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 standards. 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 international 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 - Central Law
Tier 3
Aguilar Castillo Love
Lexincorp
Romero Pineda & Asociados
Sáenz & Asociados

Within weeks of leftist president Mauricio Funes' election last March, it became clear that the prior right-leaning administration of Antonio Saca had not been upfront about the state of El Salvador's economy. While analysts blame electoral considerations for the lack of disclosure, subsequent revelations regarding skyrocketing unemployment rates, dramatically decreased GDP and plummeting remittances were no less troubling for the legal community. Regardless of political considerations, El Salvador's legal community is in agreement over the fact that, as one lawyer says: "The new government has inherited a very bad financial situation from the outgoing government."

In addition to inheriting a faltering economy, President Funes has also taken over several arbitration suits filed by foreign companies under the Cafta (Central American Free Trade Agreement) treaty. In one case, a subsidiary of Pacific Rim Mining is suing the government for not following through with promised permits to extract gold deposits discovered by the company. The outcome of this case and other pending suits in the mining and energy industries will test the strength of Cafta's terms, as well as the new administration's relations with foreign entities operating in El Salvador.

While there were initial doubts as to the direction in which President Funes would take the nation, many investors remain optimistic about their operations in El Salvador in terms of the threat of government takeover. Foreign businessmen operating in the country are buoyed by the fact that the parliament remains well mixed and President Funes has made initial promises to respect Cafta and private property rights.

Investors remained cautious at the end of 2009, but if the promise holds, there may be a flurry of investment for El Salvador in 2010. Financial lawyers see opportunities in the telecoms and IT industries, specifically in regard to outsourced call centre operations that have sprung up in the nation lately.

Perhaps one positive thing that can be said is that Saca's regime had negotiated several crucial international loans that will carry over to the new administration. At the end of 2008 the government secured a $500 million loan approved by the World Bank and another $450 from the Inter-American Development Bank, which will help float the nation through the hard times. Additionally, the International Monetary Fund granted an $800 million precautionary loan at the start of last year to boost the liquidity of the economy, though the country was expected to end 2009 with a deficit after growing 3.2% the previous year.

Arias & Muñoz

As one of two flagship offices for the regional law firm, Arias & Muñoz has a well-established leading presence in El Salvador that competitors do not deny. Not only did Arias lead the move towards regionalisation that has been the overriding trend of law firms in central America, it is considered the most fully-integrated of the regional players. In regard to its local office, one regional competitor noted: "We know for a fact that Arias & Muñoz is our benchmark here in El Salvador because their largest office is here."

Arias includes among its clients many of the world's multilateral lenders, including the Inter-American Development Bank and the International Finance Corporation, which the firm has advised on loans throughout the region. The firm's capabilities in central America are recognised by clients as similar in scope to international law firms. One client, citing problems that have arisen from working with other firms, says: "From my experience in El Salvador, Arias & Muñoz is the only law firm you can work with down there."

The El Salvador partners have an active energy client in Italy's Enel, which has been acquiring an increasing share of the state-owned company LaGeo. In 2008 Enel upped its stake in the geothermal energy developer from 12.5% to 36.2% through several capital increases. A team of Arias partners and associates are now involved in an arbitration procedure with the El Salvador government to allow Enel ultimately to acquire the entire company.

Partners Armando Arias and Ana Mercedes López negotiated $75 million in financing for local power producer Delsur from a syndicate of lenders led by HSBC. The financing allows Delsur to continue operating in the country.

Leading lawyers

F Armando Arias
Zygmunt Brett
Julio Valdés

Consortium - Centro América Abogados

While competitors say that the jury is still out regarding the Consortium franchise, there is agreement that having a central marketing strategy has benefited the partners of the El Salvador office. "They are everywhere," says one competitor. In terms of the firm's local practice, one rival notes: "They have a lot of very good lawyers that handle the areas of banking and project finance very well."

The firm's reputation in banking matters has presented opportunities for novel representation structures. One highlight was a $100 million syndicated loan awarded to regional retailer Grupo M Consortium, where the firm advised both Citibank and the Dutch Development Agency as lead arrangers of the loan. The deal involved the creation of a Chinese wall to prevent a conflict of interest, and required the approval of both lenders and the utilisation of several offices across Consortium's network.

Consortium has been active in developments within El Salvador's banking sector, advising micro-finance bank Integral in obtaining approval from the government to operate as a savings and loan entity under recently-changed banking regulations. Integral is the first of what is expected to be many such micro-finance institutions to obtain the S&L designation. In addition to allowing them to take in public savings, the designation allows micro-finance entities to access funds from multilateral lenders such as the World Bank.

Leading lawyers

Ricardo A Cevallos
Aquiles A Delgado

Guandique Segovia Quintanilla

Amid a sea of firms with regional networks, Guandique stands out as a leading firm dedicated to El Salvador. While some rivals see this as having a limiting effect on the firm's scope, others note its success at garnering an impressive list of representative clients. Says one: "They have a deep roster of clients in the telecoms and electrical businesses."

In 2008 Guandique counselled Italian developer Astaldi on its successful $219 million bid to construct a hydroelectric dam on the Río Torola in the El Chaparral region. The project is the largest energy development project in El Salvador today and represents the government's support for large-scale renewable sources of energy to combat the nation's dependence on oil imports.

Additionally, the firm has been advising AES on the construction of a 260MW coal-fired electric generating facility to power the port of La Unión. While construction of the port has been completed, the power plant project has been stalled amid disagreements within the government over concession rights.

Guandique's longstanding relationship with Scotiabank led to the bank's outsourcing of its legal operations in El Salvador to the firm in 2008. As part of the agreement, a team of 13 lawyers at Guandique will supervise all documentation and registrations with the government and handle interactions with Scotiabank's internal legal departments.

Leading lawyers

Luis Ernesto Guandique Mejia
Luis Nelson Segovia
Carlos Quintanilla Schmidt

Espino Nieto & Asociados

Long held as a traditional leader in the intellectual property market, competitors consider Espino Nieto to be one of the five largest firms in El Salvador. The firm's 45-plus year presence in the nation and full scope of services has brought well-known international corporate clients to the table, such as Colgate Palmolive, PepsiCo and Kimberly Clark. The firm is also known for its strong ties to Citibank.

While the list of transactions in the firm's financial practice is small compared to leading competitor firms, managing partner Rafael Mendoza advised in the El Salvadorian aspects of one of the region's most important transactions in the telecoms industry. Representing Millicom, Espino Nieto acted as counsel to the Swedish telecoms provider in its acquisition of Amnet's operations throughout the region. The transaction, valued at $500 million, exemplifies the shifting landscape of central America's telecoms industry as a result of the Cafta treaty.

Leading lawyers

Pedro Alejandro Mendoza
Rafael Mendoza Calderón

Latin Alliance - Torres Lemus & Asociados

As the local presence for regional network Latin Alliance, Torres Lemus is respected by competitors for its relations with local banks and banking institutions. Clients praise the firm's lawyers for their attention to detail and awareness of circumstances affecting their ongoing legal situations. As one client says: "They always reply in a timely manner and know each of our pending matters before the government."

Among the firm's banking clients Torres Lemus has been particularly active with regional bank G&T Continental, which has expanded its presence in El Salvador lately. In 2008 the firm advised G&T on several matters pertaining to the importation of liquid gas, as well as the bank's position as trustee for the Central American Bank for Economic Integration's $56 million loan for the construction of the Centro Termica Termopuerto electricity plant.

Leading lawyers

José Adolfo Torres
Raúl Ernesto Pineda

Rusconi Valdez Medina & Asociados - Central Law

Clients praise Rusconi's outstanding reliability at delivering quality service, specifically in respect to the work of partner Benjamin Valdéz Iraheta. In the words of one client: "Valdéz's firm is one of only two firms that we have never had a need to go to another counsel for assistance or because of dissatisfaction."

In terms of complexity, Rusconi's most important transaction last year involved a bond issuance for mortgage company La Hipotecaria as part of a short-term commercial paper programme. The offering of mortgage-backed securities was a novel occurrence in El Salvador, requiring creative negotiations with the government's regulatory bodies. The timing of the transaction - in the second half of 2008 - created particular challenges for the team.

Leading lawyers

Ana María Castro de Langenegger
Benjamin Valdéz Iraheta

Other ranked firms

The firm with the broadest presence in central America in terms of national offices, **Aguilar Castillo Love** is acknowledged by competitors to be a smaller player in the El Salvador markets. Still, rivals note the impact of Francisco José Barrientos in the corporate markets. Last year Barrientos and several lawyers advised

Japan's Metal One on a merger between one of its Guatemalan subsidiaries and an El Salvadorian metal fabricator. The deal took place through a Panamanian holding company, highlighting the advantage Aguilar holds over other regional firms by having an office on the isthmus.

Leading lawyers: Francisco José Barrientos

One of central America's youngest networks, **Lexincorp** is aggressively pursuing a course of integration across its various network offices and competitors note the El Salvador office's increasing presence in the market. At the end of 2008 the firm's M&A team advised Tecoloco in the sale of its shares to Saon Group. Partners in El Salvador participated in the establishment of several local operations by transnational corporations, including the start-up of multi-model maritime transport operator Multinaviera del Pacifico throughout the region.

Traditionally renowned for its litigation and arbitration practice, **Sáenz & Asociados** is noted by competitors for having made recent strides in the financial markets. In the area of M&A, the firm advised international call centre operator Stream Global Services through four months of negotiations at the height of the global economic crisis that resulted in the purchase of Dell's contact centre in El Salvador. The outsourcing of IT services has become an increasingly important sector of El Salvador's economy.

Leading lawyers: Humberto Sáenz and Mario Enrique Sáenz

Other notable firms

One firm with a recent presence in the region is **García & Bodán**, which began operations in El Salvador in 2007. Though admittedly smaller than its counterpart in Nicaragua, Garcia & Bodan is a local firm in transition to a regional one through grassroots development rather than pursuing a network structure with other established firms.

After a difficult start the firm relocated Nicaraguan partner Federico Gurdian to its San Salvador office and hopes the addition of an established name will bring renewed vigour to the local practice.