



1. Project Data:		Date Posted : 02/27/2004	
PROJ ID: P078869		Appraisal	Actual
Project Name: Programmatic FSAL I	Project Costs (US\$M)	150	150
Country: Colombia	Loan/Credit (US\$M)	150	150
Sector(s): Board: FSP - Banking (40%), Capital markets (30%), Housing finance and real estate markets (20%), Non-compulsory pensions insurance and contractual (10%)	Cofinancing (US\$M)		
L/C Number:			
	Board Approval (FY)		3
Partners involved :	Closing Date	06/30/2003	06/30/2003
Prepared by :	Reviewed by :	Group Manager :	Group:
Elliott Hurwitz	Jorge Garcia-Garcia	Kyle Peters	OEDCR

2. Project Objectives and Components

a. Objectives

The objectives of the loan were to (1) complete the cleanup of the banking system as a result of the 1999-2001 crisis, and (2) put into place a framework to strengthen the government's capacity to manage and mitigate financial system weaknesses. Another objective was to strengthen and diversify participation in the housing mortgage market, including improved access to finance for the micro sector, as well as strengthening non -bank financial services and securities institutions.

b. Components

1. Bank Regulation and Resolution --Implementation of a reformed law to enhance financial system sustainability

Bank Regulation

(a) Enhance the independence of decision-making by Financial Institutions' (FI) boards of directors; (b) enhance existing code of conduct for managers and directors at FIs; (c) integrate sanctions and rules applicable to administrative officers, boards of directors and auditors at FIs; (d) increase the powers of the Superintendency of Banks (SB) to supervise consolidated financial groups including those principally supervised by other agencies; (e) prevent conflicts of interest related to the operations of FIs; (f) strengthen SB's power to intervene FIs and apply sanctions; (g) strengthen existing regulations that prevent money laundering; and (h) regulate FIs' obligations to directly report information on cash transactions to MoF's anti-money laundering monitoring unit.

Bank Resolution

Strengthen: (a) compulsory procedures for asset and liability transfers and carve-outs from failing banking institutions; (b) Deposit Insurance Agency's (FOGAFIN) issuance of guarantees backed with deposit insurance funds; and (c) FOGAFIN's power to swap bonds issued by the securitization trust with FOGAFIN bonds. In addition, (a) Transfer Industrial Development Bank's (IFI) selected assets and liabilities to BANCOLDEX; (b) FOGAFIN to commence BANCAFE privatization; and (c) through FOGAFIN, select investment firm to implement this privatization.

Financial Sector Review

Undertake a stocktaking review of the financial sector, including : (a) the risks affecting weak banking institutions under low growth scenarios; (b) the banking sector's cash flow generation; (c) public debt securities held by commercial banks and accompanying risks; and (d) contingency plans to address potential risks caused by internal and/or external factors affecting the financial sector.

2. Housing Finance

(a) Streamline bank foreclosure-related judicial proceedings, thereby executing collateral in a timely manner; (b) Ministry of Finance (MoF) to issue decree establishing procedures for enabling finance companies to obtain financing from commercial banks to increase housing micro credit lending; (c) enhance access to housing micro credit of population segments that have limited access to financial services, and enhance the participation of banks in the housing lease market; (d) FOGAFIN to issue operational guidelines for new swap program to protect mortgage

borrowers against inflation risks; and (e) Central Bank (CB) to adopt procedures for swapping of mortgage backed securities through the FRECH fund, in order to acquire more liquid treasury securities .

3. Non-bank Financial Institutions

Establish: (a) MoF powers to determine solvency margins and technical reserves of the insurance industry, (b) minimum capital requirements for insurers and reinsurers; and (c) MoF powers to establish minimum capital requirements for the different lines of insurance business .

4. Capital Markets

(a) SB issue guidance to update and adjust market valuation regulations; (b) Securities Superintendency (SV) to issue resolution to establish a common securities and financial asset valuation methodology to unify market pricing norms; and (c) SB and SV to sign a memorandum of understanding to carry out joint supervision and surveillance of FIs and securities brokers and dealers .

5. Government Debt and Money Markets

(a) CB board to issue procedures for purchase of on -the-run securities (traded securities reflecting the series most recently issued); (b) MoF to issue resolution to regulate primary dealer operations; and (c) SV issue resolutions to regulate valuation of domestic treasury securities .

c. Comments on Project Cost, Financing and Dates

The loan is the first of two envisioned adjustment operations designed to strengthen the government's capacity to regulate the financial sector and manage and mitigate sectoral weaknesses . This first operation is designed to establish a stronger legal and regulatory framework, while the second operation will focus on the effective implementation of these measures .

3. Achievement of Relevant Objectives:

1. Bank Regulation and Resolution --Implementation of a reformed law to enhance financial system sustainability

Bank Regulation

The Government enacted Law 795-2003 which achieved all of the Bank Regulation goals listed above in sec .

2.b.1.(a-f) SB issued Circular Externa No. 046, dated October 29, 2002, strengthening regulations that prevent money laundering. Law 795-2003 also establishes FIs' obligations to report information on cash transactions to MoF's anti money laundering monitoring unit.

Bank Resolution

Law 795-2003 established compulsory procedures for asset and liability transfers and carve -outs from failing banking institutions, and provides for additional FOGAFIN's powers as specified above in sec . 2. Additional actions included:

(a) IFI's shareholders assembly of January 27, 2003, approved transfer of IFI's selected assets and liabilities to BANCOLDEX; (b) through CONPES, Document Number 3214 dated January 9, 2003, requested FOGAFIN to commence the privatization of BANCAFE, and (c) FOGAFIN has selected an investment firm to carry out the privatization.

Financial Sector Review

(a) MoF issued a commitment letter to the Bank dated March 28, 2003, to undertake a stocktaking review of the Borrower's financial sector including all commitments listed in sec . 2.b.1, above.

2. Housing Finance

(a) Law 794-2003 was enacted which streamlines banking foreclosure related judicial proceedings; (b) MoF issued Decree No. 710 (March 20, 2003) establishing procedures for finance companies to obtain financing from commercial banks; (c) Law 795-2003 also encourages increased access of underserved segments of the population (by permitting additional administrative fees to microfinance transactions and broadening access to credit guarantees); (d) FOGAFIN issued operational guidelines for a new swap program to protect mortgage borrowers against the risks of inflation; and (e) the CB adopted procedures for swapping of mortgage backed securities in order to acquire more liquid treasury securities .

3. Non-Bank Financial Institutions

Law 795-2003 also established: (a) MoF's powers to establish solvency margins and technical reserve of the insurance industry, (b) minimum capital requirements for insurers and reinsurers; and (c) MoF's powers to establish minimum capital requirements for different lines of insurance business .

4. Capital Markets

SB issued: (a) Circular 033 (August 2, 2002) to update and adjust market valuation regulations; (b) Resolution 0550 (August 2, 2002) to establish a common securities and financial asset valuation methodology to unify market pricing norms. In addition, SB and SV signed a memorandum of understanding (November 13, 2002) to carry out joint supervision and surveillance of FIs and securities brokers and dealers .

5. Government Debt and Money Markets

(a) The CB's board issued procedures for its purchase of on -the run securities; (b) MoF issued Resolution Number

001 (January 2, 2003) to regulate primary dealer operations; and (c) SV issued Resolutions Number 0964 and 1047 (December 13, 2002 and December 30, 2002) to regulate the valuation of domestic treasury securities .

4. Significant Outcomes/Impacts:

- The passage of Law 795-2003 provides a legal foundation for strengthened financial sector regulation

5. Significant Shortcomings (including non-compliance with safeguard policies):

- The capacity of government agencies and financial institutions lagged behind the reforms required or enabled by the loan. It would have been useful to have a companion TA loan to address these deficiencies

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Satisfactory	While OED concurs with the rating of satisfactory, it notes that the efficacy of the provisions of this project will not be known for some time since they have to be tested when the situations they are designed to address occur in practice . OED also wishes to note that, while the Colombian economy is showing signs of recovery: (1) The existence of an IMF program, per se, is not sufficient evidence that the macroeconomic program is satisfactory; (2) The country still has to solve serious fiscal and debt problems before it can be concluded that the macroeconomic framework is satisfactory .
Institutional Dev .:	Substantial	Substantial	
Sustainability:	Likely	Likely	
Bank Performance:	Highly Satisfactory	Satisfactory	The ICR presents insufficient evidence of Bank Performance to warrant a rating of highly satisfactory .
Borrower Perf .:	Highly Satisfactory	Satisfactory	The ICR presents insufficient evidence of Borrower Performance to warrant a rating of highly satisfactory .
Quality of ICR:		Satisfactory	

NOTE: ICR rating values flagged with '*' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

- An improved macroeconomic environment--with the important exception of the high fiscal deficit and public sector debt--provided a relatively favorable environment for this operation .
- Before PFSAL II is initiated, it would be critical to complete the sector assessment undertaken in this project (see sec. 2.b.1)
- The nature of PFSAL I, which requires passage of legislation and promulgation of regulations, strongly suggests that the Bank team should work closely with the members of Congress to convey and convince them of the importance and benefits of the proposed reforms .
- The passage of new legislation and promulgation of complex regulations, as part of a financial sector reform program, should be accompanied by a commitment from the government to upgrade technical skills

8. Assessment Recommended? ☐ Yes ☒ No

9. Comments on Quality of ICR:

The ICR is satisfactory; it competently describes the PFSAL I program, the realization of this first phase, and the economic and sectoral context . The ICR also provides ample data on macroeconomic performance and indicators of the health of the banking sector .