



LEGAL COOPERATIVE FRAMEWORK ANALYSIS

Within the ICA-EU Partnership

NATIONAL REPORT FOR EL SALVADOR

I. Introduction

This report was written as a result of the research for the Legal Cooperative Frameworks Analysis initiated by the International Cooperative Alliance (ICA) and its regional offices. The research is carried out within the framework of a signed partnership between the European Union and the ICA during the 2016-2020 period, which aims to strengthen the cooperative movement and its capacity to promote international development.

The analysis of the legal framework seeks to improve the knowledge and evaluation of cooperative legislation, with the aim of ensuring that legal regulations acknowledge the specificities of the cooperative model and ensure a level playing field compared to other forms of association. This analysis will also serve ICA members as inputs for their advocacy and recommendations on the creation or improvement of legal frameworks, to document the implementation of cooperation laws and policies, and to monitor their evolution.

In accordance with the objectives set out in the ICA-EU Project, this report looks to provide a general understanding of the Salvadoran cooperative legislation and an assessment of the degree of its ability to promote the development of cooperatives. Likewise, some recommendations are also made for the improvement of legislation in order to overcome some difficulties currently faced by cooperatives.

The document has been prepared by Rosa Nelis Parada de Hernández, Graduate in Legal Sciences in the Republic of El Salvador and as an independent expert. Contributions made by national cooperative organizations affiliated to Cooperatives of the Americas have been taken into account to create this document.

Contributions from the expert as well as Salvadoran organizations that are members of Cooperatives of the Americas were collected through a questionnaire prepared by the International Cooperative Alliance and its regional offices. The questionnaire was sent in its entirety to all members in El Salvador and the option to answer it was voluntary.





II. National Cooperative Legislation of El Salvador

i. General context

In El Salvador, the Constitution of the Republic decreed in 1986, determines in Article 114 that: "The State will protect and promote Cooperative Associations, enabling its organization, expansion and financing". Hence its foundation for the secondary legislation currently regulating Cooperative Associations called "General Law on Cooperative Associations", promulgated by Legislative Decree number three hundred and thirty-nine, dated May sixth, nineteen eighty-six, published in the Official Journal number eighty-six, volume two hundred and ninety-one dated May fourteenth of that same year, which came to replace the Law on Cooperatives of 1969.

It can therefore be perceived that the effect of having a constitutional provision that mandates the protection, promotion, organization, expansion and financing of cooperative associations, provides legal certainty to the cooperative sector in the defense of its interests, considering that none of the laws applied to a cooperative association can have a different interpretation other than what the constitution mandates.

There are also other legislative decrees that specifically regulate the activity of other cooperative sectors, such as agricultural cooperatives, thus, these cooperatives are regulated by both norms.

Can other special or general norms apply in order to solve problems for Cooperative Associations in El Salvador? The answer is YES. In El Salvador, Article 96.- of the General Law on Cooperative Associations states that "that which is not provided for in this law, will be covered by the common legislation", in such a way that when the Civil Code is applied as an additional norm, it can be found to be a solution to a variety of cases, even if they are not specifically regulated in the General Law on Cooperative Associations.

New regulations governing new situations are also applicable, using the norms that provide a solution to the factual circumstance determined.





ii. Specific Elements of the Cooperative Law

a) Definition and Objectives of Cooperatives

Article 1.- of the General Law on Cooperative Associations, hereinafter identified by its acronym LGAC or Law on Cooperatives, mentions the legal nature of this type of association, and mentions that they will be of variable and unlimited capital, of indefinite duration and limited liability with a variable number of members, for purposes of service, production, distribution and participation.

This Law includes the cooperative principles, norms and purposes of cooperative associations in Articles 2, 3 and 4, such as Unrestricted Admission and Voluntary Withdrawal; Democratic organization and control; Interest limited to capital; Distribution of surpluses among Members, in proportion to the operations they carry out with Cooperative Associations or their participation in common work; Promotion of cooperative education; Promotion of cooperative integration; Maintain institutionally strict religious, racial and political-partisan neutrality; Recognize the equal rights and obligations of all Partners, without discrimination; Recognize that all Members have the right to one vote per person, without taking into account the amount of their contributions in the Cooperative. This right shall be implemented in person and may only be implemented through a delegate in specific cases and with the limitations determined in this law. Seek the development and social, economic and cultural improvement of its Members and the community through self-effort and mutual support and through democratic management in the production and distribution of goods and services; Represent and defend the interests of its Members; Provide, facilitate and manage technical support services to its Members; and Promote the development and strengthening of the Cooperative Movement through its economic and social integration.

These articles reflect the nature of cooperatives, unrestricted entry and exit, their voluntary work, their purpose of service, etc.

Articles 7 to 12 of the LGAC establish the different types of cooperatives, which may be a) Production cooperatives; b) Housing cooperatives; and c) Service cooperatives, having been tacitly repealed in paragraph d) of Article 12, which mentions Insurance cooperatives. As of April twentieth, nineteen ninety-nine, the Law on Insurance Companies was approved, which determines that insurance companies incorporated in El Salvador should be organized and operate in the form of Limited Corporations, excluding Cooperative Associations from the possibility of engaging in this type of activity.

Social cooperatives do not expressly exist in our legislation; but the article that establishes the different types of service cooperatives states that they are not taxable, because in its



wording it indicates "Cooperative Service Associations may be among others", which leaves the possibility for other types to exist even if they are not expressly listed in the norm. Despite the fact that the legislation may allow its constitution, this type of cooperative associations do not exist in our country.

Regardless, there is a single Cooperative Association that works in providing insurance in El Salvador called Seguros Futuro A.C. de R.L. Since it was constituted back in 1994 and the new law is not retroactive, all those insurers that at the time of its entry into effect were operating in that field are respected.

b) Establishment, Cooperative Membership and Government

Cooperatives are constituted through a General Assembly held by all stakeholders, with a minimum number of members determined according to the nature of the cooperative, which cannot be less than fifteen in any case. The corresponding constitutional act must be established, for which the law does not mention any formality, which is why INSAFOCOOP does not require this act to be a public document, but rather the indications are that it be made on simple paper following the model indicated, so that it is of easy access for constituent partners. This act shall be signed by all constituent members. It is worth mentioning that the law does not require the members of a cooperative association to use the services that the cooperative provides, which is why our legislation does allow investor members.

The requirements to be a member of a Cooperative include being over sixteen years of age, regardless of race, nationality, religion, political ideas or gender, have a good reputation and to be recommended by two members of the cooperative the person wishes to join.

Those over sixteen years of age do not need the authorization of their parents or legal representatives to enter as members, to intervene in social operations and pay or receive their corresponding amounts. Similar or like legal persons who do not pursue profit may also be members of the Cooperatives.

The person who becomes a member, will respond jointly with the other members, to the obligations acquired by the Cooperative prior to their entry and until the time that their inscription as member is cancelled and their responsibility will be limited to the value of their contribution.

The General Assembly shall approve the bylaws and subscribe to the share capital, paying at least 20% of the subscribed capital.



Once established, the cooperative will apply for registration in the National Register of Cooperatives of the Salvadoran Institute of Cooperative Development, whose acronym is read as INSAFOCOOP in Spanish, presenting Certification of Constitution signed by the Secretary of the Board of Directors of the cooperative, in order to obtain its legal status, the registration entry must be published as an extract a single time in the Official Journal.

The minimum number of members for constitution of cooperatives is fifteen; ten for federations and six for confederations.

The principle of Open Membership is observed in the circumstance that any associate may withdraw from the cooperative whenever they wish to do so and for this purpose must provide a written submission to the Board of Directors, requesting their exit from the cooperative as well as the return of their assets in accordance with its statutes.

In this case, the Board of Directors will decide on how to settle the contributions, interests and financial claims of the applicant partner and their obligations in favor of the Cooperative Association, taking into account the financial situation and the availability of cooperative resources, using the real value that is established in the financial year in which the withdrawal is approved.

Members have the right to a single vote at Ordinary or Extraordinary General Assemblies, except when the cooperative operates at the national or regional level, the statutes may regulate the holding of the assemblies by delegates elected by the different groups of associates, when justified by the high number of associates, their residence in locations other than the head office and other events that make it impossible for all its members to attend such sessions.

The structure of the cooperative government is composed of three bodies: General Assembly of Members, Board of Directors and Supervisory Board.

The first is the highest authority of the cooperative, the second is the one in charge of the administration of the cooperative and is the one who executes the mandates coming from the General Assembly and the third is the one which is in charge of supervising the cooperative.

The General Assembly shall be held at the registered address of the cooperative and may be ordinary or extraordinary. The Ordinary meeting will be convened once a year, in the first ninety days of the year and the Extraordinary meeting will be convened as many times as necessary and its competencies are established in the Law on Cooperatives. Agreements made at the General Assembly are binding for the Board of Directors, the Supervisory Board and all partners present, absent, compliant or not, provided that they have been made in accordance with the law.





In this type of assemblies, once the agenda is approved no other topics will be allowed. The quorum to enter into agreements will be half plus at least one of the current members on the first call. If it is not met, the Surveillance Board shall draw up a record of said circumstance, as well as the number and names of the attendees of the Assembly. Upon completion of this formality, the Assembly may deliberate and make valid agreements one hour later with a number of current members that is not inferior to 20% of the total.

The Board of Directors is the body responsible for administrative functions and constitutes the executive instrument of the General Assembly of Members, having full authority and administration powers in the affairs of the Association. It consists of an odd number of members not less than five or greater than seven, elected by the General Assembly for a period of three years, who may be re-elected. It is made up of: A President, a Vice President, a Secretary, a Treasurer and one or more members.

If due to unavailability of one of its members or for other reasons altogether, they are unable to integrate the governing bodies with the minimum number of members established by law, the Regulations and their statutes, they may be composed of a lower number, but never less than three, and the state body INSAFOCOOP must be notified of the agreement in this regard, within a period of not more than five days. That body shall qualify the causes and whether or not it will ratify the agreement taken.

The Supervisory Board is responsible for the supervision of the cooperative and will monitor the actions of administrative bodies as well as employees. It consists of an odd number of members not greater than five or less than three, elected by the General Assembly for a term of no more than three years or less than one. It is made up of a President, a Secretary and one or more members and in the same way two alternates will be elected who will attend the meetings with a voice but without a vote.

c) Cooperative Financial Structure and Taxes

The LGAC does not set a minimum for the share capital of cooperatives, but only mentions that capitalized contributions, interest and surpluses constitute the share capital of cooperatives. In order to maintain their status in the cooperative each member must pay the amount of the contributions subscribed as established by the statutes, in order to avoid its decapitalization. In addition, each partner's contributions shall not exceed ten per cent of the share capital; but when authorized by the General Assembly of Members, they may be greater, but they may never exceed it by twenty percent.

Contributions must be made in cash, movable and immovable property or rights, will be nominative, indivisible and of equal value. These will be represented by certificates legalized





by INSAFOCOOP and, where appropriate, by the Department of Agricultural Associations of the Ministry of Agriculture and Livestock. Certificates may represent one or more contributions and may only be transferable to another member of the association, prior to authorization by the Board of Directors.

Personal creditors of the members may not seize more than the corresponding interests and the share of capital they are entitled to in the event of liquidation, when it takes place.

The Reserve Funds are constituted by the Legal Reserve Fund; of Education, Labor and Contingency for uncollectible accounts. These, together with grants, donations, and legacies, are not distributable, therefore, neither members nor their heirs are entitled to any part of these resources. Cooperatives may use their reserve funds and other available funds, except the Legal reserve and Education reserve, in easily convertible investments that provide benefits for them, provided that the assets and social surpluses are not affected.

In regard to taxes, cooperatives have an Income and Municipal Tax Exemption Regime, only, and are granted by written request submitted to the Ministry of Economy, who, after obtaining input from the Ministry of Finance, grants or denies it. As for the other tax obligations they are met normally as any taxable entity.

Some taxes that cooperatives pay include the Tax on the Transfer of Goods and Services (VAT) 13% on the net price; The employer's share toward AFPs (pension funds), which is 7.5% on the salaries of declared employees (Pension Savings System Law) and for the Salvadoran Social Security Institute, 7.5% is paid on the salaries of employees declared in conformance with the Social Security Act; also if a property that exceeds the price of \$28,571.43 is purchased, a tax on the Transfer of Property of 3% on the excess to the aforementioned amount must be paid, etc. Cooperatives are also tax retainers, such as the retention of income tax on the salaries of employees; the retention of income tax on the fees of professionals who work independently and who provide their services to the cooperative etc.; the latter obligations are imposed by the Income Tax Law.

In case of resignation, dissolution or exclusion of the cooperative, members have the right to have their contributions and interest returned to them if they are available. The Board of Directors will take into account the financial situation and the availability of resources of the cooperative for its repayment and in this context the loans in favor of the cooperative, as well as any losses, will be deducted.

Members in addition to exercising their right to voluntary withdrawal (Resignation); may also be excluded from the cooperative by agreement of the Board of Directors for proven





misconduct and serious prejudice to the cooperative, done through a majority vote and upon report of the Supervisory Board.

The excluded partner may ultimately appeal to the next General Assembly. As long as there is an appeal pending, the rights of the excluded partner remain on hold.

The surpluses provided by the Annual Income Statement of cooperatives are applied first to the Education and Legal Reserve Fund, then to the Fund for Work Compensation and Uncollectible Accounts. The percentage for the payment of interest to the members in proportion to their contributions is then established when agreed upon by the General Assembly and the remaining percentage after the previous deductions are applied are distributed among the members in proportion to the operations carried out with the cooperative or its participation in the work therein, in accordance to what is established by the General Assembly.

The percentage to be allocated to each of the reserves will be established by the General Assembly of Associates and only to the Legal Reserve. The Assembly will respect the legal percentage and will allocate what the law says, i.e. at least 10% of the surpluses and may never be more than 20% of the capital paid by members.

In regard to the percentage of the interest paid to the partners in proportion to their contributions, when agreed upon by the General Assembly, it shall not exceed the higher interest rate paid by the banking system for savings accounts.

Regarding returns of earnings to the member, the Income Tax Law establishes profits received by the taxable person as a tax-generating event. Profits that are truly perceived as such are those whose distribution has been agreed on with the partner or shareholder, whether in cash, securities, in kind or through accounting transactions that generate availability for the taxpayer, or in shares by capitalization of profits; for this reason the return to members is taxed through Income Tax.

In regard to the distributable percentage in Cooperative Associations (Distributable Surplus) this is determined by the General Assembly, deducting all legal and statutory reserves and of cooperative associations from the net surplus generated at the end of the financial year and reflecting the economic situation of the cooperative.



The General Assembly may authorize the Cooperative to obtain funds, for specific productive operations, and these loans may be backed up by investment certificates that will be regulated by the Regulations of the Law.

The Regulation of the Law stipulates that these certificates will be taken from a book, with progressive numbering, and shall be signed by the President and the Secretary of the Board of Directors and must contain: a) Name and corporate address of the Cooperative Association; b) Name of the Associate Holding the Investment Certificate; c) The value of the Investment Certificate; d) Conditions and deadlines within which the corresponding returns will be made; and e) Place and date issued.

Cooperatives may be dissolved by agreement of the General Assembly of Members convened exclusively for this purpose, with the attendance of at least two thirds of its members and their agreement must also be taken by two thirds of those present.

The causes for dissolution may be: decrease in their minimum number in the span of one year; loss of economic resources; by merger with another cooperative by fully incorporating one into the other or by the establishment of a new cooperative that takes all of the assets of the other.

d) Other Specific Characteristics

All cooperatives are subject to state supervision through the Salvadoran Cooperative Institute INSAFOCOOP, which has the authority to grant them legal personality and will also carry out the supervision of cooperatives in accordance with the Law on Creation of the Institute and its Regulations. In accordance with other supervisory laws, these may be subject to norms from other institutions, such as the "Technical Standards for the Registration, Obligations and Operation of Entities that Send or Receive Money through Subagents or Subagent Administrators" (NRP19) that regulate the activity of Remittances and the "Technical Standards for the Management of the Risks of Money and Assets Laundering and the Financing of Terrorism" (NRP-08) that regulate companies to control the Laundering of Money and Assets and the corresponding Instructions that are supervised by the Superintendence of the Financial System and the Attorney General's Office of the Republic.

These norms are issued by the Central Reserve Bank for the entire financial sector and are monitored for implementation through the Superintendence of the Financial System. In these cases, Cooperative Associations are given the same treatment as banks, there is no difference, the same norms apply.





In El Salvador, cooperatives are being regulated by the Superintendence of the Financial System, in terms of specific activities and some are specifically already regulated by this supervisor in all their operations in accordance with the Law of Cooperative Banks.

In this regard it can be stated that they are called Cooperative Banks, because the aforementioned law elevates them to that category when: a) they choose to raise funds from the public; b) its assets exceed sixty-eight million five hundred and seventy-one thousand four hundred and twenty-eight dollars with sixty cents in US dollars \$68,571,428.60 ; but the same law determines that its constitution, organization and administration be governed by their respective legal systems, depending on their nature, Article 3 of the Law on Cooperative Banks. This law does not reference principles and values, or the nature of the entities to be regulated, that is, it does not value the philosophy of the cooperatives, it only lays down rules for the operation of non-bank financial intermediaries, which can be found in its legal premises.

INSAFOCOOP, however, despite its legal supervisory authority does not implement it diligently and states that it is due to a lack of budget. For this reason, this constitutional obligation is limited due to budget reasons, so much so that the intervention on a cooperative may take up to ninety days to take place after an event is discovered or reported.

INSAFOCOOP also has development functions, in the sense of promoting cooperatives, collaborating from their very establishment and accompanying them throughout their development. We hope that in the future this inconvenience is remedied, and that the cooperative supervisory body will be able to fulfill its legal functions.

The law of cooperatives has gaps that are remedied by other laws such as the Administrative Procedures Law; Civil and Commercial Procedural Code, Civil Code and others. Resolutions determined by INSAFOCOOP may be appealed by law.

Under the Cooperatives Law, INSAFOCOOP may opt for penalties such as fines, temporary suspension of members of the Board of Directors and Supervisory Board in the performance of their duties; temporary suspension or cancellation of the authorization to operate and provisional audit, which lasts a period of thirty days and culminates with the summons of the General Assembly of Members for the resolution of the problem.

The law of cooperatives lacks a specific procedure for imposing sanctions, for this reason the imposition of sanctions may be arbitrary, and this results negatively on cooperatives. In February of this year the Law on Administrative Procedures came into force and proposes a procedure that can be adopted by any institution that lacks them; but I always believe that a



specific procedure for imposing sanctions on cooperatives is better and that it is contemplated in its law.

The self-regulation of cooperatives is not expressly found in the law, but there is no prohibition in it to do so, applying the legal aphorism that what is not prohibited is permitted.

The cooperative law allows federations to represent and defend their interests and that of their affiliated cooperatives, to provide auditing and technical assistance services; conduct audits; promote the establishment of new cooperatives, among others.

The Federations of Cooperative Associations shall be constituted through a General Assembly held for this purpose by the delegates of the cooperatives involved. A constitution assembly shall be attended by up to three delegates for each cooperative, appointed by the Board of Directors, with the right to one vote per cooperative.

Federations may carry out economic activities such as family remittances, provide accounting services, consultancies, provide loans to their affiliates and others.

Federations and confederations shall have the same privileges, rights and obligations as are granted to cooperatives in the LGAC.

Confederations may be constituted with federations and are required by law to have at least three federations of the same type or five federations of different types.

The Cooperative Act is not established in the Cooperatives Law, and it would be important for it to be recognized within the law for it to transcend into procedural terms.

III. Degree of Ease of National Legislation for Cooperatives

The tax aspects for cooperatives in El Salvador do not differ in terms of the nature of the subjects required to pay tax, and as explained above, cooperatives are exempt only from Income and Municipal taxes.

The Law of Cooperatives of El Salvador was approved thirty-three years ago, but it has not prevented the development of cooperatives, which is why its reform has not been promoted.

Cooperative legislation does not contend with the regulations of the Consumer Protection Authority, since, in all laws cooperative associations are under equal conditions with other associations, be it commercial companies, foundations, non-profit associations, etc. In short, all subjects are measured equally, if only theoretically, since cronyism and corruption also exist in this country. The contradiction could be that in this country cooperatives do not hold



a special place, even though their purpose is unlike any other for-profit commercial enterprise.

As previously stated with regard to laws and supervisory rules under the financial system, the same standards are applied to savings and credit unions as to the formal banking system, to the detriment of the legal nature of cooperatives.

To date, none of the bills proposed by stakeholders (government and cooperatives) have worked for the supervision of cooperatives, since none of them have been agreed upon; but at this time and being of the new trends to pursue corruption and money laundering, as well as organized crime, the Law against Laundering and Financing of Terrorism is being implemented, in such a way that there is already a bill at the Legislative Assembly, which will have a wide range of supervised subjects including cooperative savings and credit associations.

According to statistics as of June 30 of two thousand nineteen on the website of the Salvadoran Institute of Cooperative Development, the global number of active Cooperative Associations of various types in El Salvador amounts to one thousand two hundred and sixty cooperatives, of which only five hundred and fifty-five cooperative associations are Savings and Credit.

IV. Recommendations for the Improvement of the National Legal Framework

- That the cooperative act be recognized procedurally, in order to have special jurisdiction.
- To compile all decrees and laws concerning the regulation of the activity of cooperatives, which are currently scattered.
- That the legal nature of cooperatives be respected in laws, norms and any other document, so that they are not considered and treated as financial entities for profit.

V. Conclusions

Cooperative Associations in El Salvador are on the path to their economic and social boom. An arduous task that nevertheless is on its way.

The General Law on Cooperative Associations, despite being in effect for the past thirty-three years, meets the needs for the development of cooperatives, meaning that to date there has been no overriding need for their reform or for the approval of a new law. However, at



some point it will be necessary to adapt the law to current times, in order to apply new technologies in their processes whether administrative or judicial in nature.

To date, there is an effort being made to guide legislators to enact laws that respect the legal nature of cooperatives, because as previously mentioned the regulations issued for the banking sector, are being applied to the Cooperative Associations with the consequent detriment of their social function.

As for considering whether the law is favorable or unfavorable to the development of cooperatives, I can say that it is favorable, because it is a simple, non-restrictive law, which can have a favorable response to unresolved concerns.

San Salvador, El Salvador. October 2019.

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