptation into the specific objectives, it aims to mobilise financial resources and investments to enhance resilience against climate impacts and generate economic and social co-benefits, considering the different climatic conditions across various regions, sectors and vulnerable populations.

Determining an economic activity's contribution to climate adaptation involves:

1. **Risk assessment**: Identifying potential climate-related risks throughout the economic activity's lifespan, considering specific vulnerabilities and climate risks associated with the geographic location, material impacts and local climate data.

2. **Mitigation measures**: Implementing measures to mitigate those identified risks and prevent their escalation to other sectors, activities, regions or populations.

As a result, the sustainable taxonomy provides two types of economically significant adaptation activities:

1. **Adapted activities**: Activities incorporating measures or solutions to reduce climate risks while ensuring functionality in a changing climate.

2. **Enabling activities**: Activities facilitating adaptation by reducing climate risk and vulnerability across economic activities, communities, ecosystems or cities, through technology or specialised products/services.

Mobilisation of Sustainable Financing Strategy

In September 2023, the Ministry of Finance and Public Credit published the first version of the Mobilisation of Sustainable Financing Strategy in order to address international climate change and sustainable development commitments, which require substantial financial resources.

The strategy includes policy and financial regulatory actions, as well as enabling mechanisms to encourage large-scale financing from private and alternative sources, potentially closing the sustainable financing gap by 2030.

The strategy serves as a guide for transforming Mexico's financial system towards sustainability, redirecting financing to environmentally and socially impactful activities and projects. It focuses on three specific objectives:

1. **Access to financing**: Creating a conducive environment for sustainable-focused activities and projects to access low-cost financing.

2. **Information disclosure**: Ensuring transparent disclosure of strategic information related to sustainable financing, facilitating investment decisions and capital flow redirection.

3. **Innovative financing instruments**: Promoting the creation and development of new instruments to diversify sustainable financing sources and reduce investment risks.

To achieve its overall goal and specific objectives, the strategy is divided into three pillars:

1. **Sustainable public financial management**: Advancing the incorporation of sustainability into financial practices, systems and frameworks for public finances. This pillar aims to promote sustainable, responsible and transparent use of public resources, incorporating improved risk management, including climate-related risks.

2. **Sustainable financing mobilisation**: Focused on creating a favourable environment for the transformation of debt and capital markets. It aims to significantly increase and redirect financing flows towards sustainable activities and projects. The participation of social sector entities (such as agricultural communities or "*ejidos*") is crucial for achieving this goal.

3. **Transversal actions**: Aimed at inclusiveness in the financial measures, the incorporation of gender equality perspectives, and constantly monitored progress towards social objectives and targets.

Modifications to the Securities Market Law and Mutual Funds Law

Because they are foundational instruments of the Mexican financial system, amendments to the Securities Market Law and Mutual Funds Law can significantly impact Mexico's economic landscape. The latest amendments, enacted in November 2023, represent a significant milestone in the evolution of the country's financial framework.

While these amendments primarily aim to broaden the reach and operational scope of the securities markets, facilitating the inclusion of new, smaller participants, they also incorporate supplementary changes to bolster efforts towards climate change mitigation. Notably, the Ministry of Finance and Public Credit now holds a newly mandated responsibility to develop administrative provisions on sustainable development and gender equality. These provisions are designed to monitor and evaluate the adoption of best practices in these areas by participants in the securities market.

This regulatory shift underscores Mexico's commitment to aligning financial activities with sustainable development goals and enhancing transparency and accountability within its financial sectors. By integrating sustainability and gender equality considerations into market practices, Mexico aims to foster a more inclusive and resilient financial system that supports long-term environmental and social objectives.

Sustainability Information Standards

In May 2024, the Mexican Council for Financial Information and Sustainability Standards (CINIF for its Spanish acronym) published the first two

Sustainability Information Standards (NIS for its Spanish acronym): the A and B series.

Established in 2001, CINIF is a non-profit organisation dedicated to developing NIS as tools to compile and disclose financial information that supports sustainable development-related decision-making.

The objective of NIS is to promote the disclosure of valuable information aimed at enhancing the resilience of entities in facing sustainability challenges across various sectors. While not yet fully aligned, CINIF has committed to harmonising NIS with the IFRS Sustainability Disclosure Standards issued by the International Sustainability Standards Board. NIS A-1 and B-1 represent initial steps towards this alignment. Future thematic NIS in the B and C series, as part of Stage 2, will focus on risk and opportunity disclosure.

NIS A-1: Conceptual Framework for Sustainability Information Standards

- Establishes the Conceptual Framework for any NIS and defines the structure and application of specific NIS.
- Defines quality requirements for the information.
- Outlines fundamental qualitative characteristics and aspects for improving sustainability information.
- This NIS does not specify information requirements for disclosure but rather provides parameters for other NIS.

NIS B-1: Basic Sustainability Indicators

- Requires determination and disclosure of Basic Sustainability Indicators (IBSO) as universal metrics.
- Helps entities assess their sustainability performance.
- Entities must determine and disclose both absolute and relative values of each quantitative IBSO, with specific guidelines for calculation.
- Outlines potential information sources for obtaining data necessary to calculate or determine IBSO.
- IBSO values should be disclosed in comparison with the previous year's information (except for the initial year).

Self-Assessment Tool on Environmental and Social Governance

The National Banking and Securities Commission (CNBV for its Spanish acronym), in collaboration with the Global Green Growth Institute and with support from the UK Government's UK PACT programme, has developed the Self-Assessment Tool for Environmental, Social and Governance (ESG) and climate-related risks. This tool is designed for Mexican financial institutions to evaluate their incorporation of ESG factors and climate risks into non-financial information disclosure.

The primary objective of the tool is to increase awareness and sensitise financial entities to the global shift towards sustainable, low-carbon and climate-resilient systems and businesses. It focuses on ESG factors as well as climate-related risks.

Based on recommendations from the Task Force on Climate-Related Financial Disclosures, the Principles for Responsible Investment, and corporate governance guidelines from the Organisation for Economic Co-operation and Development, the tool is structured around three pillars:

- corporate governance for sustainability;
- ESG factors; and
- climate-related risks.

Each pillar includes subsections with thematic indicators. Within each pillar, users are required to answer a series of questions based on their entities' status.

Upon completion of all three questionnaires, users can view their results in the system or generate a digital report for internal uses. While the information and responses provided by the user entities remain confidential and visible only to them, the system aggregates responses from all users to generate comprehensive, publicly accessible reports for each pillar. These reports serve as benchmarks for the current state of sustainability indicators in Mexico.

ESG obligations for pension fund managers

In January 2022, the ESG-related obligations under the general administrative provisions on the pension fund system came into force. The Mexican pension fund system is made up of workers' individual saving accounts that are administered by pension fund managers called "AFOREs", after the Spanish acronym.

These general administrative provisions, first introduced in September 2019, contemplated ESG factors as part of the criteria to be considered by any AFORE for eligible investments. This was introduced as an acknowledgement of the impact that pension funds can have on environmental and social concerns, as a result of the large number of resources at the disposal of any AFORE.

The general objective is that pension funds are invested in projects that are sustainable from an economic and environmental perspective, resulting in direct and indirect benefits to the country and its populace.

Conclusions

The global shift towards environmentally conscious financial instruments has set a clear path that both Mexican public and private institutions are eager to follow. This trend is underscored by Mexico's NDC, climate change commitments, social matters and increasing international pressure for progress in these areas.

Several significant tools have been developed in the past year to advance these commitments:

1. **Mexican sustainable taxonomy**: Introduced in March 2023, this taxonomy classifies sustainable economic activities focusing on climate change adaptation and mitigation, gender equality and access to basic services. It sets specific sustainability criteria across key economic sectors, including agriculture, generation, construction, manufacturing, transport and waste management.

2. **Mobilisation of the Sustainable Financing Strategy**: Published in September 2023, Mexico's strategy addresses international climate change and sustainable development goals. It aims to foster a supportive environment for sustainable activities, ensure transparent information disclosure and promote innovative financing instruments. The strategy is structured around three pillars: sustainable public financial management, sustainable financing mobilisation and transversal actions.

3. **Modifications to the Securities Market Law and Mutual Funds Law**: Recent amendments in November 2023 enhance efforts to mitigate climate change impacts. The Ministry of Finance and Public Credit is empowered to issue provisions monitoring sustainable development and gender equality practices among securities market participants.

4. **Sustainability Information Standards (NIS)**: Launched by the Mexican Council for Financial Information and Sustainability Standards in May 2024, NIS aim to bolster entity resilience in sustainability challenges. NIS A-1 establishes a foundational framework, while NIS B-1 focuses on basic sustainability indicators.

5. **Self-Assessment Tool for Environmental and Social Governance**: Developed by the National Banking and Securities Commission, this tool evaluates how Mexican financial institutions incorporate ESG factors and climate risks into non-financial information disclosures. It aligns with global trends towards sustainable systems and businesses.

6. **ESG obligations for pension fund managers**: In January 2022, Mexico implemented ESG-related obligations within the pension fund system. AFOREs (pension fund managers) now consider ESG factors when evaluating eligible investments. The overarching goal is to invest pension funds in sustainable projects, benefiting both the economy and the environment, and ultimately contributing to the well-being of the country and its citizens.

These instruments represent a sample of Mexico's evolving regulatory landscape, encompassing public and private sector initiatives, guides, tools, standards and regulations aimed at supporting national commitments to climate change and sustainability. The increasing emphasis on these developments underscores a nationwide shift towards prioritising sustainability and social concerns, aiming to build a resilient economy that balances economic growth with environmental and social well-being.