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SURETY BONDS IN EL SALVADOR

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AGENDA

1. Types of surety bonds in El Salvador

2. Laws governing surety bonds in El Salvador

3. What is an on-demand bond?

4. Characteristics of an on-demand bond

5. Differences between ordinary bonds and on-demand bonds

6. Advantages and disadvantages of on-demand bonds

7. Conclusions

1. TYPES OF SURETY BONDS IN EL SALVADOR

In El Salvador the most common types of bonds are issued for the public sector:

Bid bond (90-180 days tenor, 5% of bid amount)

Performance bond (up to 1 year tenor, 10% of contract value)

Advance payment bond (up to 1 year tenor, up to 30% of contract value)

Good quality bond ("buena obra") (up to 2 years tenor, 10% of contract value)

Maintenance bond (up to 2 years tenor, 10% of contract value)



1.1 SURETY BONDS IN EL SALVADOR



In El Salvador surety bonds are payable **on-demand** and governed by laws and regulations. According to the Commercial Code, there are only two types of bonds: **Performance bonds** and **Judicial bonds**.

1.2 CHARACTERISTICS OF SURETY BONDS IN EL SALVADOR

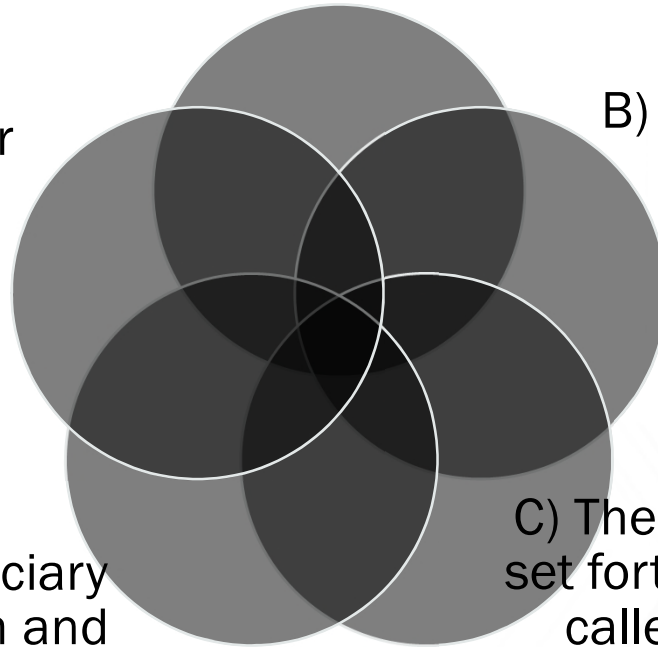
A) They are expressly governed by the Commercial and Civil Codes; there are no pre-established formats.

E) Bonds must be claimed within their term or before expiration date.

B) A main obligation to be secured by a bond is required.

D) Only the beneficiary is entitled to claim and collect the bond.

C) The parties' agreement is set forth in a written contract called "main contract"—signed by both parties—or through a purchase order.



2. LAWS GOVERNING SURETY BONDS IN EL SALVADOR

Commercial Code. Sections 1,538 to 1,550.
Created in 1970.
Last amendment: 2008

Civil Code. Created in 1895.
Last amendment: 2011

Law of Insurance Companies
Approved in 1996.
Last amendment: 2006

**Law of Procurement and Contracts of Public
Administration –(LACAP).** Chapter 4. Sections 32 to
38. Approved in 2011



2.1 SECTIONS ESTABLISHING THAT SURETY BONDS ARE PAYABLE ON DEMAND

- Section 1544. Commercial Code

- “A surety company is in arrears ten days after the submission of a written demand of payment by the beneficiary. Any agreement establishing a term different from the one set forth in this section and an interest rate for payment in arrears different from that established by law shall be null and void.”

This means that the beneficiary is bound neither to prove the principal's non-performance nor to submit any settlement or adjustment on account of the unfulfilled portion of the contract.



2.2. SECTIONS ESTABLISHING THAT SURETY BONDS ARE PAYABLE ON DEMAND

- Section 32. LACAP (third paragraph)
 - “...Said guarantees shall not be subject to other terms than the ones required by the contracting entity; they must be issued as joint, irrevocable and on-demand bonds.”

This means that in El Salvador all surety bonds issued for the public sector are to be paid on demand.



3. WHAT IS AN ON-DEMAND BOND



It may be defined as a non-traditional contract by which the surety company agrees to perform the contractual obligation towards the beneficiary upon first written demand.



3.1 PARTIES TO AN ON-DEMAND BOND

Principal

- Party who is responsible for having a guarantee (surety bond) issued in favor of the beneficiary.

Surety

- Financial entity that is bound to pay the beneficiary when payment is demanded in writing.

Beneficiary

- Party in whose favor the bond is issued and who will be paid in case of principal's non-performance.



4. CHARACTERISTICS OF AN ON-DEMAND BOND

The beneficiary's written demand is a sufficient condition for the existence of a payment obligation.

The beneficiary is not bound to prove the contractor's non-compliance.

It is more flexible than an ordinary bond, thus favoring the beneficiary.

The surety may assume equal or less liability than the principal—but not more.

On-demand bonds may have an open tenor.

4.1 DAMAGES COVERED BY ON-DEMAND BONDS

All those set forth in the main contract.

In certain cases, fines, interests and penalties are included.

5. DIFFERENCES BETWEEN ORDINARY BONDS AND ON-DEMAND BONDS

Ordinary bond

The beneficiary submits the claim and the surety company must prove whether the claim is valid.

The surety company satisfies the claim after having examined the reasons for it.

Prior to the payment, a settlement or adjustment is usually made.

On-demand bond

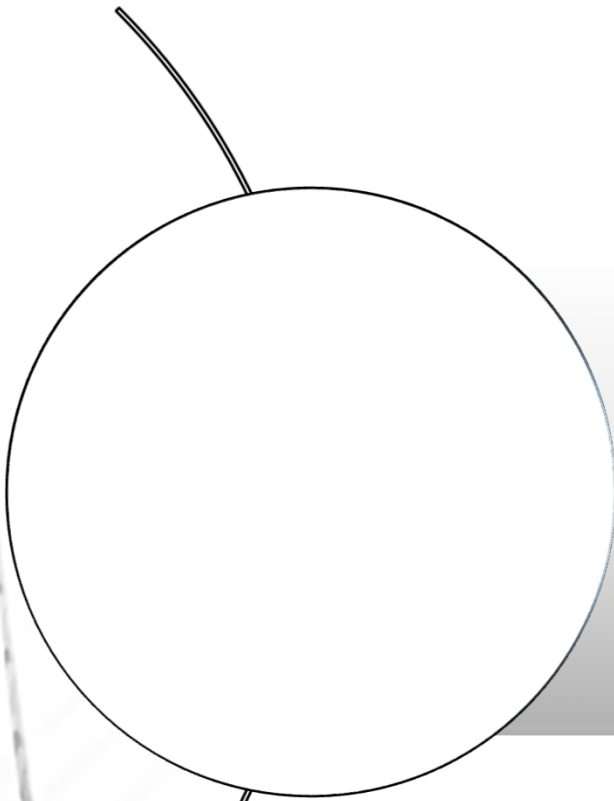
The beneficiary submits a written demand.

The surety company satisfies the claim within ten days.

There is not enough time for any settlement or adjustment before payment.



6. ADVANTAGES OF ON-DEMAND BONDS



The beneficiary must only submit the written demand to the surety company—due to principal's non-performance—and will collect the amount claimed within 10 days, otherwise default interest will accrue.



6.1 DISADVANTAGES OF ON-DEMAND BONDS

The surety company must satisfy the claim without proving the principal's non-compliance.

The absence of strict regulations in force governing the issuance of these bonds may give rise to intentional tort or fraud committed by the principal and/or the beneficiary.

According to the Commercial Code, the beneficiary is not bound to prove the principal's non-compliance.

In El Salvador the whole bonded amount—and not just the unfulfilled part of the contract—is usually claimed.



7. CONCLUSIONS

- On-demand bonds place the beneficiary in an advantageous position.
- In short they are more flexible than ordinary bonds favoring mainly the beneficiary, whose claim is satisfied just by submitting one simple written demand to the surety company.
- On-demand bonds should allow enough time to prove the principal's non-compliance and to make the corresponding adjustment, and should be paid in proportion to the unfulfilled part of the contract.

