

El Salvador

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The evolution of El Salvador's financial system

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In the late eighties and early nineties, substantial reforms were enacted in El Salvador, all of which have contributed to the consolidation of a fairly developed and modern financial system. These reforms included: (i) the reorganisation of the Salvadoran Central Reserve Bank, among others, to control inflation, preserve the internal and external value of the local currency and maintain liquidity; (ii) the regulation of all financial institutions (unregulated credit institutions were forced to convert into fully regulated members of the financial system); and (iii) the privatisation of local banks. As a result of these initial reforms, and of more recent reforms, the financial system in El Salvador has been able to maintain stability and steady growth for the past decade.

Entities participating in the local financial system include privately owned commercial banks, branches of foreign banks, non-banking financial intermediaries, state-owned banks, public credit institutions, a state-owned mezzanine bank, a reciprocal guarantee institution, insurance and reinsurance companies, private pension funds, financial leasing companies, factoring companies, bonded warehouses, brokerage/dealer firms and the stock exchange. Each of these participants and their activities has a particular regulation, which explains why El Salvador has extensive legislation in this field.

Banking

Following the national financial crisis of 1997, Congress passed a modern but restrictive new banking legislation in 1999 which provides greater protection to depositors by creating stricter capital and risk-management requirements, granting broader authority and supervisory powers to the local regulator, the Superintendent of the Financial System (SSF), and improving compliance with Basel stan-

dards. The present banking legislation in El Salvador regulates banks' financial intermediation, organisational and operational requirements and standards, and their insolvency and reorganisation processes.

In the last five years, some of the largest and most relevant M&A transactions in the Central American region have involved Salvadoran banking entities. Leading international financial conglomerates (for instance, Citigroup, HSBC and Scotiabank) have already acquired controlling interests in many of the main Salvadoran banks.

Non-banking financial intermediaries

Non-banking financial intermediaries are also contemplated by local law. These entities have been created to facilitate financial intermediation for specific financing vehicles not willing or able to create a bank, and to improve financing opportunities for individuals and small businesses. These intermediaries consist mainly of cooperative/credit unions (entities providing financial services to their members), federations (organisations of cooperatives engaging in the same type of financial activity, providing assessment and technical assistance services to their member cooperatives) and savings and loan associations (non-governmental financial entities that may take deposits from the general public and make loans). The SSF also supervises these intermediaries.

Securities and capital markets

Public offerings of securities and their trading, and public issuers and their issuances, are regulated by the Salvadoran Securities Market Law and other complementary legislation, and are subject to certain local registration requirements. Private offerings are exempt from such regulation and from local registration requirements.

Foreign securities issued by Central American states or their central banks and/or by certain regional or international financial organisms may be subject to registration and negotiation in the local stock market following approval by the local regulator, the Securities Market

Superintendent (SMS). A simple certification from the foreign stock exchange that originally listed said securities or a copy of the securities' issuance authorisation are the basic requirements to register such foreign securities locally.

Foreign securities issued by other foreign states or their monetary policy management organisms and/or by foreign public or private entities or financial institutions may also be subject to registration and negotiation in the local stock market, following approval by the SMS, provided that: (i) the securities are duly registered with a foreign stock market regulator and/or are traded in a duly organised foreign securities market; (ii) information concerning the securities is available in capital market systems acknowledged by the SMS; and (iii) the securities come from a jurisdiction that has an organised stock market with supervision requirements similar or superior to those in force in El Salvador.

Among other general requirements, to obtain approval from the SMS the brokerage firm seeking to locally trade the foreign securities must provide evidence of having sufficient resources to keep prospective investors duly informed. Local and foreign custodians must also have entered into agreements that provide for the appropriate custody of the foreign securities for which trading is sought in El Salvador, and for the terms and processes of the transaction's settlement. Also, brokerage firms are required to issue daily updates to the SMS in connection with the public trading of foreign securities.

The Salvadoran stock exchange, which has been operating for more than a decade, lists private and public companies, international entities, sovereign states and foreign central banks. However, public offerings and the trading of securities in the local market have been relatively limited where the Salvadoran state, certain commercial banks and a handful of privately owned companies have acted as issuers.

From 2004 to date, the Republic of El Salvador has issued public debt in the form of notes for trading in the national and interna-

tional markets, for an approximate aggregate amount of \$1.2 billion. The offerings have received fair ratings (Baa3/BB+) and were placed in record time on the international market, with an average over-subscription of more than 500%.

Furthermore, an important regulatory development occurred in December 2007 when the first Securitisation Law was enacted in El Salvador. This Law regulates the requirements for the creation of local securitisation vehicles and describes and regulates the asset securitisation process, including loans, securities, financial flows and real property. As of July 2008, one securitisation entity has already been authorised by the SMS.

Additionally, the government has passed an investment fund legislation proposal to Congress; this proposal is now under analysis.

Current investment conditions

A US dollar-based economy, limited trade barriers within the region, the ongoing modernisation of roads and ports, advanced communications and technology and one of the leading financial systems in the region create favourable conditions for investing in El Salvador. The country has enacted several important Laws to stimulate investment, including the Investment Law (which provides, among other things, for the free repatriation of investment funds and any other payment from legal investment activities in the country), the Industrial and Commercial Free Trade Zones Law (which allows for the establishment and operation in free trade zones of both national and foreign entities, with significant tax exemptions), as well as modern and updated intellectual property and antitrust legislation.

During 2005 and 2006, Congress enacted: (i) a new Consumer Law to strengthen consumer defence and protection policies and reinforce the regulatory authority's control and supervising faculties; and (ii) the first Antitrust Law. Several tax reforms have also been enacted, principally to close tax loopholes and fight tax evasion.

The Central American and Dominican Republic Free Trade Zone Agreement (Cafta-DR) has been in effect between El Salvador and the US for two years. This agreement has caused the elimination (or significant reduction) of customs barriers with the US, and will continue to provide social, labour and economic benefits for El Salvador.

In June 2008, important reforms to the Salvadoran Code of Commerce were approved by Congress. These reforms seek to facilitate and thus promote investment through the formation of local companies by domestic and foreign entrepreneurs and include, among others, simplification of the

process and reduction of capital requirements for the formation of Salvadoran companies.

Financial and corporate

Recommended firms

Tier 1

Arias & Muñoz
Consortium Centro América Abogados
Guandique Segovia Quintanilla

Tier 2

Espino Nieto & Asociados
Latin Alliance - Torres Lemus & Asociados
Rusconi Valdez Medina & Asociados

Tier 3

Aguilar Castillo Love

The buzz word in El Salvador is consolidation. This has been a regional trend, but nowhere is the consolidation occurring on a larger scale than in El Salvador; the four largest banks in the country were bought by local other local players.

El Salvador has one of the most sophisticated markets in the region. The country has a highly functional system of banking superintendants to regulate the financial industry. Another reason that international institutions find acquiring banks in El Salvador attractive is the fact that it is a dollarized economy. This sophistication has affected other industries; corporate transactions are now being conducted in accordance with US and European standards.

Not all of these consolidations have met with immediate success, and banks are having trouble post-acquisition. As separate institutions, each local bank had distinct identities, which are not coalescing easily under one umbrella. Although alarmists suggest that some of these newly acquired banks may be spun off, it is more likely certain amount of managerial finesse will be necessary to promote corporate cohesion.

Even with the increased presence of international institutions, many financial experts do not expect local banks to liquidate. They are still able to service a niche sector that prefers the familiarity and expediency that local banks provide. While many of the foreign banks need to consult with regional headquarters in Colombia, or even New York, before approving a loan or a line of credit, many local banks are not similarly constrained. There has also been some speculation that once the contractual non-compete provisions expire, the owners that sold their local banks may re-enter the market. Some have maintained operations in

the region, perhaps with the strategic aim of eventually returning to El Salvador.

Most experts do not expect to see further consolidation in the financial sector. There are no privately owned banks left in El Salvador, and almost all the banks are foreign controlled. In fact, some are predicting spinoffs at these financial institutions, as they attempt to shed some components that are not part of their core business, like brokerage houses or fund managers. More likely is a continued wave of M&A activity in other sectors like manufacturing and textiles. As an early example, international apparel company, Hanesbrands, made recent acquisitions in the country.

Salvadorian lawyers are anticipating local law firms to grow in the next year, due to the numerous bank consolidations, which result in larger institutions outsourcing their legal work more frequently. Additionally, the level of legal diligence required in order to comply with the standards of other international banks is necessarily higher; this means that lawyers will need to become more specialised.

Arias & Muñoz

Arias & Muñoz distinguishes itself with a regional network, and the ability to provide a standardised level of service to its clients. As one client explained, "we have a presence in the region, and Arias & Muñoz has always been able to provide us with more than adequate service in all the countries." Competitors are also complimentary: "Arias & Muñoz does very good work and deserve to be where they are."

Arias & Muñoz advised on some bank consolidations in the past year. In May, the firm assisted Citibank, primarily advising it on the regulatory issues surrounding the acquisition of Banco Cuscatlán, the second-largest corporate and commercial bank in the region. The firm is also involved in the merger and integration process of the financial groups that Citibank controls in El Salvador. Citibank's acquisitions were among the biggest transactions in the country over the last year, with an aggregate value of \$3.5 billion.

Project finance has been steadily growing in El Salvador, and Arias & Muñoz has been actively working on these types of deals. Led by partners F Armando Arias, Lilian Zelaya and Roberta Gallado, the firm advised Cutuco Energy Central America in the commencement of a project that consists of a terminal of liquefied natural gas, a combined-cycle energy plant, transmission lines, substations, natural-gas distribution pipelines and a distribution plant. The total value of the project is \$680 million.

Leading lawyers

F Armando Arias
Zygmunt Brett
Roberta Gallardo
Julio Valdés
Lilian Zelaya Panting

Consortium Centro America Abogados

“Consortium is always reliable and provides the type of legal advice that you would expect from a major US firm,” explains one client. “They can translate not only the language, but the legal and cultural issues surrounding a deal too.”

Peers recognise the firm mostly for its work in the banking sector, but Consortium has been active in a number of important M&A deals over the past year, such as the Hanesbrands acquisition in December 2007. Led by Ricardo Cevallos and Julio Sibrian, the firm advised Hanesbrands on the acquisition of 100% of the capital of the Salvadorian company Bonaventure.

Consortium advised the Colombian group Caravajal in the acquisition of 80% of Grupo Industrial Diversificado & Termo Formados Modernos, one of the main plastic-product manufacturers in Central America. In May 2007, the firm advised on the \$1 billion acquisition of the shares of the British company Globeleq, the direct owner of Cinergica, the company in charge of administering and operating a power plant in El Salvador.

In February 2008, the firm advised on the final leg of Bancolombia’s acquisition of Banco Agrícola. The firm acted as Salvadorian counsel to the buyer in its purchase of the final 10% of the bank, which was structured a private sale between Bancolombia and Byssa, the holding company that owned the final 10% Banco Agrícola stock that was not purchased in a public tender offer last year. The firm represented Bancolombia in the 2007 tender offer as well.

Leading lawyers

Federico Guillermo Avila
Ricardo Cevallos
Aquiles Delgado

Guandique Segovia Quintanilla

The three-partner firm of Guandique Segovia Quintanilla has more than 30 years of experience in El Salvador, and is well respected by the legal community in the country. One rival corporate partner comments: “Guandique Segovia Quintanilla have maintained a good reputation over many years and have a very interesting roster of clients.” The firm, known to be more conservative than its main rivals,

has not developed a strategy of regionalisation, but is instead content to act as a traditional local firm.

Between them, the partners have a wide range of professional experiences. For example, Luis Nelson Segovia and Carlos Quintanilla Schmidt have both served in government, while Luis Ernesto Guandique Mejía has been more focused on the practice of law, and has developed an especially strong reputation in banking law.

Peers expect the firm to benefit from the rise in the banks’ needs to outsource legal work as procedures and standards become more formalised and bureaucratic. Partners note that Guandique has very strong ties to Scotiabank in particular. Large financial groups like Scotiabank will surely be requiring more legal services to help with compliance and regulatory matters.

The firm counts Citigroup, Shell Oil, Delta Airlines, Philips Lighting and British American Tobacco among its international clients, and works extensively with many US law firms.

Leading lawyers

Luis Ernesto Guandique Mejía
Luis Nelson Segovia
Carlos Quintanilla Schmidt

Other notable firms

Espino Nieto & Asociados, headed by partner Rafael Mendoza, is gaining recognition as an important firm in El Salvador, largely because of the work it does for its main client, Citibank. Clients have expressed their satisfaction; says one: “Espino Nieto is a first-class law firm by Central American standards.” Last year, Espino Nieto advised Citibank and Ashmore Energy in the process of a granting loan to Ashmore for its acquisition of the majority of the capital stock of Delsur, a local energy distribution company.

“Rusconi Valdez Medina & Asociados is a young firm doing very well,” says a rival. The young partners at the firm have amassed considerable and varied experience in their relatively short careers, including advising on acquisition financings, bond issuances, and project finance. The firm is a part of the Central Law regional legal network, and so has the ability and presence to work on cross-border and multi-jurisdictional deals with its partner offices.