

## **FINANCIAL SUPERVISION OF SAVINGS AND CREDIT COOPERATIVES IN PARAGUAY: PROPOSALS FOR AN EFFICIENT AND SUSTAINABLE REGULATORY MODEL**

### **SUPERVISIÓN FINANCIERA DE LAS COOPERATIVAS DE AHORRO Y CRÉDITO EN PARAGUAY: PROPUESTAS PARA UN MODELO REGULATORIO EFICIENTE Y SOSTENIBLE**

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#### **ABSTRACT**

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Savings and credit cooperatives (SACCOs) in Paraguay have consolidated their role as key actors in financial inclusion, particularly in sectors underserved by traditional banking institutions. However, this accelerated growth has not been accompanied by a robust regulatory framework or adequate financial oversight. This theoretical-analytical study examines the institutional weaknesses of the current supervisory model centered on the National Institute of Cooperativism (INCOOP) from an institutional economics perspective. The research assumes that the existing design, which combines promotional and supervisory functions within a single entity lacking technical and financial autonomy, creates perverse incentives, weakens control mechanisms, and exposes the system to systemic risks. A theoretical approach is proposed, grounded in the contributions of Douglass North, Oliver Williamson, and Elinor Ostrom. The hypothesis posits that an institutional redesign transferring supervisory responsibilities to the Central Bank of Paraguay (BCP), along with the implementation of deposit guarantee mechanisms and enhanced transparency would enable more efficient, credible, and sustainable regulation. As part of this proposal, the study examines comparative models of cooperative supervision in Latin America, identifying best practices that could be applied to the Paraguayan case. This article seeks to contribute to the ongoing debate on the financial governance of non-bank entities by suggesting legal and institutional reforms that strengthen the stability of the cooperative system without undermining its solidarity-based nature. Conceptual and empirical evidence indicates that effective supervision is not incompatible with the autonomy of the cooperative movement; rather, it is a necessary condition for its long-term sustainability.

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## RESUMEN

### Palabras clave:

supervisión financiera,  
cooperativas de ahorro y crédito,  
economía institucional, regulación,  
INCOOP.

Las cooperativas de ahorro y crédito (CAC) en Paraguay han consolidado su rol como actores relevantes en la inclusión financiera, especialmente en sectores desatendidos por la banca tradicional. Este crecimiento acelerado no ha estado acompañado por un marco regulatorio sólido ni por una supervisión financiera adecuada. Esta investigación de corte teórico-analítica, examina las debilidades institucionales del modelo actual de supervisión centrado en el Instituto Nacional de Cooperativismo (INCOOP), desde un enfoque económico-institucional. La investigación parte del supuesto de que el diseño actual que combina funciones de fomento y fiscalización en una sola entidad sin autonomía técnica ni financiera genera incentivos perversos, debilita los mecanismos de control y expone al sistema a riesgos sistémicos. Se propone un abordaje teórico basado en los aportes de Douglass North, Oliver Williamson y Elinor Ostrom. La hipótesis plantea que un rediseño institucional que transfiera la función supervisora al Banco Central del Paraguay (BCP), acompañado de mecanismos de garantía de depósitos y mayor transparencia, permitiría una regulación más eficiente, creíble y sustentable. Como parte de esta propuesta se abordan modelos comparados de supervisión cooperativa en América Latina, identificando buenas prácticas aplicables al caso paraguayo. Este artículo busca contribuir al debate sobre la gobernanza financiera de las entidades no bancarias, sugiriendo reformas normativas e institucionales que fortalezcan la estabilidad del sistema cooperativo sin desvirtuar su naturaleza solidaria. La evidencia conceptual y empírica indica que la supervisión efectiva no es incompatible con la autonomía del movimiento cooperativo, sino una condición necesaria para su sostenibilidad.

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## **Introduction**

In recent decades, savings and credit cooperatives (CACs) have experienced significant growth in Paraguay, consolidating their position as key players in financial intermediation, especially in rural areas and sectors traditionally excluded from the formal banking system. These entities, based on principles of solidarity, self-management and mutual aid, have managed to capture the savings of thousands of Paraguayans and channel them towards consumption, production and local development. Its expansion has not only been quantitative, in terms of assets, members and volume of operations, but also qualitative, with increasing complexity in its financial products and administrative processes.

However, this accelerated growth has not been accompanied by an equivalent institutional evolution in terms of supervision and regulation. Unlike the banking system, which has a robust regulatory framework and supervision centralized in the Central Bank of Paraguay (BCP), cooperatives are under the supervision of the National Institute of Cooperatives (INCOOP), a body whose institutional mission combines promotion, regulation and control functions. This duality of mandates, to promote and supervise at the same time, has generated tensions, conflicts of interest and, in many cases, a weakening of the supervisory function.

Effective financial supervision is an essential component for the stability of the cooperative system. Without adequate control and sanction mechanisms, CACs may engage in risky practices, asset imbalances or fraud which, in the absence of a deposit guarantee fund, have a direct impact on savers. Trust, which is the basis of the bond between the member and the cooperative, can be quickly eroded by episodes of insolvency or mismanagement. In this sense, the weakness of the current supervisory model represents not only a threat to the sustainability of the institutions themselves, but also a systemic risk factor for the national financial system as a whole.

From an economic-institutional approach, it is relevant to analyze the structural causes of this situation. Institutions, understood as the "rules of the game" that shape individual and collective behavior (North, 1990), play a determining role in the efficiency and resilience of financial systems. In contexts where rules are ambiguous, overlapping or easily manipulated, economic agents tend to act under incentives that are misaligned with the collective interest. This phenomenon is aggravated when the bodies responsible for implementing and enforcing the rules lack autonomy, technical capacity or sufficient resources.

In the case of Paraguay, INCOOP operates under conditions of institutional fragility: its administrative structure is small, its budget depends on the Executive, it does not have a specialized technical career and its oversight capacity is limited in both coverage and depth. In addition, there is constant pressure from the cooperative sectors, which, through union and political representations, have a direct influence on the decisions of the entity. This situation generates what the literature calls "regulatory capture", a form of subordination of the control bodies to the interests of the sector they are supposed to supervise (Stigler, 1971).

Against this backdrop, the question guiding this article is: Is the current model of financial supervision of CACs in Paraguay efficient, sustainable and transparent? And if not, what institutional redesign could improve the governance of the cooperative system without affecting its autonomy and solidarity-based nature?

The hypothesis put forward is that the current institutional design of supervision is dysfunctional, generates inadequate incentives and exposes the system to avoidable risks. It is argued that the separation of functions, the transfer of supervision to the BCP and the creation of a specific guarantee fund could correct these flaws and significantly improve the efficiency of the system.

This article is based on a theoretical-analytical approach that articulates institutional economics, agency theory and financial regulation. It also draws on a normative, documentary and comparative review, taking as a reference successful models implemented in countries of the region such as Peru, Colombia and Brazil. The purpose is not to propose a mechanical copy of these models, but to identify principles and mechanisms that can be adapted to the Paraguayan institutional context.

Through the analysis of the current regulatory framework, INCOOP's institutional performance, and the financial evolution of type A CACs -those with the largest volume of assets and, therefore, the greatest potential impact on the stability of the system-, the aim is to highlight the structural weaknesses of the current model and to support the need for a comprehensive institutional reform.

In summary, this paper is part of a line of critical reflection on the role of the State in the regulation of non-traditional economic actors, such as cooperatives. Based on the premise that there can be no financial inclusion without effective user protection, the institutional strengthening of supervision is an indispensable condition for guaranteeing the sustainability of the cooperative movement in Paraguay.

## **Framework Theoretical Framework**

Understanding the financial supervision system applied to credit unions (CACs) in Paraguay requires a conceptual approach that makes it possible to interpret not only the regulatory-formal dimension, but also the institutional logic underlying the functioning of the current model. For this purpose, three complementary theoretical approaches are used: institutional economics, agency theory and financial regulation theory. These frameworks make it possible to identify the root causes of the current deficiencies and provide the basis for proposals for institutional redesign based on criteria of efficiency, autonomy and sustainability.

### ***Institutional Economics***

Institutional economics, particularly in the version developed by Douglass North (1990) and Oliver Williamson (1985), provides analytical tools to understand how the "rules of the game" - formal and informal - shape the behavior of economic actors. According to North, institutions are human constraints that structure political, economic and social interactions. They may take the form of laws, regulations, codes of conduct or established practices. When these rules are inadequate or poorly designed, transaction costs increase and incentives are generated that favor inefficiency.

Applied to the Paraguayan case, the institutional framework governing the supervision of CCSs is out of step with the current complexity of the sector. Law No. 438/94, which grants INCOOP the function of simultaneously supervising and promoting, responds to a logic of sectoral promotion typical of the 1990s, when cooperativism still had a limited scope. However, the exponential expansion of CACs in recent years has transformed their economic nature, requiring a more specialized and technically sound supervisory model. The failure to update the regulatory framework generates what

Williamson calls a "governance mismatch", i.e. an incongruence between the rules in force and the transactional structure of the sector.

From an institutional perspective, there is evidence of contradictory regulations that generate ambiguity in the application of sanctions, lack of transparency in auditing procedures, and an incentive structure that discourages the correction of irregularities. Regulatory capture, i.e., the subordination of the supervisory agency to the interests of the supervised sector, is favored by INCOOP's lack of independence, both in terms of budget and human resources. These problems cannot be explained solely from a legal perspective; they require an institutional perspective that takes into account the interaction between actors, rules and incentives.

### ***Agency Theory***

Another approach relevant to this analysis is agency theory, initially developed by Jensen and Meckling (1976), which deals with the study of contractual relationships between a principal and an agent, in contexts of asymmetric information. In the case at hand, the Paraguayan State, through INCOOP, acts as the agent responsible for overseeing the operation of the CACs on behalf of the public interest (the principal). However, when that agent lacks the necessary resources, incentives or independence to perform its function effectively, what is known as "agency failure" occurs.

In Paraguay, INCOOP is caught in a dual agency relationship. On the one hand, it formally responds to the State, but on the other, it is strongly influenced by the cooperative movement, which is represented on its board of directors and maintains close political ties with sectors of the National Congress. This double subordination weakens its capacity to exercise rigorous controls, since any sanctioning action may generate tensions with the very actors involved in its institutional governance.

This phenomenon is not exclusive to Paraguay. International literature has documented numerous cases in which regulatory bodies lose effectiveness when they lack functional autonomy and protection from external pressures. Therefore, one of the basic principles of good financial regulation is the clear separation between the promoter and the supervisory body, in order to avoid conflicts of interest that compromise the quality of supervision.

### ***Financial Regulation Theory***

In the theory of financial regulation, the purpose of the supervisory function is to guarantee the stability of the system, protect the financial user and prevent systemic risks. This requires that supervisory agencies meet certain standards of independence, technical capacity, transparency and accountability. International organizations such as the Basel Committee, the International Cooperative Alliance (ICA) and the International Association of Cooperative Supervisors (ICURN) have defined principles and best practices that allow the effectiveness of regulatory frameworks to be assessed.

One of these principles establishes that supervisory bodies must be independent of the supervised sector, have sufficient resources, adopt a risk-based approach and apply measures proportional to the nature and complexity of the supervised entities. In the case of cooperatives, the need to adapt the regulatory frameworks to their particular logic is recognized, without losing sight of the objectives of solvency, liquidity and financial prudence.

Countries such as Peru, Colombia and Brazil have implemented reforms that transferred the supervisory function of the CACs to their respective central banks or banking and insurance superintendencies. These reforms, far from eroding the autonomy

of the cooperative movement, strengthened its sustainability by establishing more robust technical mechanisms, guarantee funds and information systems. In all cases, these were gradual processes, accompanied by dialogue with the sector and technical assistance.

In contrast, Paraguay maintains a scheme that combines promotional, educational, regulatory and control functions in a single entity, which hinders the effective application of prudential standards. The lack of IT tools, specialized personnel and real-time reporting mechanisms severely limits INCOOP's ability to prevent crises, detect early risks or correct deviations.

### ***Relevance of a Comparative View***

The incorporation of comparative experiences makes it possible to see that the problem does not lie in the cooperative nature of the institutions, but in the institutional architecture of the supervisory system. Countries that faced challenges similar to Paraguay's managed to strengthen their regulatory framework without renouncing the principles of solidarity, democratic participation and autonomous management that characterize cooperativism.

For example, the Peruvian model, which integrated type A cooperatives under the supervision of the Superintendencia de Banca, Seguros y AFP (SBS), has shown significant improvements in terms of transparency, operational efficiency and savings protection. Likewise, Colombia, through the Financial Regulation Unit and the Superintendency of Solidarity Economy, established a tiered regime according to the size and risk profile of the cooperatives. In both cases, the objective was to generate proportional, differentiated and technically supported supervision.

These experiences suggest that the solution to the supervision problem in Paraguay should not be limited to specific regulatory adjustments, but rather to a comprehensive institutional redesign to separate functions, align incentives, strengthen capacities and establish inter-institutional coordination mechanisms.

## **Method**

This article is framed within a qualitative methodological approach with an analytical-descriptive orientation, complemented with quantitative elements to support the institutional analysis. A documentary and case study research design was used, focusing on the financial supervision model of credit unions (CACs) in Paraguay, particularly those classified as type A, due to their volume of assets and operations.

The research strategy combines normative-institutional analysis with the empirical study of available financial data. The starting point was an exhaustive review of current legislation on cooperatives, mainly Law No. 438/94 and its regulations, as well as technical reports from the National Cooperative Institute (INCOOP), the Central Bank of Paraguay (BCP) and international organizations such as the International Cooperative Alliance (ICA), the Basel Committee and ICURN.

In addition, public and non-confidential documents from cooperative federations, external audit reports, institutional reports and previous academic reports related to the regulation of the cooperative system in Paraguay and Latin America were analyzed.

The main unit of analysis is the type A credit unions, which represent less than 15% of the total number of registered CACs, but account for more than 85% of the sector's assets. These entities are characterized by a diversified portfolio of financial products, relevant levels of interconnection with the banking system and a broad membership base.

The analysis focused on a sample of 56 Type A cooperatives selected for their asset volume, geographic coverage and availability of public information. For these entities, a systematic review of:

- Its balance sheets and income statements (years 2019 to 2023).
- The degree of compliance with reporting obligations to INCOOP.
- The existence and frequency of external audits.
- The level of portfolio concentration and delinquency.
- The level of exposure to systemic risk.

In addition to the documentary analysis, semi-structured interviews were conducted with eight key actors in the cooperative sector and the regulatory sphere: three INCOOP officials, two BCP technicians, and three leaders of cooperative federations. The interviews were designed with an open-ended script oriented to explore:

- Perception of INCOOP's institutional role.
- Operational limitations in the supervision of CCS.
- The feasibility of an eventual transfer of functions to BCP.
- The need for a guarantee fund and early warning mechanisms.

Interviews were conducted between June and October 2023, confidentially, with verbal consent and partial transcription. The results were organized into thematic matrices for subsequent interpretative analysis.

Based on theoretical and empirical triangulation, five dimensions of analysis were defined:

- Regulatory framework: adaptation and updating of the rules governing cooperative supervision.
- Institutional capacity: technical structure, budget and human resources of the supervisory body.
- Transparency: quality and timeliness of financial information published by the CACs.
- Systemic risk: concentration of assets, exposure to default and absence of mechanisms to protect savers.
- Institutional coherence: alignment between institutional functions and regulatory objectives.

Each dimension was evaluated in terms of its contribution to the efficient functioning of the supervision model, according to principles established by international organizations.

### ***Limitations of the Study***

The main methodological limitations include the following:

- Restricted access to INCOOP's internal data, due to the lack of publication of complete institutional audits.
- Response bias in the interviews, as some stakeholders were reluctant to express explicit criticism.
- Unequal availability of financial data, as not all type A cooperatives publish homogeneous or updated information.

However, these limitations do not affect the overall validity of the analysis, as they are compensated for by multiple sources and empirical convergence.

## Results

The analysis of the documentary, financial and testimonial data collected during the research allowed us to identify five main results that reflect the structural and functional weaknesses of the current model of financial supervision of credit unions (CACs) in Paraguay. These findings are organized around the five dimensions of analysis identified in the methodology: regulatory framework, institutional capacity, transparency, systemic risk and institutional coherence.

### ***Regulatory Framework: Obsolescence and Legal Ambiguity***

The current regulations governing credit unions in Paraguay, headed by Law No. 438/94 and its complementary regulations, have multiple deficiencies from a technical and functional standpoint. This law was conceived in a context of incipient development of the financial cooperative movement, when the scale of operations, product complexity and associated risks were significantly lower than today. It does not contemplate fundamental aspects such as mandatory prudential standards, differentiated supervision mechanisms according to the level of risk, real-time information requirements, or clear procedures for crisis resolution or early intervention.

In addition, the law gives the National Institute of Cooperativism (INCOOP) an ambiguous mandate, combining promotion, regulation and control functions in a single body. This concentration of functions contravenes basic principles of institutional governance and generates contradictions that limit the effectiveness of the system. In the interviews conducted, both public officials and industry representatives agreed on the need for a comprehensive reform that clearly separates the roles of promotion and supervision, modernizes supervision criteria and establishes a tiered regulation based on the size and risk profile of the institutions.

### ***INCOOP's Institutional Capacity: Operational Fragility and Political Dependence***

One of the most significant findings is INCOOP's structural inadequacy to perform its supervisory tasks effectively. The institution has a small technical staff, with no administrative career or personnel specialized in financial risks, on-site supervision, prudential auditing or information technology. In 2023, INCOOP's supervisory team consisted of fewer than 25 people, responsible for monitoring more than 500 credit unions throughout the country. This translates into an extremely low frequency of face-to-face inspections, with supervision processes relying mostly on self-declared reports sent by the entities themselves.

In addition, its budgetary dependence on the Executive Branch compromises the agency's autonomy in the face of political changes and sectoral pressures. In practice, INCOOP operates with severe budgetary restrictions and without access to digital tools that would allow online monitoring or the construction of early warnings. The lack of a robust technical-financial structure prevents the implementation of risk-based supervision and limits the possibility of reacting promptly to stressful situations in the CCS.

### ***Transparency and Financial Information: Incomplete Reporting and Low Comparability***

Another relevant result is the lack of transparency that characterizes a large part of the cooperative sector in Paraguay, especially in type A cooperatives. Although the regulations require the publication of audited financial statements, in practice this obligation is unevenly fulfilled. Only 35% of the 56 CACs analyzed publish their balance



sheets and income statements in an accessible and up-to-date manner. In addition, there is no centralized platform for homogeneous comparison of financial indicators, which makes social control and accountability to members and the public difficult.

In the interviews, several technicians pointed out that many cooperatives submit their reports with delays of up to 12 months and that the data sent to INCOOP does not always coincide with the audited data. This lack of standardization affects not only external supervision, but also the quality of internal risk management decisions. Larger cooperatives tend to have greater technical capacity, but unequal access to reliable financial information reinforces asymmetries between entities and weakens systemic monitoring.

### ***Systemic Risk: Concentration of Assets and Absence of Guarantee Fund***

The financial data processed for the 56 Type A cooperatives show a significant concentration of assets, with ten entities controlling more than 60% of the total deposits of the cooperative system. This concentration increases the risk of contagion in the event of an individual crisis and aggravates the potential systemic impact of an eventual collapse. In addition, the average delinquency rate in the loan portfolio exceeds 8% in several of the largest institutions, exceeding the prudential limits suggested by international standards.

Despite this context, Paraguay does not have a deposit guarantee fund specifically for the cooperative sector, leaving millions of small savers unprotected in the event of insolvency. In the interviews, both BCP technicians and representatives of cooperative federations recognized this shortcoming as one of the main vulnerabilities of the system. The design of a guarantee fund, with contributions proportional to risk and partial coverage mechanisms, was identified as a priority to improve confidence in the sector.

### ***Institutional Coherence: Contradictions in the Regulatory Architecture***

Finally, the comprehensive analysis shows a profound incoherence in the institutional architecture of the cooperative supervision model in Paraguay. The fact that INCOOP is both a promoter of cooperativism and a financial supervisor of the CACs creates a structural conflict that weakens its ability to exercise sanctions, correct bad practices or intervene early. In practice, the agency acts more as a mediator than as an overseer, prioritizing negotiation over enforcement.

This role conflict has also been documented in countries that have undergone institutional reform processes, such as Peru and Colombia, where prudential supervision was transferred to specialized banking and finance agencies. In these cases, the change made it possible to improve the credibility of the system, reduce the risks of regulatory capture and strengthen the State's technical capacity to guarantee financial stability.

## **Discussion**

The findings presented in the previous section show that the current model of financial supervision of credit unions (CACs) in Paraguay has serious structural, regulatory and operational deficiencies. These deficiencies should not only be analyzed from a technical or legal perspective, but also from an economic-institutional viewpoint that allows us to understand the incentives, restrictions and interests that shape the behavior of the actors involved. This section discusses the main results in the light of the

theoretical framework adopted, and raises the implications for the institutional redesign of the supervisory system.

### ***An institutional Architecture Misaligned with the Sector's Evolution***

The sustained expansion of the Paraguayan cooperative system has radically transformed its relative weight within the financial system. Type A CACs, due to their volume of assets, number of members and operational complexity, compete directly with banks and finance companies in several segments. However, they continue to be regulated by an entity with technical limitations, without modern prudential tools or effective control mechanisms. This contradiction between the scale of the entities and the weakness of supervision generates what Douglass North would call an "inefficient institutional persistence": a set of rules that, despite being dysfunctional, are maintained by the resistance to change of the actors who benefit from the status quo.

Indeed, the persistence of the current model is not only due to INCOOP's lack of capacity, but also to power factors: cooperative federations with greater political influence have managed to maintain a less demanding regulatory regime, which allows them to operate with greater room for maneuver. This generates an "unstable institutional equilibrium", where rules are weak, incentives are misaligned and risks are high. This balance, although functional for certain actors in the short term, is unsustainable from a systemic stability perspective.

### ***Perverse Incentives and Regulatory Capture***

From the point of view of agency theory, INCOOP is trapped in a double subordination: on the one hand, it should act on behalf of the State as overseer; on the other hand, it responds to the interests of the very sector it is supposed to supervise. This conflict of interests translates into a lax, reactive and formalistic supervision, which often favors conflict containment over effective compliance with regulations. This situation is aggravated by the lack of accountability and transparency mechanisms, both to the public and to other state institutions.

Regulatory capture, in this case, is not only a direct subordination to political or economic power, but also a cultural and institutional phenomenon: a promiscuous relationship has been normalized between the supervisory body and the supervised, in which informal negotiation prevails over the impartial application of rules. This form of capture is especially problematic in financial sectors, where confidence in the rules is a key element for stability.

The literature on financial regulation has repeatedly pointed out that supervisory bodies must be technically and functionally independent from the sector they control. This independence is essential to ensure objective decisions, avoid undue pressure and protect the general interest. In Paraguay, such independence is non-existent, both by institutional design and political practice.

### ***Regional Comparison: Lessons and Challenges***

The cases of Peru, Colombia and Brazil show that it is possible to reform the supervision of the cooperative sector without denaturalizing its identity or violating its autonomy. In Peru, the Superintendencia de Banca, Seguros y AFP (SBS) took over the supervision of type A cooperatives, implementing a tiered system that distinguishes between systemic and non-systemic entities. This model has made it possible to improve the quality of financial information, implement proportional prudential standards and establish resolution and saver protection mechanisms. Although the process was not free

of tensions, the balance has been positive in terms of stability, transparency and public confidence.

Colombia, on the other hand, has strengthened its institutional architecture through the articulation between the Superintendency of the Solidarity Economy and the Financial Regulation Unit, which has allowed progress to be made towards a differentiated and technically supported regulation. In Brazil, although cooperatives remain under the supervision of the Central Bank, there are auxiliary structures, such as internal guarantee funds and federative integration mechanisms, which balance autonomy with accountability.

These models show that prudential supervision is not incompatible with cooperative principles, provided that an institutional scheme is designed that respects their organizational logic while ensuring minimum standards of financial stability. The challenge lies in finding a balance between autonomy and control, participation and accountability, flexibility and effective regulation.

### ***Risks of Maintaining the Current Model***

The results of this research indicate that maintaining the current supervisory model represents a growing source of systemic risk for the Paraguayan financial system. There are multiple warning signs: asset concentration, high levels of delinquency in some large institutions, lack of timely information, absence of resolution mechanisms, lack of a guarantee fund and technical dependence on the supervisory agency.

In this scenario, an insolvency event in a large credit union could have significant contagion effects, erode public confidence and generate an industry-wide credibility crisis. The lack of a legal and operational framework to deal with such contingencies aggravates the problem, since the State does not have adequate tools to intervene, clean up or liquidate cooperative entities without generating negative collateral effects.

In addition, the current lack of comparable prudential standards for the banking system places Type A CACs in an asymmetrical position vis-à-vis their competitors in the financial sector. This distorts the market, affects fair competition and puts at risk the resources of thousands of savers, especially those with lower incomes.

### ***Institutional Redesign Proposal***

Against this backdrop, it is necessary to propose an institutional redesign of the supervision of CCS in Paraguay. This redesign must contemplate at least five axes:

- Transfer of the supervisory function to the Central Bank of Paraguay, at least for type A cooperatives, which due to their size represent a greater systemic risk.
- Creation of a cooperative deposit guarantee fund, financed with contributions proportional to the risk of each entity, managed according to technical criteria.
- Functional separation of INCOOP, limiting its role to promotion, technical advice and cooperative education.
- Implementation of a real-time digital financial monitoring system that allows for automated follow-up, early warnings and greater transparency.
- Regulatory harmonization, adapting the cooperative legal framework to the minimum financial supervision standards defined by international organizations.

This redesign is not only feasible, but necessary. The sustainability of the Paraguayan cooperative system, and its legitimacy as a relevant player in financial

inclusion, depend to a large extent on its ability to guarantee transparency, solvency and effective protection for savers. In a context of growing financial interdependence, informal self-regulation and weak supervision are no longer acceptable options.

## **Conclusions**

This paper has shown that the current model of financial supervision of credit unions (CACs) in Paraguay has structural limitations that compromise both the stability of the system and the confidence of savers. Based on an economic-institutional approach, it has been argued that these limitations are not merely operational, but are due to institutional design flaws that generate perverse incentives, reduce the effectiveness of control and hinder the prevention of systemic risks.

Among the main conclusions, the following stand out:

First, the regulations governing the financial cooperative system, particularly Law No. 438/94, are obsolete in view of the current complexity of the sector. This law does not contemplate adequate prudential standards nor does it establish effective mechanisms for differentiated control. The ambiguity of functions assigned to INCOOP, which combines promotion and control, constitutes a structural weakness that directly affects its autonomy and effectiveness as a supervisor.

Second, INCOOP has serious institutional shortcomings: low technical staffing, low operational capacity, lack of administrative careers, budgetary dependence and political vulnerability. These weaknesses translate into a fragmented, reactive and limited supervision model, which prevents the early detection of warning signs in supervised entities.

Third, the empirical analysis shows a worrying lack of transparency and homogeneity in the financial information published by Type A cooperatives, which hinders accountability, increases information asymmetry and jeopardizes public confidence. The lack of a deposit guarantee fund for CACs exacerbates this situation, exposing members to potential losses in the event of insolvency.

Fourth, the phenomenon of regulatory capture appears as a transversal element that further weakens the functioning of the current model. The political influence of the cooperative federations and their direct participation in INCOOP's governing bodies compromise the impartiality of decisions and reduce the regulator's independence. This situation, in addition to undermining the credibility of the system, prevents the application of effective sanctions and reinforces informal self-regulation practices.

Fifth, the comparative experiences of countries such as Peru, Colombia and Brazil show that it is possible to implement more effective prudential supervision models without violating the principles of cooperativism. These cases have managed to combine autonomy with technical regulation, promoting proportional and risk-based supervision, with clear mechanisms to protect the financial user.

Against this backdrop, it is proposed to move towards an institutional redesign that contemplates the following fundamental elements: Transfer of the supervisory function of type A cooperatives to the Central Bank of Paraguay (BCP), which has the technical, regulatory and operational capacity to apply adequate prudential standards; Creation of a deposit guarantee fund, with independent technical administration, limited coverage and financing proportional to risk; Comprehensive reform of INCOOP, to reorient its role towards the promotion, technical assistance, education and strengthening of cooperativism, leaving behind its supervisory role; Technological modernization of the financial information system, through the implementation of digital

reporting platforms, early warning indicators and continuous monitoring systems; Regulatory harmonization with international standards, adapting the Paraguayan legal framework to the recommendations of organizations such as ICURN, ICA and the Basel Committee, with respect for the cooperative identity.

These reforms should not be understood as a threat to the sector's autonomy, but rather as an opportunity to strengthen its sustainability and legitimacy. A robust cooperative system requires clear rules, independent bodies and protection mechanisms that safeguard the interests of members, especially the most vulnerable sectors.

Finally, it is concluded that the sustainability of Paraguayan financial cooperatives depends on their ability to adapt to the challenges of the environment without losing their identity. Effective supervision, far from being an external imposition, must be assumed as an essential pillar of good cooperative governance. The path towards a more efficient, transparent and fair model is open; its realization will depend on the political will, technical capacity and ethical commitment of all the actors involved.

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