

El Salvador

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The evolution of El Salvador's financial system

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During the end of the 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 in the country. Such reforms included: (i) the reorganization of the Salvadoran Central Reserve Bank (BCR), 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 privatization 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 half-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 sector.

The banking sector

Following a national financial crisis during 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, by granting broader authority and supervising powers to the local regulator – the Superintendence of the Financial

System (SSF) – and by improving compliance with Basel standards. The present banking legislation in El Salvador regulates banks' financial intermediation, their organization and operation requirements and standards, and their insolvency and reorganization processes.

In the last five years, some of the largest and most relevant M&A transactions in the Central American region have involved Salvadoran entities in the banking sector. Leading international financial conglomerates (e.g. Citigroup, HSBC and Scotiabank) have already acquired controlling interests in many of the principal 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 (organizations of cooperatives engaging in the same type of financial activity that provide assessment and technical assistance services to their member cooperatives), and savings and loans 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 follow-

ing approval by the local regulator, the Securities Market Superintendence (SMS). A simple certification from the foreign stock exchange that originally listed said securities or a copy of the securities' issuance authorization 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 organized foreign securities market, (ii) information concerning the securities is available in capital markets systems acknowledged by the SMS, and (iii) the securities come from a jurisdiction that has an organized stock market with similar or superior supervision requirements to those in force in El Salvador.

To obtain approval from the SMS, among other general requirements, 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. Further, 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 43 private companies, four public institutions and 18 international entities, sovereign states and foreign central banks. However, public offerings and trading of securities in the local market have been relatively limited, where the Salvadoran State, some commercial banks and a handful of privately owned companies have acted as issuers.

From 2004 to 2007, 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 in the international market, with an average over-subscription of more than 500%.

The government has discussed some important legal projects, including the regulation of securitization, investment funds, and related transactions.

Proposed merger of regulatory authorities

In 2006, a bill was passed to Congress to unify all of the supervising and controlling entities of the local financial system (SSF, SMS and PS) into a single entity or “super” Superintendence. This proposed regulation aims to standardize supervision and control mechanisms, centralize information, and thus allow a more consolidated supervision of the entire financial system.

Current investment conditions

A US-dollar based economy, limited trade barriers within the region, the ongoing modernization 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.

In addition, the Central American and Dominican Republic Free Trade Zone Agreement (CAFTA-DR) is now in effect between El Salvador and the US. This agreement will cause the elimination or significant reduction of customs barriers with the US, and will of course provide other social, labour and economic benefits to El Salvador.

Financial and corporate

Recommended firms

Tier 1

Arias & Muñoz
Consortium Centro América Abogados
Guandique Segovia Quintanilla

Tier 2

Aguilar Castillo Love
Espino Nieto & Asociados
Latin Alliance – Torres Lemus & Asociados
Rusconi Valdez Medina & Asociados

This has been an extremely busy year for the financial markets in El Salvador. Like the rest of Central America, the country has been energized by important banking acquisitions. Citibank acquired Banco Uno, the largest credit card issuer in Central American, and then bought out the region’s (and El Salvador’s) second-largest bank, Banco Cuscatlán, in a December 2006 purchase. That same month, Bancolombia announced its intentions to purchase a controlling stake in Banagrícola, El Salvador’s largest bank.

There has also been wave of consolidations among domestic companies in varied industries like retail, auto dealers and stock brokerages, resulting in fewer but stronger companies. These domestic deals, along with several billion dollars of international bank acquisitions, are indicative of the level of confidence in the Salvadoran economy. One leading attorney said: “If Citibank has invested \$3 billion in El Salvador that should tell you something about what’s going on.”

What’s going on is a country with a very strong economy, a stable government, and a market that has made the US dollar its legal tender. This alone gives foreign investors a measure of comfort, since it minimizes currency fluctuations. It also provides another vehicle by which El Salvador’s markets increase liquidity – about 20% of the Salvadoran population lives in the US, sending home some \$3.5 billion of remittances. That money goes directly into the local markets, a home-grown variation of direct foreign investment.

These conditions have led multinational corporations to choose El Salvador as a Latin American location. Computer manufacturer Dell, for example, chose El Salvador for its new service centre instead of Chile or Panama; political stability and a dollar economy made it an easy choice. Salvadoran market watchers believe that their only competition for foreign dollars within the region is Costa Rica.

El Salvador’s law firms also benefit from a unique trend that has emerged recently: the regionalization of firms across Central

America. Some of El Salvador’s firms have been in the forefront of this movement. The Central America Free Trade Agreement (Cafta) has meant new region-wide investments from multinationals and they need representation across the area. Several firms in the region are looking to become the one-stop shop for those companies’ needs in Central America.

Arias & Muñoz

“Arias is a top-tier firm with strong leadership from Armando Arias. He has created a good team that does good work and is very thorough.”

That sort of commendation from a rival partner strongly suggests the quality of work that Arias & Muñoz can put together. With a client list that includes some of the country’s most important multinational entities like Citibank, HSBC and Dell, the firm participates in many of El Salvador’s largest transactions.

The firm is a big player in the banking industry. Armando Arias led the team that advised Banagrícola, El Salvador’s largest bank, in the sale to Bancolombia; the bank’s documents list the sale price at \$791 million, with an option to purchase a further \$75 million from minority shareholders. The December 2006 deal enhanced the reputation of Arias & Muñoz as the bankers’ law firm.

That reputation was cemented by a concurrent deal, the Banco Uno acquisition by Citibank. Partner Armando Arias led a team which included lawyers from the other four Central American offices in another December 2006 deal. This deal helped demonstrate the ability of Arias & Muñoz to handle a client’s needs across several countries.

If the firm’s ability to handle multi-jurisdictional deals were ever in question, its handling of the Courts-Regal Forest situation should put any doubts to rest. Arias represented Central American consumer electronics leader Regal Forest in a \$370 million buy-out of Courts’ operations in 12 Caribbean countries.

In a further show of the firm’s flexibility, Arias represented Costa Rican company Durman Esquivel when the pipe-and-tubing manufacturer sold its interests to Belgian company Aliaxis in another December 2006 transaction. It fell to Arias to conduct the due diligence for the South American portion of the \$200 million joint venture.

Arias & Muñoz is one of the firms leading the regionalization charge, with offices in all five countries of Central America. Results indicate that the firm has a good handle on how to accomplish this sort of expansion.

Clients appear to choose Arias for its abilities in El Salvador, and beyond.

The general counsel of one regional company said: "From my point of view, A&M is the only fully integrated firm. Just hire one partner, and he gets a response from any of the markets. This is an enormous advantage for us."

Leading lawyers

F Armando Arias
Zygmunt Brett
Roberta Gallardo
Julio Valdés
Lillian Zelaya

Consortium Centro América Abogados

In a market like El Salvador, there are only a few participating in the biggest deals, and Consortium Centro América Abogados is one of them. Formerly known as Delgado & Cevallos, Consortium is another firm that wants to take advantage of the regional opportunities that Cafta affords.

Considering its reputation, and with banking deals so much in the news, it makes sense that Consortium's biggest deals are bank acquisitions. The firm was counsel for the Citigroup acquisition of Banco Cuscatlán, representing Cuscatlán in the \$1.5 billion sale. Then Consortium represented Bancolombia in its \$791 million acquisition of El Salvador's largest bank, Banagrícola. The March 2007 sale also allowed Bancolombia an option for an additional \$75 million share purchase from minority shareholders. These two banking deals were the largest in the country, solidifying Consortium as one of the top financial law firms.

In yet another banking acquisition, the firm performed due diligence and advised on regulatory matters for HSBC over its purchase of Banistmo. The largest privately held bank in Central America, Banistmo sold for \$1.8 billion in July 2006.

But Consortium is not just a bank law firm. Consortium's telecoms client Digicel Group acquired the mobile phone company Digicel Holdings (commonly referred to as DHL, and unrelated to the acquirer). This was a region-wide transaction, and the first entry into Central America for the acquirer. Consortium partners in Honduras, Nicaragua and Guatemala participated, with the entire operation overseen by partner Ricardo Cevallos from El Salvador.

A partner in a firm that worked across from Consortium said: "They invest a lot in marketing, but they are good anyway. If you throw a dart at any big deal, they are there!"

Leading lawyers

Federico Guillermo Ávila
Ricardo Cevallos
Aquiles Delgado

Guandique Segovia Quintanilla

Unlike the other two firms in the top tier, Guandique Segovia Quintanilla prefers to concentrate on domestic deals. The firm has a small international presence, and would rather work with Salvadoran companies. A leading partner at another firm said: "The firm doesn't have an international practice, but they are a respected firm. And they don't market themselves, but they are still known."

The three-partner firm, one of the oldest in the country, garners a lot of respect simply from its longevity in the market. The firm, however, also has enough presence to be a relevant player. After all, it represented Citibank in the bank's acquisition of Banco Uno. The firm sat across from Arias & Muñoz in the March 2007, representing the interests of the seller, in El Salvador.

This sort of top-level deal-making is why Guandique maintains its top status. The firm was also representative to Citibank in its other significant acquisition, the \$1.5 billion Banco Cuscatlán takeover. Again, another top-tier firm – Consortium – was on the other side of the table.

Banco Salvadoreño issued a floating-rate securitization of diversified payment rights in September 2006. The bank's parent company, Grupo Banistmo (recently acquired by HSBC) acted as the placement agent for the offering, with Guandique advising Banistmo on the \$125 million deal.

Guandique's stellar reputation among the biggest banks in El Salvador continues to provide the firm with business. Its old-school ways of doing business have proven effective, even in a market that is looking beyond domestic boundaries. With no indications that the firm has any intentions to grow beyond El Salvador, it appears that Guandique wants to buck the trend of the other large firms in the region.

Leading lawyers

Luis Ernesto Guandique Mejía
Carlos Quintanilla Schmidt
Luis Nelson Segovia

Other notable firms

The Salvadoran office of **Aguilar Castillo Love** is headed by the respected Francisco José Barrientos. The two-lawyer firm has been sought for legal advice by consulting firm Accenture and by the international law firm White & Case in separate cases. The firm has

more of a reputation in the country for its intellectual property work, but as part of the Aguilar Castillo Love regional network, its presence in El Salvador should be monitored.

The eight lawyers at **Torres Lemus & Asociados**, part of the Latin Law Alliance, specialize in banking and financial matters. The firm, led by José Adolfo Torres Lemus, has participated in transactions involving HSBC in El Salvador, as when HSBC subsidiary Banistmo acquired Banco Salvadoreño. Its client list includes other financial companies like Banco G&T Continental and insurers Aseguradora Mundial, besides Banistmo and HSBC. Pharmaceuticals multinational GlaxoSmithKline is also included as a client. At least one partner at a leading Salvadoran firm suggests that Torres Lemus might be an up-and-coming firm in the next few years.