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COLOMBIA

FINANCIAL SECTOR ASSESSMENT

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A joint IMF and World Bank team conducted virtual missions to Colombia in May, June, September and November 2021 to update the findings of the Financial Sector Assessment Program (FSAP) conducted in 2012.[1] This report summarizes the main findings of the mission, identifies key financial sector vulnerabilities and developmental issues, and provides policy recommendations.

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GLOSSARY

ACH	Automated Clearing House
AFP	Private Pension Funds (Administradora de Fondos de Pensiones y de Cesantías)
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
API	Application Programming Interface
AUM	Assets Under Management
BCP	Basel Core Principles
BO	Beneficial Ownership
BR	Central Bank of Colombia (*Banco de la República*)
BVC	Colombian Stock Exchange (*Bolsa de Valores de Colombia*)
CAR	Capital Adequacy Ratio
CCB	Capital Conservation Buffer
CCSSF	Financial Sector Coordination & Monitoring Committee (*Comité de Coordinación y Seguimiento del Sistema Financiero*)
CET1	Core Equity Tier 1
CF or FC	Financial Conglomerate (*Conglomerado Financiero*)
CFC	Collaborative Financing Companies
CI	Credit Institution
CIF	Collective Investment Funds
CIR	Resolution Intersectoral Commission (*Comisión Intersectorial de Resolución*)
CONPES	National Council for Economic and Social Policy (*Consejo Nacional de Política Económica y Social*)
COP	Colombian Peso
CRCC	Central Counterparty Clearing House
DGPE	General Directorate of State Participations (*Dirección General De Participaciones Estatales*)
DIAN	Taxes and Customs Directorate (*Dirección de Impuestos y Aduanas Nacionales*)
DNFBP	Designated Non-Financial Business and Professions
DNP	National Planning Department (*Departamento Nacional de Planeación*)
e-KYC	Electronic Know-Your-Customer
ELA	Emergency Liquidity Assistance
ESG	Environmental, Social, and Governance
FAG	Agricultural Guarantee Fund (*Fondo Agropecuario de Garantías*)
FATF	Financial Action Task Force
FCL	Flexible Credit Line
FCP	Private Capital Funds (*Fondos de Capital Privado*)
FMI	Financial Market Infrastructure
FNA	National Savings Fund (*Fondo Nacional del Ahorro*)
FNG	National Guarantee Fund (*Fondo Nacional de Garantías*)
Fogafin	Deposit Insurance Fund (*Fondo de Garantías de Instituciones Financieras*)
GAFILAT	Financial Action Task Force of Latin America
GB	State-owned financial conglomerate (*Grupo Bicentenario*)
GR	Resolution Group (Grupo de Resolución)
HQLA	High Quality Liquid Assets
IAIS	International Association of Insurance Supervisors
IBR	Interbank Overnight Rate (*Indicador Bancario de Referencia*)
ICP	Insurance Core Principles
ICR	Interest Coverage Ratio
IFRS	International Financial Reporting Standards
INFI	Subnational development banks (*Institutos Financieros de Fomento y Desarrollo*)
IPNNC	Personal Insolvency Law (*Insolvencia de Personas Naturales No Comerciantes*)
IRL	Liquidity Risk Index (*Índice de Riesgo de Liquidez*)
LCR	Liquidity Coverage Ratio

LTV	Loan to Value
MHCP	Ministry of Finance and Public Credit (*Ministerio de Hacienda y Crédito Público*)
MER	Mutual Evaluation Report
MSME	Micro, Small and Medium Enterprises
NDC	National Determined Contributions
NPL	Non-Performing Loan
NPS	National Payment System
NSFR	Net Stable Funding Ratio
PAD	Program to Support Debtors (*Programa de Acompañamiento de Deudores*)
P2P	Peer-to-Peer lending
RAM	Risk Assessment Matrix
ROE	Return on Equity
RRP	Recovery and Resolution Planning
RWA	Risk Weighted Assets
SAS	Simplified Equity Companies (*Sociedad por Acciones Simplificada*)
SDG	Sustainable Development Goals
SEDPE	Companies Specialized in Electronic Payments and Deposits (*Sociedades Especializadas en Depósitos y Pagos Electrónicos*)
SFC	Superintendency of Financial Institutions (*Superintendencia Financiera de Colombia*)
SIC	Superintendency of Industry and Commerce (*Superintendencia de Industria y Comercio*)
SIFI	Systemically Important Financial Institution
SOFI	State-Owned Financial Institutions
SS	Superintendency of Companies (*Superintendencia de Sociedades*)
TDA	Agricultural Development Bonds (*Títulos de Desarrollo Agropecuario*)
TES	Short-Term Treasury Securities (*Títulos de Tesorería*)
UIAF	Information and Financial Analysis Unit (*Unidad de Información y Análisis Financiero*)
URF	Financial Regulation Agency (*Unidad de Regulación Financiera*)
WEO	World Economic Outlook

EXECUTIVE SUMMARY

The banking system entered the COVID-19 pandemic from a position of relative strength, and the authorities mounted a strong policy and support response. In addition to a substantial fiscal and monetary response, the Superintendency of Financial Institutions (SFC) allowed the release of countercyclical provisions, and banks were allowed to provide temporary grace periods, extensions, and other loan modifications. Further, the SFC launched the Program to Support Debtors (PAD) to support viable borrowers, which was phased out at end-August 2021. The corporate vulnerability analysis shows that while the pandemic shock led to a deterioration in repayment capacity and profitability in 2020, it did not trigger widespread systemic failures thanks to pandemic-related policy actions. Looking ahead, bank solvency appears resilient to stress, while the liquidity stress tests indicate some vulnerability to very severe pressures.

Although the financial system has weathered the pandemic relatively well so far, it faces some structural and emerging risks. The financial system is dominated by large and complex financial conglomerates (FC) with increasing cross-border exposures that make the monitoring of interconnectedness and contagion channels essential. Colombian conglomerates have become systemic players in several Central American countries. While considerable progress has been made in cross-border information sharing and supervisory cooperation, further development of monitoring tools to bolster early-warning systems (EWS) is recommended. Moreover, resolution planning for cross-border institutions should be strengthened. In the domestic banking system, although overall pre-pandemic credit growth was contained, consumer credit growth, particularly in the unsecured segment was growing rapidly, and this portfolio was subsequently had high impairment rate during the pandemic. As lending to households is expected to grow strongly after the pandemic, closing data and oversight gaps on the indebtedness of households is needed.

The authorities have taken important steps to strengthen and develop the financial system since the last FSAP. Financial supervision and systemic risk oversight have been enhanced. Importantly, the law giving the SFC supervisory and regulatory powers over the holding company of a financial conglomerate ("Conglomerates Law") has been approved in 2017. Strong and sustained public sector commitment towards financial inclusion coupled with relevant legal and regulatory reforms paid off with the achievement of access targets, though digital payments are lagging, and inequalities persist due to high costs and frictions among others. A thorough diagnostic and consensus building between public and private stakeholders under the 2018 Capital Markets Mission has led to several legal reforms, though challenges remain. The insurance sector is in a mid-development phase and experiencing considerable change, with inclusive insurance gaining relevance and with ample scope to increase coverage to a greater share of the population. Finally, Colombia is at the forefront in the region in developing a supportive regulatory and supervisory environment to facilitate capital mobilization towards sustainable projects and enhance the financial sector's role in managing climate-related risks. The successful launch of a sovereign green bond and the upcoming adoption of a green taxonomy are important policy steps.

The Basel Core Principles (BCP) review shows significant improvements to the regulatory and supervisory framework and highlights a few areas for further enhancement. The implementation of the Conglomerates Law and the authorities' move to gradually implement Basel III requirements have resulted in a stronger framework for banking supervision. Although, the operational independence of the SFC has been largely enhanced since 2015, the SFC and its staff continue to lack legal protection for acts carried out in good-faith performance of their official duties. The recommendation to make large exposure and related-party limits more comprehensive and streamlined has not been implemented yet but appears to be in progress. Areas for further improvement include developing more specific guidance on concentration, transfer and country risks, related party transactions, internal capital assessment and the interest rate risk in the banking book, introducing additional formal safeguards to enhance the operational independence of the SFC, and adjusting or defining some parameters used in the computations of the local liquidity ratios to further align with Basel III requirements.

The institutional and regulatory framework for competition in the financial sector should be strengthened to further support enforcement, while risks to maintaining a level playing field persist and may require additional competition safeguards. Despite relatively high levels of concentration and immaterial movements in market shares, declining lending rates and high costumer mobility – partly due to the practice of portfolio purchases – indicate the presence of competitive dynamics in the banking sector. Close monitoring of certain practices between financial and real sector entities is warranted given their potential exploit by dominant players in a country with presence of large economic groups. The *Grupo Bicentenario* needs to be assessed from a competitive neutrality perspective to ensure a level playing field with private operators. Key elements of the payment system-infrastructure are vertically integrated and controlled by commercial banks, potentially affecting access of smaller and new players. Finally, the cooperation between the SFC and the SIC and their enforcement powers need to be strengthened, together with the development of a systemic regulatory impact assessment on competition.

While Colombia has made steady progress on financial inclusion, there is a need to accelerate structural reforms as a precondition for increasing digitalization of financial services. While the institutional framework for financial inclusion was recently revamped, the articulation between the public policy and the newly formed intersectoral commission should be clarified along with the role of the BR in the national financial inclusion agenda (consistent with its mandate). Closer coordination of the digital inclusion and digital government agendas should be pursued. Authorities should leverage on the draft payment system law to set out functional requirements and expand the range of entities that may provide payment services, while ensuring coordination in the respective regulatory powers of the MHCP and BR. The recent open finance regulatory initiative may result in new and improved services being made available to individuals and firms but requires sound governance arrangements to ensure a balanced distribution of value amongst stakeholders. Authorities should monitor the impact of recent reforms on barriers to access to low-value payment systems and interoperability and stand ready to induce prompt corrective action. In consultation with the industry, authorities should draw up a fast payment roadmap with a time-bound plan to overcome the issues affecting the development of fast payments. Lastly, there is still scope to further digitize social benefit payments and introducing beneficiary choice as well as other key drivers of financial inclusion (e.g., basic product design, interoperable access points/channels, awareness and financial literacy).

State-owned financial institutions (SOFIs) and broader interventions by the state need to play a more prominent role in supporting financial inclusion, green activities and fostering competition among private financial providers. While SOFIs have been generally perceived as complementary to the private sector, their recent incursion into direct lending and commercial activities could raise competitive neutrality considerations, if subsidies are involved. Improving product design, incorporating best practices, strengthening governance, and continuing to improve risk management would support expansion of SOFIs activities in a non-distortionary way. Interventions could be better coordinated to improve efficiency, avoid duplication, and ensure alignment with policy objectives. The formalization of *Grupo Bicentenario* should contribute to these objectives. Monitoring and evaluation (M&E) of public credit support policies and programs could be strengthened. Finally, interest rate controls and mandatory investment requirements to fund the agricultural sector should be reviewed to limit distortions.

Colombia has a well-developed market for NPL management, while the insolvency framework is in a stage of transition and with areas for improvement. Strong and efficient NPL resolution and insolvency frameworks are key for financial sector stability and development. There is an active and competitive market for sales of written-off loans, mainly in unsecured segments, with an extensive availability of investors and market infrastructure. Active resolution of NPLs should continue to be encouraged by the SFC, particularly for commercial NPLs, for which NPL management by third-party providers is scarce. Several recent regulations related to the insolvency framework have been introduced, including temporary emergency decrees that make considerable modifications to the corporate insolvency system. This transitory situation creates uncertainty in the users of the insolvency system, in particular large corporations, and creditors. The incorporation of some of the provisions from these temporary decrees into the bankruptcy law would be advisable. The ultimate judge of corporate insolvency is an administrative entity (the Superintendency of Companies) which is specialized and enjoys good reputation, but the rotation of its authorities and the executive’s capacity to remove them poses severe challenges for the predictability of its criteria. Finally, the personal insolvency system requires urgent attention.

Table 1. Colombia: Key Recommendations

Recommendation[2]	To be adopted by	I/ST/MT*	Paragraph
Banking supervision			
Introduce necessary legal amendments to strengthen the independence of the SFC: (i) specifying that the Superintendent is appointed for a minimum term and removed from office only for reasons specified in the law; and (ii) provide explicit legal protections to the SFC.	SFC, URF	MT	33
Develop more specific guidance/regulations on concentration, transfer and country risks, related party transactions, internal capital assessment and the IRRBB.	SFC	MT	36
Establish a consolidated body of requirements on related-party transactions.	URF	ST	35
Readjust or determine some parameters used in the computation of the local LCR and NSFR ratios to further align with Basel III requirements and require the local NSFR ratio to be also calculated at a consolidated level.	SFC	MT	37
Maintain a direct and intrusive supervision of banks by the SFC, including an adequate level of on-site inspections, and avoid over-reliance on external and internal auditors when performing supervisory tasks.	SFC	ST	38
Climate risks and opportunities			
Channel public sector resources strategically to boost investments in climate and environmental priorities, through targeted fiscal incentives to induce greater supply and demand for green finance instruments, and the strategic use of SOFIs.	MHCP	MT	31
Improve the availability of climate-relevant data through implementation of the green taxonomy, alignment of disclosure standards with global best practices, and enhanced oversight of ESG data providers and external reviewers.	SFC	ST-MT	31
Competition in the Financial Sector			
Reinforce inter-institutional cooperation between SFC and SIC to promote competition in the financial sector through an MoU complemented by an Action Plan to foster implementation.	SFC, SIC	I	36
Strengthen the competition regulatory framework economy-wide, including revised procedures to review mergers and acquisitions in the financial sector.	Executive, Parliament, SFC, SIC	ST-MT	37
Develop tools to embed competition in financial markets through advocacy/competition *Regulatory Impact Assessments (RIAs).*	URF, SFC, SIC	ST	38
Strengthen implementation of the competitive neutrality framework, especially in the context of the newly established *Grupo Bicentenario*.	Executive, Parliament, SFC, SIC, MHCP	I-ST	33
Digital Financial Inclusion			
Clearly articulate and coordinate the powers of authorities in charge of regulating, supervising, and overseeing payment systems, schemes, and instruments.	MHCP, BR	I	41
Develop governance arrangements for open finance with the objective to ensure functionality of third-party services and a balanced distribution of value across stakeholders while maintaining flexibility to regulate specific aspects as needed.	URF, SFC	ST	42
Draw up a roadmap for fast payments setting out clear roles for the public sector/Central Bank and the private sector.	MHCP, BR	ST	43
Role of the State in the Financial Sector			
Evaluate impact of credit ceilings and mandatory investments as well as options for modification.	DNP, BR,	ST-MT	46

[2] For recommendations on financial stability topics, see the IMF's Financial System Stability Assessment (FSSA).

Formalize *Grupo Bicentenario* (GB) to begin operations with a view to improve efficiency and synergies among SOFIs by: (i) updating CONPES 3851 and board appointment policies to clarify the permanence of the role of the MHCP/DGPE, introduce the role and purpose of the GB, and to establish a clear division of labor between the MHCP/DGPE and the GB; (ii) appointing permanent boards and managers to the GB.	DNP, MHCP	ST	48
Enhance M&E of public credit programs by: (i) compiling information on programs in ARCO platform (ii) conducting a program review of public policies and programs to support credit incorporating functional and impact assessment.	DNP, MHCP	ST-MT	53
Insolvency, Creditor Rights and NPL Resolution			
Encourage banks to reduce NPLs and forborne exposures to historical trends.	SFC	ST	55
Ensure that removal of the remaining deviations from IFRS 9 regarding individual level loan reporting and provisioning proceed as planned.	SFC, URF	MT	54
In the short term, extend the temporary application of the emergency decrees. In the medium term, enact a unified Insolvency Law to centralize regulations into a single and accessible piece of legislation.	Parliament, SS	ST-MT	56
Strengthen the personal insolvency system by i) creating a data collection body to monitor personal insolvency; ii) having personal insolvency cases heard in specialized courts by specialized judges within the existing jurisdiction (municipal courts); and iii) extending the secured creditor status created by Law 1676 to personal insolvency cases.	Parliament, Consejo Superior de la Judicatura	MT	57
Strengthen the enforcement of mortgages and unsecured claims and consider introducing an effective out-of-court workout enforcement mechanism.	Parliament, Consejo Superior de la Judicatura	MT	57
Resolve the lack of predictability of the system by professionalizing the functions of the Delegate Superintendent of Bankruptcies	Parliament. SS	MT	57
Insurance			
Review distribution regulation to reflect the increasing use of new channels.	SFC, URF	MT	62
Maintain momentum in the implementation of the consumer protection SupTech project.	SFC	ST	62
Ensure that implementation of IFRS 17 and Solvency II proceed on schedule, with a close supervision of margins and capital of insurance companies during the transition period.	SFC, URF	ST-MT	61
Capital Markets Development			
Approve draft Law 413 preserving critical reforms regarding capital markets.	Parliament	I	64
Resume past efforts to eliminate (or gradually reduce) the 4x1000 financial transaction tax.	DIAN, MHCP	MT	65
Introduce flexibility in the application of the mandatory investment in private capital funds when issuing implementing regulation of Law 2112 of 2021.	SFC	ST	69
Redefine the concept of net worth loss (*detrimento patrimonial*) in the management of public assets.	URF	ST	69

* I: Immediately; ST: short term= less than 1 year; MT: medium term= 1–5 years.
BR: *Banco de la República*; DIAN: *Dirección de Impuestos y Aduanas Nacionales*; DNP: *Departamento Nacional de Planeación*; MHCP: *Ministerio de Hacienda y Crédito Público*; SFC: *Superintendencia Financiera de Colombia*; SIC: *Superintendencia de Industria y Comercio*; SS: *Superintendencia de Sociedades*; URF: *Unidad de Regulación Financiera*.

BACKGROUND

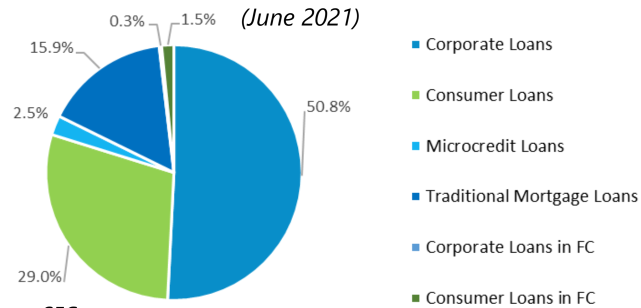
A. Macrofinancial Context

1. **Colombia has strong macroeconomic framework and policies, but the economy is still relatively dependent on commodity exports and is exposed to capital-flow shocks.** With commodity exports amounting to about half of total exports, the economy is highly exposed to terms of trade shocks. Moreover, Colombia is exposed to changes in external financial conditions via high nonresident participation in the local bond market, at about 8 percent of GDP and 24 percent of the total holdings before the pandemic. Before the onset of the pandemic, a flexible exchange rate, central bank credibility under an inflation targeting framework, a medium-term fiscal rule, and strong institutions helped withstand external shocks and promote economic growth. External vulnerabilities are limited by adequate foreign reserves buffers and access to a Flexible Credit Line (FCL) from the Fund.

2. **The pandemic led to Colombia's first recession in over 20 years and the largest on record.** GDP fell by about 7 percent in 2020 in response to lockdowns, spillovers from lower oil prices, and the collapse of global growth (Figure 2). The severe downturn and the need to respond to the pandemic led to a substantial widening of the budget deficit, and the fiscal rule was suspended. The contraction triggered job losses, with unemployment reaching record levels and labor force participation dropping. As restrictions were eased in Q3 2020, activity started to recover, and economic growth bounced back stronger than expected at about 10.6 percent in 2021.

Figure 1. Colombia: Banking Sector Gross Loans by Type

(June 2021)



Source: SFC

3. **Before the pandemic hit, credit had recovered in line with the economic cycle after the 2014–16 oil price shock.** Increased competition in the banking sector had reduced costs and boosted consumer credit growth (Figure 3). In particular, growth in unsecured lending ("Libre inversion") was high and concentrated in the two largest FCs. Overall mortgage loan growth was more modest and concentrated in the subsidized housing loan segment. Rising only gradually to about 23 percent of GDP at end-2021, household indebtedness is relatively low, but there are shortcomings in the data for consumer debt. FX lending by banks is low, and the rise in corporate FX debt relative to GDP in recent years is mostly due to the peso's depreciation following the oil price shock in 2014–16. Leverage of large corporates increased significantly after 2013, mostly due to the aforementioned depreciation. FX denominated debt is about 35 percent of the private sector corporate debt. This relatively high level of corporate FX debt makes corporates vulnerable to a potential tightening of global financial conditions.

4. The authorities mounted a strong response to help banks deal with the crisis and avoid a tightening of credit supply. The SFC allowed the release of countercyclical provisions built up in the past. Banks were allowed to provide temporary grace periods, extensions, and other loan modifications on a case-by-case basis, without affecting the debtor's credit rating or leading to a reclassification of the loan as nonperforming, but provisioning rules were not relaxed. The SFC launched the Program to Support Debtors (PAD) to support viable borrowers, which was phased out at end-August 2021. It triaged borrowers according to the degree to which they had been affected by the crisis, with higher provisioning for those debtors severely affected by the pandemic.[3] The transition of loans under the PAD to the ordinary regulation is expected to be relatively smooth; by the end of the PAD, loans under this program represented only 6.8 percent of total gross loans.[4]

5. The impact of COVID-19 on nonbank financial institutions has been mixed. Most notably, collective investment funds (CIFs) faced significant investor withdrawals of COP 24.6 trillion during March 2020, resulting in 32 percent decline in total assets. The fire sale pressure on CIFs was subsequently alleviated by extraordinary liquidity support by BR. This led to an increase in retail deposits at banks, and CIFs' AUM returned to pre-pandemic levels by end-2020. COVID-19 also had an impact on insurance companies, as claims on life insurance products saw a sharp increase, cutting profitability in 2020.

B. Financial System Overview

6. Colombia's financial system is large and complex. Credit institutions' assets are equivalent to about 76 percent of GDP, followed by trust companies and private pension funds and, to a lesser extent, by insurance companies. The share of pension funds and trusts has increased considerably since the last FSAP (Table 2).

7. Financial conglomerates lie at the core of an interconnected financial system. Domestically, conglomerates own assets of both financial and nonfinancial entities, with the five largest conglomerates controlling 60 percent and 80 percent of financial system and banking sector assets, respectively (Figure 4). Banks lie at the core of the financial network, providing the main source of financing for households and nonfinancial corporations, while figuring prominently as an asset in the balance sheets of investment funds, insurers, securities firms, and trusts. Asset concentration in bank securities is due in part to the limited development of domestic capital markets (with market capitalization of about 40 percent of GDP), which restricts domestic investment alternatives beyond government and bank securities for institutional investors

8. The growing size and complexity of financial conglomerates have come with increasing cross-border exposures in the system. Colombian conglomerates are now present in 14 countries in various business lines, including banking, insurance, and asset management services,

[3] Two additional regulatory provisions were introduced to account for: (i) accrued but not collected interest from grace periods granted during the first wave of measures, and (ii) the expected losses that may arise from a further deterioration in economic outlook, resembling the IFRS9 forward-looking estimates.

[4] The NPL ratio, which was already in a declining trend since reaching 5.2 percent in January 2021, has continued to fall after the phasing-out of the PAD, reaching 4.2 percent in November 2021, driven primarily by consumer credit.

and have become systemic players in selected Central American markets (Figure 5). Financial entities abroad increased in number from 46 to 288 between 2009 and 2020, with corresponding exposures rising over eight-fold from US$11 billion to US$93 billion during the same period and more than doubling since the last FSAP. About 83 percent of these assets are held in Central American countries and, although system-wide geographical concentrations of loans and deposits is moderate, specific entities can be highly exposed to specific countries, such as Panama, Costa Rica, El Salvador, and Guatemala.

9. State owned financial institutions (SOFIs) play a significant role in the provision of financial services and have been recently grouped under a state-owned financial conglomerate. SOFIs operate in all financial sectors and hold about 0.1 percent of asset managers' assets, about 8 percent of insurance sector assets, and 12 percent of banking sector assets (Figure 6 and Table 3).[5] A credit guarantee fund (FNG) has played a key role supporting financing during the pandemic. Only Banco Agrario, a state-owned bank, collects deposits from the public (3.5 percent of total deposits). The rest raise funds from capital markets, institutional depositors, and multilaterals. The National Savings Fund (FNA) administers worker contributions for unemployment benefits and Caja Honor collects deposits from the military and the police. SOFIs do not currently present financial stability risks and are well capitalized. *Grupo Bicentenario* was created as a holding company for SOFIs under MHCP and will be subject to the Financial Conglomerates Law. There are 14 subnational development banks (INFIs) albeit the size of the sector is unknown as most do not disclose their balance sheet.[6] INFIs cannot collect deposits,[7] although there have been some instances of illegal activities in this regard. In addition to credit programs implemented by SOFIs, private institutions provide subsidized lending using budgetary resources, particularly housing finance. In the past, agricultural producers have received debt relief, undermining credit culture.

10. While progress has been made on financial inclusion, cash heavily dominates retail payments, inequalities persist, and access to finance remains a constraint. Financial inclusion is high with more than 85 percent of adults owning at least one financial product.[8] Earlier demand-side measurements suggested that the level of transaction account ownership was just under half the population.[9] Account dormancy and lack of awareness may partly explain this discrepancy as product ownership has yet to translate into effective, widespread, and frequent usage. While digital payments have increased, in part driven by COVID-19 related restrictions, cash continues to dominate retail payments given the scarce and expensive electronic payments acceptance, among other factors. There are important developmental challenges, including a large urban-rural gap (32

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[5] In addition, there are two deposit insurance institutions and a pension provider which administers the defined benefit pension scheme and the voluntary pension scheme for low-income individuals. However, data on their assets is not included in these calculations.
[6] It is estimated that the largest INFI holds about 60 percent of sector assets.
[7] Only four INFIs with an external rating of AA or higher (provided by a credit rating agency) are authorized by the SFC to manage liquidity surplus from municipalities and are supervised by the SFC.
[8] Financial products include deposits (savings, checking, and low-value deposits), and credit products (commercial and consumer credit, credit cards, microcredit, and mortgage loans). See *Reporte de Inclusión Financiera* 2020.
[9] Based on 2017 Findex and the BR's *Encuesta nacional sobre provisión de los billetes y monedas e instrumentos de pago* (Epbmip) of 2019 (see *Reporte de Sistemas de Pago* 2020).

percentage points for the access indicator) and the MSME financing gap, estimated to be equivalent to USD 3.9 billion.[10] This picture does not fully take into account the role of (non-bank) fintech players although anecdotal evidence suggests limited impact (with few exceptions, e.g., SEDPEs).[11] Key indicators on financial inclusion and access to finance can be found in Figure 7.

11. COVID-19 related disruptions led to vulnerabilities in the nonfinancial corporate sector, while monitoring of the consumer sector is warranted given their weight in the lending portfolio of banks. At the aggregate level, banks are exposed to sectors that have been strongly affected by COVID-19, i.e., manufacturing, construction, and transportation and storage. While NPLs of the accommodation sector (hardest hit) and mining and quarrying are relatively higher and increased in 2020, banks' direct exposure to these sectors is very small. By end-2020, corporate NPLs reached the previous peak (2018), and credit growth had slowed down. While NPLs remain contained, mostly reflecting the impact of strong policy support and regulatory relief measures, the micro data analysis suggests a deterioration in the repayment capacity of firms. In the consumer segment, a strong effort in write-offs (45 percent year-on-year increase in June 2021) contained NPL growth in this segment. However, consumer loans – the majority of which is unsecured – require close monitoring given their weight (30 percent of total loans) and higher impairment rate.

12. Given the structure and characteristics of the Colombian financial sector described above, there are intertwined forces that can have a significant impact on access to finance, financial inclusion, and overall financial sector development. Competition becomes key in a financial sector with a large presence of financial conglomerates, the relevance of SOFIs in the provision of financial services, and the growing presence of new market players (i.e., fintechs). Digital transformation presents significant opportunities to foster access to finance and financial inclusion and can also contribute to capital market development. The COVID crisis highlighted the importance of having a robust insolvency framework and a sound financial sector that is well equipped to manage increasing levels of NPLs. Finally, authorities and financial institutions (both public and private) will play a critical role in the response of the financial sector to climate risks and allow finance to flow to sustainable activities.

RISK ASSESSMENT

A. Financial Sector Conditions and Risks

13. The financial system was impacted by the Covid-related economic contraction in 2020, but so far it appears to be resilient. Banking sector soundness indicators show already improvement towards pre-pandemic levels as of June 2021 (Figure 8 and Table 4). Banks entered

[10] World Bank Group. 2018. MSME financing gap (https://www.smefinanceforum.org/data-sites/msme-finance-gap)

[11] SEDPEs were created through the Financial Inclusion Law (Law No. 1735 of 2014), with the explicit objective to broaden access to transactional financial services. Like banks and financing companies, SEDPEs are deposit-taking institutions supervised by the SFC but cannot engage in lending. As of 2020, there were five licensed SEDPEs.

2021 with markedly higher capital ratios compared to pre-pandemic levels due to converge to Basel III and strengthening of regulatory capital through subordinated debt and retained earnings.[12] Bank profitability also bounced back from the previous downturn entering the pandemic with relatively strong buffers.

14. The main vulnerability to banks stems from the credit risk. When the pandemic hit, Colombian banks had almost recovered both in terms of profitability and asset quality from the 2014-16 downturn, which mainly impacted the commercial portfolio, coupled with an acceleration on credit growth, particularly on consumer lines. After initially declining due to debtor support and regulatory relief programs, NPLs peaked later in 2020 but started declining in 2021. However, if the pandemic is prolonged, borrowers could come under built-up pressure resulting in larger than expected risk revelation, especially for consumer portfolios and sectors that are most affected by the pandemic. Furthermore, though banks maintained healthy net interest margins so far, these could be compressed with the global financial tightening risks materializing.

15. Banks hold ample of liquidity, but they rely significantly on wholesale funding. Almost 80 percent of funding comes from mainly unsecured wholesale (nonfinancial corporates and financial institutions) sources (Figure 9). Wholesale funding is dominated by demand deposits, followed by term deposits, with bonds and bank loans accounting for a relatively low share. Retail demand and term deposits comprise about 16 percent and 7 percent, respectively, of total funding. The Net Stable Funding Ratio (NSFR) and—even more so—the local Liquidity Coverage Ratio (IRL, for its initials in Spanish) increased during 2020, mainly due to higher holdings of liquid assets by banks. Liquidity had benefited from substantial support from the BR, as well as from the reallocation of funds to the banking system due to a flight-to-stability motive, and from slower loan growth. The data do not indicate significant exposure to exchange rate risks.

16. Conglomerate banks are at the core of the network and provide multiple transmission channels across the domestic system and internationally, making the system vulnerable to contagion risk. FCs consist of complex interconnected networks of not only banks, but also trusts, insurers, pension funds, securities firms, and other institutions. This complexity motivates the need to properly understand intra- and inter-conglomerate contagion channels. Financial conglomerates' sizeable cross-border exposures present an important vulnerability to cross-border contagion risk.

17. The corporate sector was highly impacted by the Covid-19 pandemic, increasing its vulnerability to an adverse macroeconomic shock such as prolonging the pandemic. Both corporates and small-and-medium enterprises (SMEs) exhibited a relatively stable level of liquidity, leverage, solvency, and profitability during the pre-pandemic years. However, the pandemic shock worsened their repayment capacity and profitability indicators in 2020.[13] Due to the nature of the shock, both corporates and SMEs accumulated more cash, which raised their cash available ratio

[12] Banks benefited from the inclusion of new items in the CET1 and lower risk-weighted assets. All banks follow the standardized approach for risk weights, which resulted in smaller RWA under Basel III for most banks.

[13] This analysis uses information from *Supersociedades*: end-December financial and income statements of corporates and SMEs for the period 2016–2020 in 21 industries. For the methodology, see the Technical Note on Risk Analysis.

(Figure 10). Leverage indicators (debt-to-assets and debt-to-equity) showed a slight decline. At the sectoral level, some financial indicators (e.g., repayment capacity and profitability) showed a deterioration across many sectors, which signals an increase in firms' vulnerability, especially those related to the services sector.[14] At the same time, the debt share of firms with an interest coverage ratio (ICR) of less than 1[15] increased across most economic sectors.

B. Stress Tests

Solvency Risk Analysis

13. The solvency risk analysis is based on the assessment of banking sector vulnerabilities and risks, particularly those emanating from a prolongation of the pandemic. The stress-testing exercise included 12 banks (at individual levels) comprising 94 percent of banking system assets and was based on full-fledged macroeconomic scenarios comprising a baseline and a severe but plausible adverse scenario over a three-year horizon from mid-2021 through mid-2024.

- The **baseline** scenario is aligned with the October 2021 World Economic Outlook (WEO) projections, with an underlying strong 2021 rebound from the largest recession on record.

- The **adverse scenario** features a protracted recession incorporating key macrofinancial risks from both global and Colombia-specific factors identified by the Risk Assessment Matrix (Table 5). Prolonging of the pandemic continues to be a threat to sustainable economic recovery. Colombia's elevated financing needs make it vulnerable to external risks, including renewed weakness or volatility in energy prices, and to a general risk-off episode in financial markets. Domestically, increasing fiscal pressures can lead to further sovereign downgrades and test market access. Political and social uncertainty imply the risk of capital outflows and have the potential to slow down economic activity and delay reforms. The two-year cumulative shock to GDP under the adverse scenario corresponds to about 2.5 standard deviation relative to the baseline (see Tables 6 and Figure 11 for the full set of scenario assumptions).

18. The capacity of the banking system to withstand severe but plausible shocks suggests broad resilience at the aggregate level, albeit with pockets of vulnerabilities in a few banks. High starting levels of system-wide capital and strong profit buffers allow most banks to absorb a large shock under the adverse scenario and retain substantial buffers, with domestic systemically important banks (DSIBs) and domestically owned banks impacted somewhat less than non-DSIBs and foreign-owned banks, respectively. Sensitivity tests show that some banks would be vulnerable to the default of their largest nonfinancial corporate exposures.

19. To strengthen the authorities' ability to monitor cross-border exposures, it would be important to fill data gaps on the exposures and risk metrics of ultimate subsidiaries. This would also enable the authorities to conduct a fully consolidated stress testing, incorporating

[14] For the oil sector, the ratios also exhibit the effects of the sharp oil price decline.

[15] The debt share of firms with an ICR<1 in 2020 was above half for corporates and around a third for SMEs.

potential contagion channels, and establish early-warning indicators to detect vulnerabilities as they are building up.

Liquidity Risk Analysis

20. The banking system is largely resilient to liquidity stress, with liquidity shortfalls relatively small in the very extreme funding shock. To assess the short-term resilience of banks to an abrupt withdrawal of funding, the stress tests, based on the Liquidity Coverage Ratio (LCR, included adverse scenarios that impose more severe assumptions on run-off rates for demand deposits than the regulatory scenario. These adverse scenarios simulate retail and wholesale demand deposit runs. The "wholesale" and combined adverse scenarios reveal some weaknesses in the event of very large deposit withdrawals. The stronger impact of simulated funding shocks on DSIBs reflects the fact that, even though their reliance on wholesale deposit funding is similar to non-DSIBs measured as a share of total assets, DSIBs hold relatively lower amounts of liquid assets. However, even in the very extreme scenario, the aggregate liquidity shortfall is of a manageable magnitude at 1.7 percent of total assets of banks in the sample, and liquidity shortfalls for the individual banks do not exceed 3 percent of total assets.

21. The cashflow-based analysis identifies small liquidity shortfalls for some banks under very severely adverse conditions. However, even in the extreme case, the combined shortfall of 1.6 percent of assets for banks in the sample is manageable, given the BR's ability to provide liquidity to the system. The cashflow analysis supports the results of the LCR-based test.

22. Expanded data collection would enhance the liquidity risk analysis. More granular data on assets and liabilities generating cashflows by significant currencies, as well as those related to cross-border exposures, would benefit liquidity monitoring. The regulatory parameters used for computation of IRL and NSFR could be readjusted or determined to be further aligned with Basel III requirements.

Interconnectedness and Contagion Risk Analysis

23. To evaluate the interconnectedness of Colombia's financial system and potential stress transmission channels, a network and contagion risk analysis was conducted in three stages. First, the financial system was mapped at both the sectoral and entity levels across a total of 10 financial and nonfinancial sectors. Second, conglomerates and foreign counterparts were identified, and their role and structure were studied through the lens of network analysis. Third, using multi-layer network data distinguishing across eight different exposure types, contagion was evaluated through the lens of a balance-sheet based model,[16] yielding several insights:

[16] For this exercise, the FSAP team assessed contagion risk using an expanded version of the CoMap model from G. Covi, M.Z. Gorpe, and C. Kok. "CoMap: Mapping Contagion in the Euro Area Banking Sector." In: Journal of Financial Stability 53 (2021), p. 100814. For a description of the methodology, see the Technical Note on Risk Analysis.

- **Systemic banks are the most contagious in the system—though the network's structure is such that others can induce entity failures as well**. Overall, bank failures can lead to three contagion failures in other banks, and six failures in nonbank entities.

- **Cascade effects from bank failures are limited**. No bank failure scenarios led, by themselves, to second-round failures in other entities. Although some banks might directly induce the failure of a subset of bank and nonbank entities in the network—the configuration of interlinkages is such that those entities do not spread further failures forward.

- **Cross-border exposures can lead to substantial losses, but no entity failures were suggested by the model simulations.** This applies to shocks through equity exposures in Central America, as well as shocks through large holdings of foreign securities.[17]

- **Stress scenarios stemming from household and government risk produce the most contagion, while other sectors do not produce cascade failures in the system.** From the experiments conducted assuming extreme shock, the government and household default scenarios produce 16 and 8 entity failures, respectively, among multiple contagion rounds.

24. Although the system is resilient, the financial network's evolving complexity calls for the further development of monitoring tools. Even though some of these contagion channels might be currently small, they have the potential to grow rapidly. Suggested data coverage and methodology improvements include the incorporation of individual trusts and securities firms in the contagion risk analysis, advancing the identification of foreign creditors on Colombian claims to monitor cross-border funding risks, and gathering further data on the composition of conglomerate subsidiary operations in Central America.

<u>Firm-level Analysis: Corporates and Small and Medium Enterprises</u>

25. The share of firms with lower repayment capacity (ICR<1) and the share of firms with potential borrowing needs increase under an adverse scenario.[18,19] For both corporates and SMEs, the share of firms with an ICR<1 increases by about 3 percentage points, and the share of firms with a negative cash available ratio increases between 8 and 9 percentage points. Finally, the adverse scenario puts pressure on firms' solvency position, especially for corporates. The share of corporate firms with a solvency ratio of less than 5 percent increases by about 1.5 percentage points compared to less than 1 percentage point for SMEs.

26. The firm-level analysis suggests that the authorities need to continue monitoring the nonfinancial corporate sector, especially the services sector, to identify potential pockets of vulnerability. An important element for such monitoring is the ongoing work on early warnings

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[17] Ownership in subsidiaries or related entities abroad are captured in the form of equity (unlisted) exposures in the construction of the network.

[18] This analysis uses information from *Supersociedades*: end-December financial and income statements of corporates and SMEs for the period 2016–2020 in 21 industries. For the methodology, see the Technical Note on Risk Analysis.

[19] The adverse scenario used for this analysis is the same as the one used for the bank solvency stress test.

("*Alerta Temprana*"), which could be broadened to increase the number of firms in the sample. Sharing the (part of) information provided by the early warnings with other supervisory institutions would be useful to complement the monitoring efforts.

C. Climate Risks and Opportunities

Transition and Physical Risks

27. The transition risk stress-testing exercise assessed the effects of a higher carbon tax on the banking sector at both granular and aggregate levels.[20] The results show that transition risks driven by a higher carbon tax are more concentrated in some sectors: agriculture, manufacturing, electricity, and wholesale and retail trade; and transportation sectors appear to be the most important in the transmission of risk to the banking system. In the first scenario of a sharp US$70 per ton increase in tax (from the current US$5 per ton level) to meet the US$75 per ton target, the risks for the banking system are sizeable, but potentially manageable. Transitions risks are also quantified under alternative scenarios, with lower (US$20, US$15, and US$10 per ton carbon) increases in carbon tax. Risks are much lower in those cases, as could be expected. This suggests that gradual increases to meet the target of US$75 per ton, instead of a one-time sharp increase, may be preferable in terms of a smoother adjustment for the financial sector and other stakeholders.

28. A physical risk stress testing exercise was performed at the municipal level to investigate banks' vulnerability to severe riverine floods. Physical risk is another source of climate risk that derives from the financial system's exposure to economic sectors that are vulnerable to natural disaster events.[21] Large-scale riverine floods are the main climate-related disaster risk in Colombia. Three flood scenarios were considered: one based on the 2010 and 2011 floods related to La Niña, and two more severe floods with return periods of once in 500 years. For those three scenarios, Colombian banks experienced an average decline in the CAR between 0.3 and 1.1 percentage points. A fourth scenario, investigating a severe flood coinciding with a recession, finds an average decline in the CAR of 3.2 percentage points. Three banks are substantially more vulnerable to flood hazards than most others, owing to high exposures in rural areas or relatively large sovereign exposures.

Supervisory Response and Market Deepening

29. Stress test results show differences in climate-related vulnerabilities in credit portfolios between banks, underscoring the importance of risk-based supervision. Authorities are encouraged to adopt a risk-based approach in supervision for climate-related risks and continuously improve information disclosures (both by nonfinancial corporates and by financial

[20] See Perez-Archila, Manuel and Sever, Can (2021): Climate-related Stress Testing: Transition Risk in Colombia. IMF Working Paper No. 2021/261

[21] See Reinders, Henk Jan; Calice, Pietro; Uribe, Mariana Escobar; 2021. Not-So-Magical Realism: A Climate Stress Test of the Colombian Banking System. Washington, D.C.: World Bank Group.

institutions) and data availability. Capacity building in the banking sector, potentially including new tools such as scenario analysis and full bottom-up stress testing, will be required. Importantly, those institutions with the highest vulnerability to climate-related risks also have a high potential to contribute to greening the Colombian economy by stimulating climate mitigation in these sectors.

30. Colombia needs to continue working on measures to improve the flow of finance towards greener activities, including the region's first draft green taxonomy. Colombia's investment needs to meet their National Determined Contributions (NDCs) under the Paris Agreement and Sustainable Development Goals (SDGs) exceed the amount than can be financed through public sources alone. As a result, Colombia has embarked on a range of policies that help support the capacity of financial sector entities to adequately assess climate related risks and invest in relevant opportunities, thereby channeling financial flows in ways that can contribute to the country's low carbon future.

31. Though Colombia's debt capital market is relatively large, the country's green bond market remains small. In order to boost the availability of finance that flows to fund Colombia's green investment priorities, the authorities can deepen their efforts by: (1) channeling public sector resources strategically to boost investments in climate and environmental related priorities, through targeted fiscal incentives to induce greater supply and demand for green finance instruments, and the strategic use of SOFI balance sheets; (2) improving the availability of climate-relevant data in the marketplace to ensure comparable sustainability information can inform greener investment decisions, through implementation of the green taxonomy, alignment of climate-related disclosure standards with global best practices,[22] and enhanced oversight of the activities of ESG data providers and external reviewers.

FINANCIAL SECTOR OVERSIGHT

A. Banking Supervision

32. There have been significant improvements to the legal framework and supervisory process since the last Basel Core Principles (BCP) review in 2012. The SFC is an integrated supervisor, with a purview that includes banks, finance companies, insurance, securities, and other financial intermediaries. Additionally, the SFC is also the bank resolution authority. The Conglomerates Law has strengthened the framework for consolidated supervision by adding holding companies as supervised entities. Moreover, it defined the scope of supervision of financial conglomerates, setting standards with regard to risk management, adequate capital, and corporate governance, as well as minimum requirements for managing concentration risks and conflicts of interest in intragroup and related-party exposures.

[22] ESG reporting requirements for listed companies were published on December 22, 2021 (Circular Externa 031 of 2021). Another Circular Externa (CE 008 of 2021) covers ESG disclosures for voluntary pension funds.

33. The SFC's operational independence has been largely enhanced since 2015, but additional formal safeguards could still be considered. The issuance of a new decree in 2015 on the appointment and dismissal of the Superintendent addressed a number of potential impediments to the operational independence. Nevertheless, this decree has been partly censured in 2020. It is then important that the law: (i) specifies that the Superintendent is appointed for a minimum term and is removed from office during his/her term only for reasons specified in it; and (ii) explicitly provides statutory legal protections to the SFC, the Superintendent, and staff for actions taken and/or omissions made while discharging both their duties for supervisory oversight and implementing resolution measures in good faith.

34. Since 2015, the SFC has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile. In the last three years, as part of its regular monitoring, the SFC has ordered an increase of capital to two supervised entities, so that they achieve a CAR of 12 percent. The SFC's assessment is based on published high-level criteria and an internal assessment guideline. This could be supplemented by publishing clear guidance on what supervisory actions might be considered, or what bank actions may be expected to manage the enhanced risk when predetermined guidance triggers or thresholds are reached.[23]

35. The regulations define related parties and apply lending limits but do not establish a consolidated body of requirements on related-party transactions. The legal framework was judged deficient at the last BCP assessment, and the framework has not been amended. The URF is working on a decree that will address deficiencies noted concerning transactions with related parties. It aims to consolidate all exposures with subsidiaries, ensure homogenous treatment of groups of related parties, consolidate the various limits currently in place, and reduce the number of existing exemptions.

36. A regulation on country risk has been drafted, which will include transfer risk provisioning; currently there are deficiencies with the supervisory framework.[24] Banks have important exposures in Central America, which expose them to possible transfer and contagion risks. The current framework focuses mainly on country risk ratings and Basel risk-weights. However, given the interconnectedness of Central American economies, the important role played by remittances as a source of foreign currency and the level of bank exposure, detailed guidance, surveillance, and provisioning guidelines are warranted.

37. Since 2012, the Colombian authorities have made progress converging their regulations on capital adequacy, liquidity, and operational risks toward the Basel III framework, but further enhancements are recommended. Now, the definition of capital and risk coverage, including operational risk, are broadly aligned with the relevant Basel III standards, and short- and long-term liquidity ratios have been determined based on the LCR and NSFR standards.

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[23] SFC has a capital supervision guide and a defined supervision protocol that applies in case any early warnings are triggered related to capital, liquidity, profitability, and risk management, among others.

[24] Since completion of the BCP analysis, a country and transfer risks' regulation has been enacted, through CE 018/2021.

However, several regulatory parameters used in the computation of those ratios are not totally aligned with those prescribed by the Basel III standards, or are not determined yet, reducing the comparability between the subsidiaries of financial conglomerates, where different liquidity metrics can be used, depending on the jurisdiction of establishment. It is then recommended to further align the local LCR and NSFR ratios with international standards and, as already envisaged by the SFC, to require the NSFR ratio to be also calculated at a consolidated level.

38. Looking forward, the SFC should continue to maintain a direct and intrusive supervision of banks. The SFC has expanded its offsite exercises and has increasingly requested direct involvement of statutory auditors in a number of supervisory matters over the past years. It is important that the SFC keeps an adequate level of onsite inspections going and avoids over-reliance on external and internal auditors when performing supervisory tasks.

B. Macroprudential Framework, Crisis Management, Resolution and Financial Safety Nets[25]

39. The institutional framework has been effective for conducting macroprudential policy so far. The systemic risk monitoring framework is advanced, and the macroprudential toolkit has been enhanced in line with Basel III recommendations. Nevertheless, it would be useful to prepare a macroprudential oversight strategy, jointly drafted and signed by all relevant institutions. The central bank's role in macroprudential policy could be strengthened to harness its expertise in macro-financial analysis. To address potential leakages and risks from potential rapid growth in household indebtedness, the Loan-to-Value (LTV) and Debt-Service-to-Income (DSTI) tools could be expanded to cover leasing products and nonbank credit, and the DSTI tool to include nonmortgage debt.

40. The authorities undertook a series of wide-ranging reforms, but some features of the crisis management and safety net framework need improvement. This includes the introduction of new resolution mechanisms and tools, identification of tools for systemic and non-systemic crises and improving information exchange and coordination within the safety net. The FSAP recommends enhancing several areas of the framework, particularly: (i) strengthening the operational independence of the resolution unit within the SFC; (ii) reviewing the responsibility for developing recovery and resolution plans and expanding the content of recovery plans; and (iii) strengthening the safeguards for Fogafin's fund and providing unambiguous access to a back-up liquidity facility.

[25] For a more detailed discussion on these topics and on financial stability aspects in general, see the IMF's Financial System Stability Assessment (FSSA).

FINANCIAL SECTOR DEVELOPMENT

A. Competition in the Financial Sector[26]

31. **Despite relatively high concentration and sticky market shares, price pressure, portfolio purchases and high customer mobility indicate the presence of competitive dynamics in the banking sector, particularly in the retail credit segment.** The Colombian banking sector is relatively concentrated, and the top-3 banks have a combined market share of more than 50 percent across most major lending and deposit product categories. Market shares have shown little variation over the past decade on the back of few entries, exits and mergers in the banking sector that kept the number of banks operating in Colombia relatively constant and market shares sticky. Nevertheless, lending interest rates have declined over the past years, particularly for consumer credit and credit card loans. Lending rates are often reduced through so-called portfolio purchases, where a bank offers clients better conditions if they move their outstanding loan to them. Such portfolio purchases are very present in the Colombian consumer banking market, they facilitate high customer mobility and, together with the falling interest rates, suggest a non-trivial degree of price competition.

32. **Financial conglomerates and interlinkages between financial service providers and firms in the real economy warrant attention from a competition perspective.** While the recent *Financial Conglomerates Law* strengthens both the prudential supervision and corporate governance of the conglomerates while the cross-selling of products is restricted by the general prohibition of tying and other specific regulations (i.e., regarding mortgage related insurance), linkages between financial and real sector entities within wider economic groups may raise competition concerns. Such linkages allow financial institutions to use the physical infrastructure network (i.e., retail stores, hospitals) of the related real sector entity to on-board clients and distribute products. They also allow them to exclusively access data for tailoring and pricing of products, subject to prior consent of the individual. Nevertheless, such linkages are not limited to entities within the same economic group as several agreements have been signed between unrelated entities that grant the financial institutions either access to the distribution network or client data. Such practices may rise concern from a competition perspective if implemented by a dominant player and warrant a detailed assessment and close monitoring.

33. **In this context, the recent formation of the state-owned financial conglomerate *Grupo Bicentenario* may pose new challenges to maintaining a level playing field with private operators.** The government is in the process of consolidating its various holdings of first and second tier financial institutions into a new state-owned financial conglomerate, *Grupo Bicentenario*. *Grupo Bicentenario* will eventually be the third largest conglomerate in Colombia, and it plans to compete with private institutions in addition to its developmental role. In this sense, the final design and

[26] Box 1 presents a summary of the methodology applied for the assessment of competition in the Colombian financial sector.

governance of the Grupo need to be assessed from a competitive neutrality perspective to ensure that *Grupo Bicentenario*'s commercial activities do not benefit from its status as a state-owned entity and preferential access to funding. Absent the necessary competition guarantees, this consolidation may have a negative impact in terms of competitive neutrality.

34. Vertical integration between large banks and the payment system-infrastructure requires additional competition safeguards. The main payment service provider, which accounts for 95 percent of all Automatic Clearing House (ACH) transfers, is a private entity owned by the major banks. While its pricing structure has recently been reformed and made more flexible, steeply declining costs per transaction make it disproportionally more expensive for small and new players with a lower volume of transactions to use the payment system infrastructure compared to large banks. Authorities have recognized the importance of competition in the retail payment system and enacted new regulation in late 2020 with the aim of reinforcing interoperability, prohibiting multihoming[27] limitations, facilitating divestiture of vertical integrated structures and establishing corporate governance requirements.

35. Vertical integration might make it more challenging for the new retail payment system regulation to achieve its intended goal. Decree 1692 of 2020, which enacted new sectorial regulation for retail payment systems, has been designed to facilitate competition (e.g., mandatory interoperability and protection of multi-homing). However, switching incentives for retail payment participants, mainly commercial banks, are low since they own the main platform. Therefore, authorities should strive to support inter-platform competition between interoperable payment systems administered by different competitors[28] and not only allow but also promote the formation of new payment networks or systems instead of encouraging the permanence of incumbent payment systems. Moreover, authorities should also try to minimize intra-platform competition risks, i.e., preventing strategies that self-favor the vertically integrated dominant platform, by ensuring that Rules of Procedures developed by each retail payment administrator under the approval of SFC[29] are designed to guarantee interoperability with other platforms and payment systems participants.

36. Formal instruments to articulate the cooperation of the SFC and the cross-sectoral competition authority, the *Superintendencia de Industria y Comercio* (SIC), both between themselves as well as with other regulators, could reinforce their ability to tackle competition issues in the financial sector. On the one hand, the SIC is in charge of enforcing and promoting competition across sectors, including in financial markets. On the other hand, in addition to ensuring financial stability as its primary function, the SFC maintains a central role in shaping efficient market dynamics in the financial sector both through regulation, as well as merger control powers when all parties are under its supervision. In such cases, SIC's intervention is channeled through non-binding opinions. However, cooperation between the SFC and the SIC has not been formalized through an

[27] Multi-homing refers to the ability of payment participants to connect and switch between more than one payment platform and thus, commonly using more than one provider.
[28] Promoting inter-platform competition requires preventing exclusionary strategies to foreclose rival platforms from achieving scale or by impeding access to data or other critical resources for them to operate, degrade functionality and interoperability to favor related parties over competitors, increasing switching costs to avoid multihoming, among others.
[29] Rules of procedures are those that establish: i) communication protocols, security protocols, liability rules, and pricing.

MoU. In addition, given the increasingly important role of financial service providers not supervised by the SFC (e.g., a majority of Fintechs) and the links to adjacent sectors (e.g., telecommunications) supervised by other regulators, reinforcing inter-institutional cooperation in the financial sector could be key to shape efficient market dynamics in the middle run.

37. Strengthening enforcement powers, in general, as well as the procedure to review the competition impact of mergers and acquisitions in financial markets in particular, including conglomerate mergers, would be important to reinforce competition warranties in the financial sector. On the one hand, the SIC has become a regional reference in terms of enforcement, yet no anticompetitive practices have been sanctioned in the financial sector in the past years.[30] Although limited enforcement in the financial sector is a trend observed in LAC, it could also be related to certain weaknesses still persisting in the Colombian competition regulatory framework, from potential confidentiality challenges affecting the effectiveness of the leniency policy[31] to suboptimal level of fines.[32] On the other hand, horizontal and vertical mergers and acquisitions in the financial sector are not benefitting from the strong analytical and procedural safeguards applied by the SIC across other sectors, from a multiphase review that allows to adapt the analysis to simple/complex cases to strong communication/cooperation with parties/other market operators in order to design remedies that limit negative effects of market consolidation. Moreover, contrary to international experience, conglomerate mergers are excluded from competition law scrutiny by the SIC,[33] thus the SFC review could be instrumental to prevent anticompetitive effects and complement other measures to supervise financial conglomerates until amendments to the competition law are introduced.

38. A systematic assessment of regulations from a competition perspective may help leveling the playing field for small/new players. Regulation geared to tackle a market failure in the financial sector might have unintended consequences from the point of view of competition. While the SFC has rightly focused on interventions from a prudential point of view, as per its primary financial stability mandate, embracing a competition lens will enable it to minimize, whenever possible, potential restrictions to competition caused by new prudential rules. In this context, the SIC's competition advocacy mandate and experience will also be key to complement the SFC efforts. Thus, closer coordination could facilitate implementation of a systematic competition assessment. The gradual implementation of a systematic regulatory assessment of impact on competition can be critical to identify potential concerns in rules, guidelines or broader prudential interventions and, when possible, design less distortive alternatives that still preserve the prudential policy objective.

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[30] Some investigations have been opened, including a 2005 case which was closed with commitments of the parties. (see Technical Note on Competition in the Financial Sector for details). Lack of compliance with such commitments resulted in 7 decisions from SIC sanctioning operators for non-compliance.

[31] Leniency programs allow the first cartel member to approach the competition authority with information on a cartel to be exempted from the fine.

[32] For example, in their most recent competition law assessment, the OECD recommended, among others, that Colombia should provide a broader range of options to calculate fines to enable the imposition of heavier penalties; and modify the leniency program to accord protection against disclosure of the identity of applicants and evidence submitted, and shield participants from other types of criminal and civil liability. See OECD, 2016. Pp. 130-133.

[33] See Art. 9 of Law 1340.

B. Digital Financial Inclusion

39. Despite a strong commitment towards financial inclusion and high-level public ownership, digital payments are lagging, and inequalities persist. Due to high-level public ownership of the financial inclusion agenda and ambitious legal and regulatory reforms,[34] aided by the role of the private sector in supporting public policy objectives, Colombia made steady progress on financial inclusion. However, although digital payments have been gaining traction fueled by product innovation (mobile wallets) and COVID-19 related restrictions, cash heavily dominates retail payments, while electronic means/transaction accounts are perceived to be more costly and less safe than cash. Colombia lags regional peers such as Brazil and Mexico regarding the implementation of fast payments, which help drive digital payments uptake and financial inclusion in many jurisdictions. The urban-rural access gap has widened, and the gender gap has not narrowed.

40. Key payments and ICT infrastructures exist but often lack reachability thereby limiting innovation and deployment of low-cost solutions while less than full interoperability erodes the potential of new technologies and business models to reduce barriers. In line with international standards, Colombia issued regulation to discourage discriminatory practices in access to low-value payment systems (LVPS) and to instill competition. However, participation of smaller, non-bank entities is limited, and fast payment volumes modest, and mobile wallets operate mostly based on non-interoperable proprietary QR codes. Pending the implementation of open banking, transaction data remains untapped for credit decisions. The national ID infrastructure facilitates electronic know-your-customer (e-KYC); incipient private digital ID initiatives enable customers to verify their identity. The Government began issuing digital ID cards and is implementing a suite of digital services to facilitate citizen-government interactions, but these initiatives are not yet explicitly connected to the financial sector. Mobile and fixed broadband coverage is in line with peers, but access remains uneven and usage barriers disproportionately affect poor households.

41. There is a need to continue and accelerate structural reforms as a precondition for digitalization to boost financial inclusion; this work requires establishing more effective institutional arrangements. The institutional framework for financial inclusion was recently revamped, but the articulation between the public policy and the newly formed intersectoral commission should be clarified. The BR should articulate its role in national financial inclusion agenda consistently with its mandate to ensure smooth domestic and international payments. Closer coordination of the digital inclusion and digital government agendas with the financial inclusion agenda should be pursued. A national payments council (NPC) should be created to drive consensus and foster cooperation amongst all stakeholders; the NPC could be co-chaired by the MHCP and BR.

[34] For example, Decree 222/2020 to facilitate financial inclusion, Decree 1692/2020 on low value payment systems, External Circular 002/2021 issued by the SFC on mobile and digital correspondents, Decree 1517/2021 creating the Intersectoral Commission for Economic and Financial Inclusion and Education: "*Banca de las Oportunidades*". Usury ceilings are 1.5 times the weighted average of rates applied by all providers to the segment. Housing ceiling rates were introduced after the mortgage crisis of the late 1990s and are calculated by the central bank on real terms to ensure they are lower than rates in other products. The central bank collects information of bank rates for other products and calculates a rate that would provide banks with a 10 percent ROE while covering administrative, credit and funding costs. Interest rates on agricultural loans are determined by a National Commission

The end of the current planning cycle (2022) represents an opportunity to enhance financial inclusion indicators to accurately measure usage and quality of financial products.

42. A more diverse payments ecosystem requires a modern, flexible, and risk-proportional regulation, and a clear articulation and coordination of authorities' powers in the area of payments. Colombia enacted several reforms of relevance to financial inclusion. Recent initiatives include measures to enhance governance and competition in the LVPS, a regulatory sandbox, a legislative proposal on payment systems and a proposed regulation on open finance. There is a concern that incremental regulatory reforms to catch up with new players through an entity-based approach may result in inconsistencies in risk management standards, consumer protection, and service levels. Furthermore, current regulation does not enable the provision of payment services by entities other than account servicing payment service providers (besides acquirers). The payment system law represents an opportunity to set out functional requirements and expand the range of entities that may provide payment services. The scope and articulation of the Government's powers in the draft payment system law should be coordinated with the powers of BR to avoid gaps and overlaps. The regulatory approach to open finance requires maintaining flexibility to regulate specific aspects as needed and establishing governance arrangements to ensure functionality and a balanced distribution of value amongst stakeholders.

43. Strengthening the payments infrastructure would require a balanced mix of competition and industry-wide cooperation. Authorities should monitor the impact of recent reforms on participation in LVPS and fees. They should review the costs that systems that enjoy a certain market power impose on their participants and the markets they serve, and induce change as needed, in consultation with the competition authority (SIC). In consultation with the industry, authorities should draw up a fast payment roadmap with a time-bound plan for the industry to overcome the issues affecting the development of fast payments and to meet agreed targets. Failing this, the BR may have to consider a different role in fast payments. BR's investigations on options to enable non-banks to open settlement accounts while ensuring risk mitigation are encouraged.

44. Key drivers of access and usage of transaction accounts and digital payments by underserved segments, such as low-value accounts (DBM) and government payments, should be further leveraged for financial inclusion. There is still scope to further digitize social benefit payments, by phasing out the current system based on public tendering and shifting to direct payments to beneficiary accounts of their choice. Ongoing efforts should be accompanied by measures to ensure broad participation in the ACH infrastructure, and neutrality and fairness towards financial service providers. Communication campaigns could be run in parallel, with content addressed to first-time users, and the use of *cédula digital* could be incorporated during pilots. Given the key role of DBM in this context, authorities should ensure that these products can meet most users' payment needs at a low cost and consider ways to minimize the impact of the financial transaction tax on the frequent and effective use of these accounts.

C. Role of the State in the Financial Sector

45. While SOFIs have traditionally complemented the private financial sector, they are increasingly focusing on direct lending and commercial operations to cross-subsidize developmental interventions. State-owned banks have focused on underserved rural areas, small agricultural producers, MSMEs, or infrastructure projects often at subsidized rates and in a countercyclical manner (see Figure 6). Many development banks operate wholesale (through financial intermediaries). Abundant banking sector liquidity, a relatively underdeveloped non-bank credit intermediary sector, and difficulties in transferring subsidies to final borrowers, have prompted some institutions (e.g., Bancoldex and FINDETER) to develop direct lending products. SOFIs do not currently present financial stability risks and are well capitalized (Table 7). To maintain profitability, many SOFIs have diversified their activities. Positiva for example has developed commercial products, FNA loans to higher income households account for about half of its loan portfolio, and public asset managers compete with private ones to administer collective investment funds and business structuring.

46. In addition to providing financial services through SOFIs, the authorities regulate interest rates for all types of credit and have established mandatory investment requirements to fund the agricultural sector. In Colombia, all credit is subject to interest rate ceilings and caps.[35] Banks are also obliged to fund agricultural loans at the regulated rate or invest in special securities (*Títulos de Desarrollo Agropecuario* – TDAs), which are remunerated at below market rates. FINAGRO, a wholesale agricultural development bank, lends funds from TDAs mostly to Banco Agrario to on-lend to small rural producers.[36] As part of the pandemic response, the BR reduced monetary reserve requirements and banks were mandated to invest those resources on securities used to fund government expenditures (*Títulos de Desarrollo de Solidaridad*) remunerated at market rates. Interest rate controls and mandatory investment requirements should be reviewed to limit distortions. Consideration could be given to calculate different ceilings for banks and non-deposit taking credit providers.[37] Subsidized lending to small rural producers through a tax on deposits introduces significant distortions. Consideration should be given to progressively increase interest rate ceilings and returns on TDAs. During the transition, the amount invested in TDAs could be increased to ensure the flow of resources to the sector.

47. Market participants generally perceive SOFIs as complementary although new direct lending activities of credit SOFIs could affect financial indicators and raise competitive neutrality considerations, if they were to receive subsidies. Market participants value the focus

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[35] Usury ceilings are 1.5 times the weighted average of rates applied by all providers to the segment. Housing ceiling rates were introduced after the mortgage crisis of the late 1990s and are calculated by the central bank on real terms to ensure they are lower than rates in other products. The central bank collects information of bank rates for other products and calculates a rate that would provide banks with a 10 percent ROE while covering administrative, credit and funding costs. Interest rates on agricultural loans are determined by a National Commission.

[36] As other financial intermediaries find the regulated rate on this segment too restrictive and focus their operations on larger producers.

[37] This would help develop an ecosystem of alternative credit providers, which typically charge higher rates than banks and focus on riskier segments.

of SOFIs in underserved segments and, so far, do not perceive unfair competition from SOFIs. Wholesale institutions venturing into direct lending are unlikely to pose competitive threats to private participants given the higher funding costs of SOFIs, unless credit programs become subsidized. As SOFIs transition to direct lending, credit risk and administrative costs (particularly retail programs) are likely to increase.

48. Formalization of the *Grupo Bicentenario* should accelerate. The stated goals of the GB include the consolidation of shareholding, building synergies among members of the group, and adopting modern corporate governance practices. The GB furthers the CONPES 3851 goal of ownership centralization, by bringing together all financial institutions under the MHCP and the GB, regardless of the past ownership stakes of the former line Ministries. However, implementation has been slow. The MHCP should appoint permanent boards and managers to the GB, with strong financial expertise and ramp up operations (especially around board appointments to the SOFIs). The MHCP should also work to clarify the respective roles of MHCP and the GB.

49. The corporate governance framework for SOFIs appears to be generally in line with international good practice albeit many board members and managers are politically appointed. The corporate governance framework for private financial institutions applies to SOFIs. In addition, the MHCP has issued several norms for public enterprises and financial institutions. To date, GB has not issued any additional corporate governance policy of its own. SOFIs' corporate governance arrangements follow many elements of good practice with two important exceptions regarding the appointment of board members and management of the institutions. The GB should appoint board members and the Board should appoint the Chief Executive Officer (CEO) of the institution. GB should develop its own corporate governance policy for SOFIs.

50. SOFIs should play a more prominent role in fostering inclusion and competition among private financial providers. Except for a few programs, most SOFI interventions focus on improving credit terms for existing borrowers who could be served by private participants. SOFIs could support the development of financing platforms in which all private intermediaries could offer financial services to targeted segments. Auctioning of SOFI resources in some programs (i.e., FAG guarantees) could be explored to ensure funds are allocated to intermediaries offering better conditions to final borrowers. SOFIs should intensify efforts to support non-bank credit providers to diversify financial sector intermediation.

51. Interventions could be better coordinated to improve efficiency, avoid duplication and ensure alignment with policy objectives. The creation of GB provides an opportunity to conduct and ambitious review of the SOFI operations with a view to prepare a strategy to restructure the group to increase efficiency, including through mergers and transfer of functions from one institution to another. Bancoldex and Banco Agrario direct loans to MSMEs and small rural producers are guaranteed respectively by FNG (partially owned by Bancoldex) and FINAGRO (through FAG) which could be better used by private intermediaries while public ones could assume and manage the risk directly.[38] If found appropriate, part of the capital of FNG and FAG could be transferred as funds to these institutions to cover credit risks so that administration of such resources by the institution that originates the credit supports incentive alignment. Authorities should also adopt policies to increase the number of hectares covered with agricultural insurance and cease to provide debt relief programs.

52. Improving product design, incorporating best practices, strengthening governance and continuing to improve risk management would support expansion of SOFI activities in a non-distortionary way. Consideration should be given to scale up FNG operations with private intermediaries, improving features such as payment at 90 days of loan delinquency and introduction of first loss portfolio guarantees. This would (i) make the guarantee more attractive to private intermediaries, (ii) increase the amount of credit mobilized, and (iii) reduce moral hazard. Guarantee auctions would help transfer benefits to borrowers. Expansion of guarantees and creation of platforms for factoring, leasing or SME lending could support SME finance. SOFIs should continue to improve risk management as they expand the range of products and counterparties to include fintechs and other new players, and to deal with climate risks. SOFIs should be further sheltered from political interference through full implementation of the *Grupo Bicentenario*, continued focus on improving corporate governance, and gradual removal of special corporate governance rules (especially at Banco Agrario). Consideration should also be given to include minority investors with know-how in the capital of some of the SOFIs following the FDN model.

53. Monitoring and evaluation (M&E) and disclosure of public credit support policies, programs and their costs could be substantially strengthened to assess value for money. No institution monitors and discloses the total amount of subsidized credit.[39] There are no impact evaluations of interest rate ceilings or credit programs. Most SOFIs do not have a dedicated M&E unit, and performance indicators focus on outputs (e.g., amounts disbursed, number of clients served, etc.) instead of outcomes in terms of economic impact (e.g., jobs created, sales, productivity, etc.) or increased financial inclusion (e.g., number of new borrowers brought into formal credit, number of graduated borrowers, etc.). SOFIs do not report ROE excluding all subsidies and most do not monitor this indicator.

D. Insolvency, Creditor Rights and NPL Resolution

54. NPLs and loans subject to regulatory relief measures are intensely and effectively supervised by the SFC through a wide variety of strategies and tools, and Colombian banks have extensive and experienced resources dedicated to NPL management. Banks favor internally driven loan restructurings and workouts for resolving NPLs, minimizing use of court-driven and legally enforced solutions, given traditional long delays and inefficiencies in the judicial debt

[38] Another example is Bancoldex, which is expanding its direct leasing product. An agreement to commercialize it through the Banco Agrario network could not be reached as the latter could offer it under better conditions and decided to develop its own leasing product.

[39] The ARCO platform operated by the National Planning Department (DNP) does not systematically include finance programs.

recovery process. There is an active and competitive market for sales of written-off loans, mainly in unsecured segments, with an extensive availability of investors (including foreign ones) and market infrastructure (experienced debt collectors, valuation experts, legal and financial advisors, and credit bureaus, among others). However, sales of earlier stage delinquent loans and commercial, SME and mortgage NPLs are not significant, despite some interest from investors, including international ones. Availability of third-party providers specialized in NPL management in those segments is minimal. International Financial Reporting Standards (IFRS) have been incorporated into the Colombian regulatory framework and are fully applicable to all banks supervised by the SFC, except for some of the IFRS 9 provisions relating to the loan portfolio and its impairment, as well as to the classification and measurement of financial instruments for individual financial statements. Collateral valuations are carried out and revised at appropriate intervals and moments of relevance, following international best practices, with reasonable availability of quality valuation experts, even for the most complex assets.

55. Active resolution of NPLs should continue to be encouraged by the regulator. Given the relatively strong capital and financial position of the sector, it is encouraged that the SFC considers requirements for reducing overall or segment NPLs and forborne exposures to their historical trends. This is particularly relevant for commercial NPLs, which are more difficult to manage by third parties. In addition, measures could be explored to help banks make further use of capital markets for NPL reduction, particularly through the sector's experience in securitization, for example by requesting banks to report what volumes of their NPLs meet NPL securitization content and quality requirements.

56. The Insolvency and Creditors/Debtors rights system in Colombia has several recent norms and is in a stage of transition. The legal system of individual enforcement of secured and unsecured loans, as well as the insolvency system are critical for the well-functioning of the NPL system as a whole. Colombia has a reasonably modern Civil Procedural Law (*Código General de Proceso*), a Secured Transactions (Law 1676 of 2013) that is less than a decade old, and a modern Insolvency Law (Law 1116/2006), which has been supplemented by several pieces of emergency legislation since the beginning of the pandemic. Some of these emergency laws will expire in the coming months (early 2022) and, therefore, urgent measures need to be adopted as to whether they will be extended or not, bearing in mind that some of these decrees (i.e., Legislative Decree 560/2020) make considerable modifications to the corporate insolvency system. In the medium to long term, it is important to modify Law 1116 to incorporate all the insolvency provisions in one single text, in line with international good practices.

57. There are areas for improvement to further strengthen the framework for insolvency and creditor rights (ICR) in Colombia. While the *Superintendencia de Sociedades* (SS) is a very sophisticated administrative body with judicial functions in corporate insolvency proceedings, the rotation of its judges and consequent changes in criteria make the system unpredictable. Individual enforcements (with exception of pledge enforcements regulated in the Law 1676 of 2013), take a considerable amount of time. Procedural laws also contain cumbersome provisions, including in issues such as auctions, valuations, appeals and defenses in executive proceedings. Enforcement of mortgages and unsecured claims is long and cumbersome, and they are frequently delayed by permitting debtors to file "causal" defenses that are usually beyond the scope of enforcement proceedings in most jurisdictions. The Corporate Insolvency Law would benefit from updating in several aspects, including the treatment of secured creditors, voting in classes and its liquidation provisions. Finally, the personal insolvency system requires urgent attention. Currently, the *centros de conciliación* are tasked with administering reorganization proceedings. The lack of up-to-date data on many aspects of Colombia's personal insolvency system means it is difficult to make targeted improvements. Local municipal courts are not specialized enough, nor sufficiently resourced, to deal with a large number of complex personal insolvencies. The Personal Insolvency Law (*Insolvencia de Personas Naturales No Comerciantes* - IPNNC) should also be updated, bearing in mind the importance of consumer credit for the financial system as a whole.

E. Insurance

58. The insurance market is in a mid-development phase, albeit that usual comparative indicators are at levels attributable more to compulsory than voluntary insurances. Insurance premiums totaled COP 30.5 billion in 2020 while insurance penetration, measured as the value of insurance premiums to GDP, stood at 3.1 percent in 2020, up from 2.2 in 2010. This represents an average growth of 6.2 percent per annum in real terms. Life insurance penetration was 1.6 percent of GDP compared to non-life insurance of 1.5 percent of GDP. There are 43 insurers (25 non-life insurers and 18 life insurers). Exits and new entrants, foreign and locally founded entities and two state owned insurers are evidence of an open and competitive market.

59. Despite aggregate level steady growth, the insurance industry is responding to considerable change. COVID has had a far-reaching impact, including on claims levels for life insurance, changed risk profiles for non-life risks, changed consumer attitudes, strong motivation to establish new distribution channels, and encouraged digitization of the value chain. The industry has also been characterized by process disruption, product simplification, and cyber risk. Increased inclusion in the insurance space continues to progress as insurers can reach more parts of the population with access to banking services. Parametric insurances are of interest, especially given visible impacts of climate change and a desire to find relevant cost-effective solutions for rural communities.

60. Non-life insurance is particularly competitive with constrained margins limiting investment in innovation. The non-life Herfindahl index of 795 is well below international benchmark averages, whereas the life market index of 1775 is closer to neutral settings. In part, the response to competition appears in commission rates and the search for alternative distribution. Innovation is critical to moving to a more sustainable market structure. Stakeholders acknowledge that the sandbox is not utilized as much as would be desirable.

61. Companies meet the current solvency regulation and are profitable (with few exceptions).[40] Industry average solvency coverage ratios of 2.08 in 2020 have been increasing. Current reporting standards are expected to change in 2023 with the introduction of IFRS 17 and the EU inspired Solvency II, both of which are expected to enhance transparency of tight financial margins and require increased provisioning and capital, and some price increases. The implementation of IFRS and Solvency reforms are desirable and will enhance observance of the IAIS Solvency Principles. It is recommended that the SFC maintains a close watch on margins and capital in advance of full implementation. The capital injection for the state-owned life insurer should proceed as planned.

62. The SFC has successfully developed and implemented a system of oversight in the areas of regulation and supervision that were a focus of the mission. The mission reviewed: i) ICP 9 – Supervisory review and reporting; ii) ICP 16 – Enterprise risk management for solvency purposes; iii) ICP 18 – Intermediaries; and iv) ICP 19 – Conduct of business. The risk-based approach to supervision is advancing well. The SFC shows little sign of unhelpful residual compliance-based approaches. Enterprise risk management is consistently implemented at insurers. Consumer protection requirements are comprehensive in scope. The SFC is now developing an impressive and genuine SupTech initiative with positive sector support. Distribution regulation and supervision is consistent with international standards although it may need to be reviewed to keep in step with market changes as they shift away from face-to-face channels.

F. Capital Markets Development

63. Despite a robust regulatory framework and a large, liquid local currency government bond market, capital markets for private equity and debt in Colombia are shallow, illiquid, and dominated by financial institutions, limiting private sector investment and growth. While there is notable progress in some segments, the size and liquidity of the Colombian stock exchange is below the peer group average. The private debt market is concentrated in blue-chip issuers, leaving most firms lacking financing. Equity issuance is concentrated in a small number of companies with shares equivalent to half of total market capitalization issued by Ecopetrol and four large financial conglomerates. The non-government debt market is constrained by low liquidity and demand for investable assets by domestic pension funds, which increases prices.

64. Several reforms are being implemented or drafted that could be a turning point for capital markets. These reforms are the result of a thorough diagnostic and consensus building between public and private stakeholders under the leadership of the MHCP – the 2018 Capital Markets Mission, with a considerable part of the recommendations having been included in the draft Law 413 of 2021 for Payment Systems and Capital Markets, currently under discussion in Congress. It will be key to approve this law preserving several critical reforms: i) the introduction of a more flexible functional licensing regime that would lower entry barriers and harmonize regulations of equivalent services conducted by different entities; ii) addressing regulatory constraints that

[40] Exceptions are related to profitability. At the time of the assessment, all insurance companies complied with current solvency regulations.

prevented competition and long-term investment strategies for institutional investors, such as the use of the minimum return rule for assessing performance or the special reserve for potential shortfalls of private pension funds (AFPs); iii) addressing regulatory and risk obstacles for access of SMEs to listed and unlisted financing instruments, such as the authorization for simplified equity companies (SAS) to issue debt; iv) consolidation of the Interbank Overnight Rate (IBR) as the reference rate in the money market; or v) clarification and strengthening of the role of financial sector regulators and supervisors.

65. Strides towards a more reliable money market have been taken but some shortcomings could be addressed to enhance its efficiency. In recent years, money markets have benefitted from the increased use of the more reliable IBR, more regular issuance of short-term treasury securities (TES), clearing of sell-buy-backs through the Central Counterparty Clearing House (CRCC) or extending maturities in BR monetary operations. Sell-buy-backs are the most important liquidity management instrument in the market, with maturities concentrated mainly overnight, whereas the use of repos is mostly limited to transactions between BR and market participants. A more leveled playing field could be created by strengthening the repo framework to allow for the re-use of collateral and to increase its legal robustness. In addition, it is recommended to resume past efforts to eliminate (or gradually reduce) the 4x1000 tax on financial transactions that continues to hamper the development of the market.

66. The Government bond market is well developed and relatively liquid. At 35 percent of GDP in end-2020, the market is efficient, with two reliable local currency Government bond yield curves, one in fixed coupon bonds (69 percent of the debt) and the other one in index-linked bonds (31 percent of the debt). Maturities at issuance go up to 15-30 years. Secondary market liquidity is mostly concentrated in medium tenors of 3 and 4 years. The planned introduction of an Issuer-Driven exchange trade fund (with government bonds as underlying assets) by the government will contribute to the diversification of the investor base (including retail investors) and increased liquidity in the secondary market. The main challenge is to develop liquidity in the short and long-term tenors of the Government yield curve, so as to provide a reliable price reference for private financial assets in those tenors. Finally, the 5 percent withholding tax for foreign investors, albeit reduced recently in 2019 from 14 percent in 2018, continues to be high if compared to other countries in the region that have foreign investors exempted.

67. Non-government bond markets are not a substantial financing source for the real economy, and equity markets are heavily concentrated in a small number of large issuers. Notwithstanding remarkable achievements such as the development of capital market solutions for Colombia’s ambitious infrastructure investment program in the past years, or the creation of a hybrid bond issuance regime (Segundo Mercado), non-financial corporates (particularly SMEs) continue to resort to bank lending to a great extent. At end-2020, Colombia's market capitalization accounted for 36 percent of GDP. The number of listed companies (64) is less than half of that of its regional peers (185 in Chile, 133 in Mexico and 175 in Peru). Despite a general global trend in declining equity listings, Colombia ranks lower than its peers, with new issuances declining since 2014.

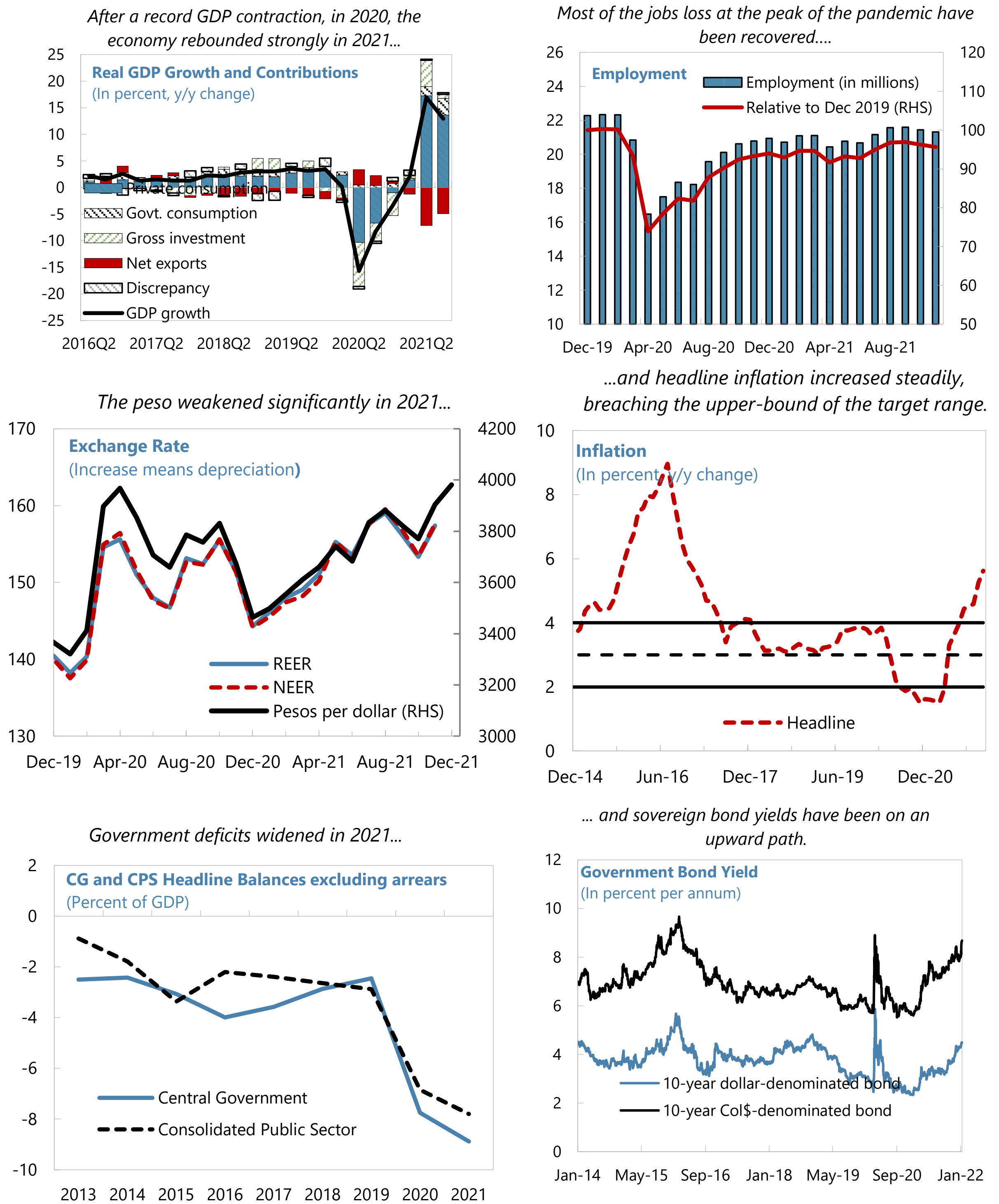
68. SMEs are almost absent from Colombian capital markets, but recently approved regulations enabling new instruments could substantially increase their access to finance. They include: i) authorization for SAS to issue debt; ii) subsidized guarantees offered by the National Guarantee Fund (FNG) on SME corporate debt issued by SAS and others; iii) FNG portfolio guarantees for private debt funds lending to SMEs that could help establish these funds as a new asset class; and iv) revised investment regulations for pension funds and insurance companies enabling them to invest in corporate debt funds. These regulations were launched in the context of the post COVID-19 economic recovery plan. However, they could have a more permanent impact in the disintermediated market if they are designed following best practices, once subsidized guarantees are withdrawn.

69. The Government is engaged in an ambitious reform to increase competition and diversity among highly concentrated institutional investors, however, there are two important dysfunctionalities that would need to be addressed. First, the recently approved Law 2112 of 2021 prescribed a 3 percent mandatory investment in private capital funds (FCP), which could have perverse effects and lead to an erosion of investment value, an inadequate risk-return of portfolios and a misallocation of pension fund assets. This Law contradicts the spirit of Decree 1393 of 2020, which increases flexibility in investment regulations so they can be more closely matched to the different profiles of beneficiaries and adopt a risk-based approach instead of rigid investment buckets. The Law's implementing regulation should provide flexibility to pension funds in the application of this mandatory investment, including the potential measurement by investment commitments as opposed to disbursements. Secondly, the figure of "net worth loss" (*detrimento patrimonial*) as currently stands is a disincentive for public assets managers to adequately invest in higher yield assets other than government bonds, and the interpretation of the net worth loss concept in Article 6 of Law 610 of 2000 should be clarified and redefined. Lastly, any initiative to allow early withdrawal of pension funds savings should be discarded as it could negatively impact the stability of the financial system and limit the debt placement options of governments, among other negative consequences.

70. Growth of crowdfunding borrowing has been low since the enactment of the crowdfunding framework in 2018. Just one platform, sponsored by the Colombian Stock Exchange (BVC), has been launched to date,[41] with only 82 projects financed since 2018. The low participation by the MSMEs in this new financing platform can be attributed to two reasons. First, only entities with a securities market license called "Collaborative Financing Companies" (CFC) can offer crowdfunding services. Second, regulation limits crowdfunding platforms to issue tradable debt and equity. Peer-to-peer lending (P2P) is explicitly excluded from Decree 1235 of 2020, which, following experience from advanced and other emerging economies, is where the largest share of digital lending takes place for MSMEs.

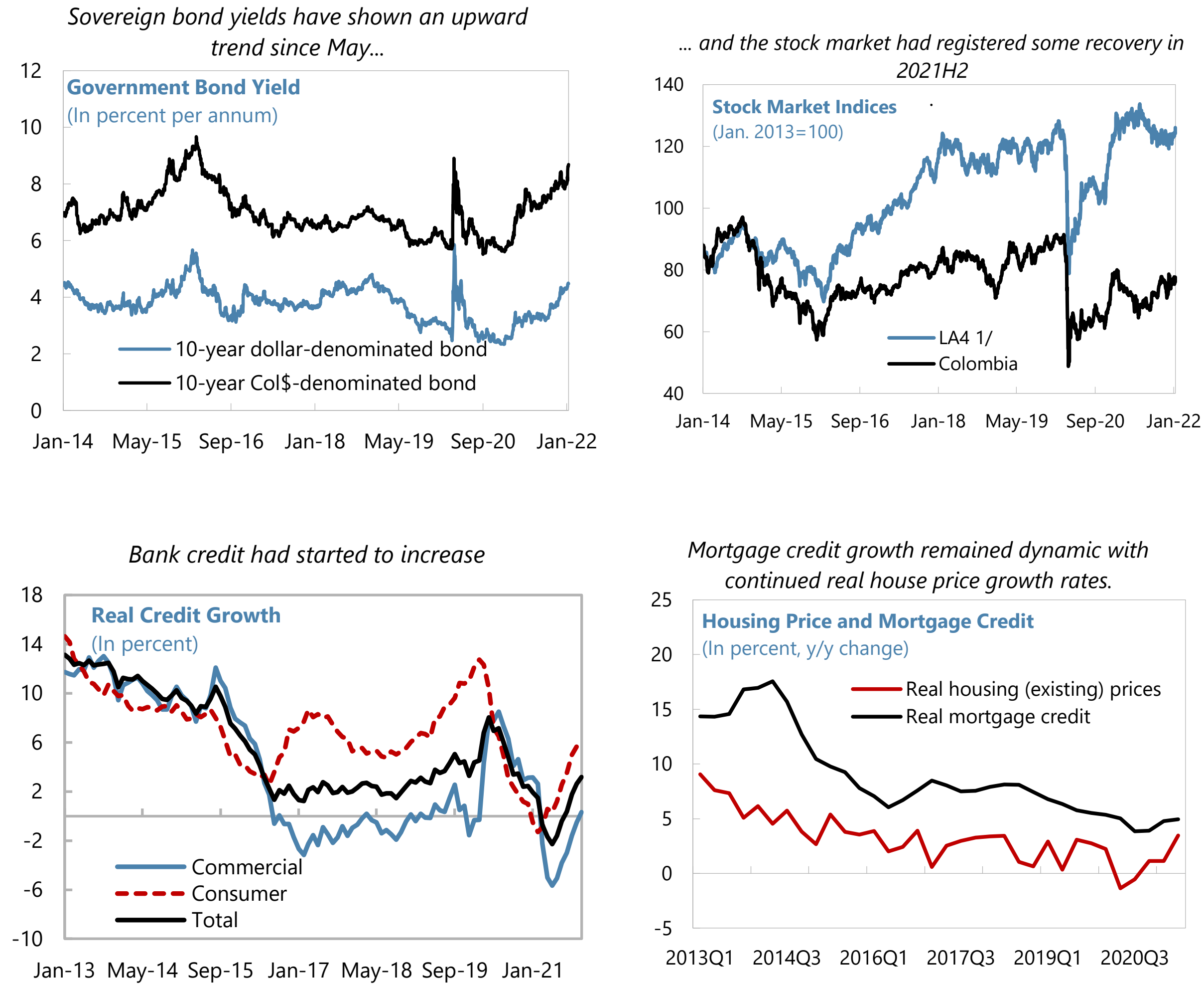
[41] There are two more authorized platforms expected to start operations shortly: one for real estate projects, and one MSME financing.

Figure 2. Colombia: Selected Economic Indicators



Sources: Departamento Administrativo Nacional de Estadísticas (DANE), Banco de la República (BR), Ministerio de Hacienda y Crédito Público (MHCP), and IMF staff estimates.

Figure 3. Colombia: Macrofinancial Developments



Sources: Banco de la República (BR); DANE; Bloomberg; and IMF staff estimates.

Figure 4. Colombia: Financial Conglomerates

Conglomerate Shares in the Financial System

Conglomerate Shares in the Banking Sector

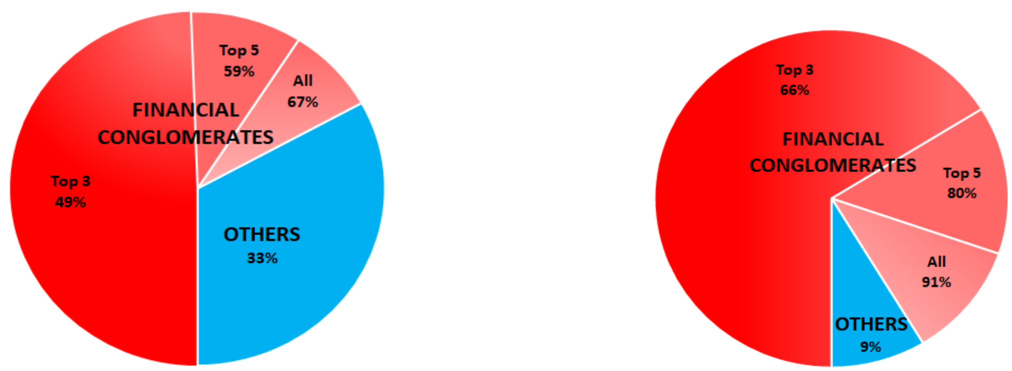
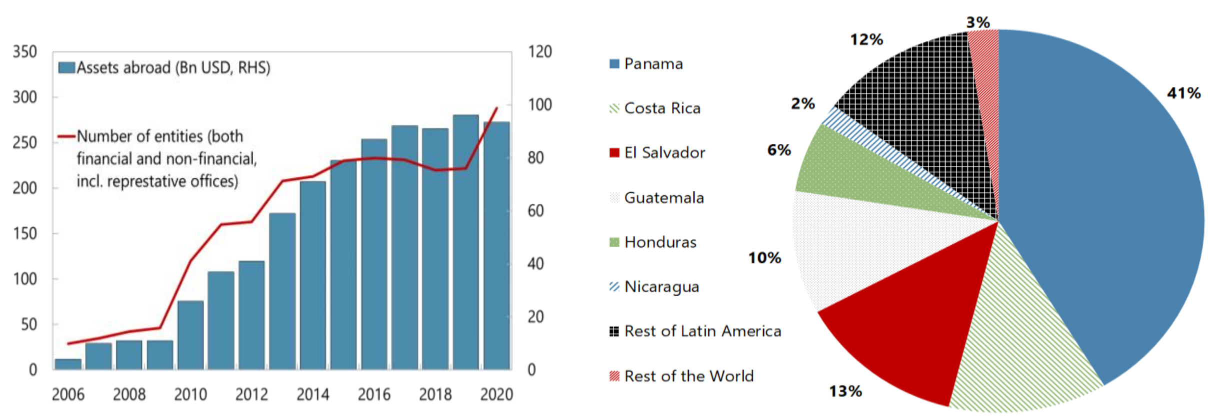


Figure 5. Colombia: Conglomerates' Cross-border Exposures

Evolution of Conglomerates' Foreign Exposures

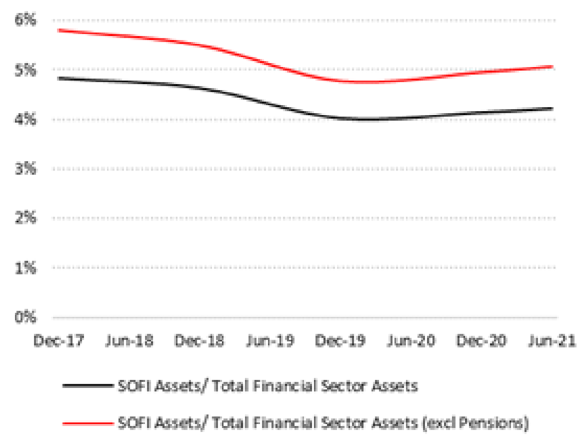
Conglomerates' Foreign Exposures by Geography
(share of subsidiaries' total assets, unconsolidated)



Sources: SFC; and staff calculations.

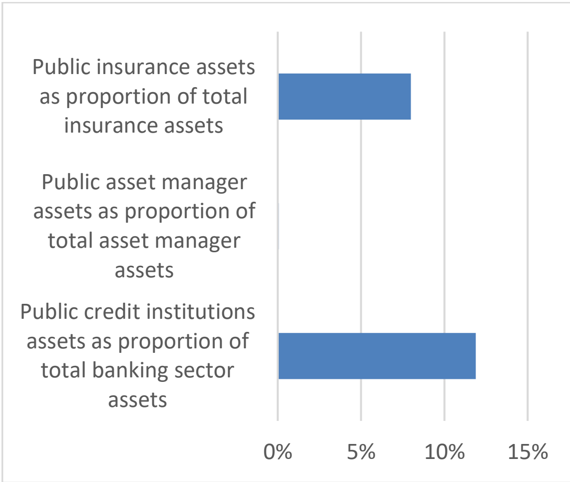
Figure 6. Colombia: State-owned Financial Institutions (SOFIs)

SOFIs assets account for less of total financial sector assets…



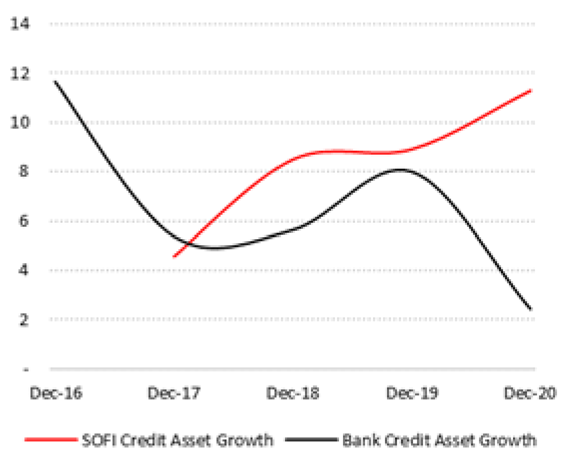
Note: SOFIs Assets exclude Fogacoop, Fogafin and FNG.
Source: SFC

…but they have significant operations in some financial segments



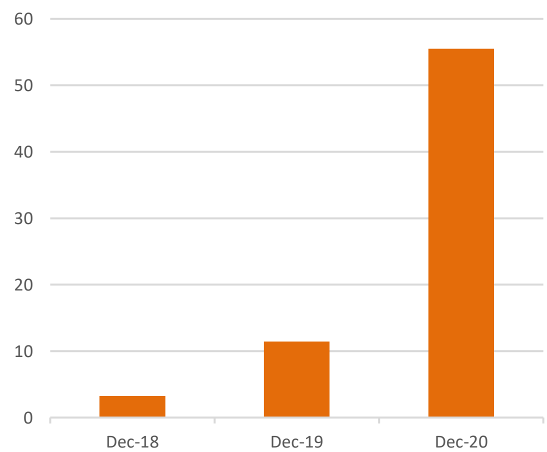
Source: SFC

SOFIs credit is countercyclical…



Note: SOFIs and Bank Credit Assets are derived from the Balance Sheet
Source: SFC

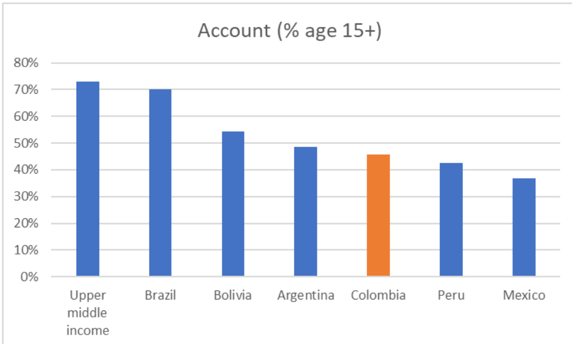
… and credit supported by public guarantees grew rapidly during COVID pandemic



Note: FNG credit is guaranteed credit
Source: SFC

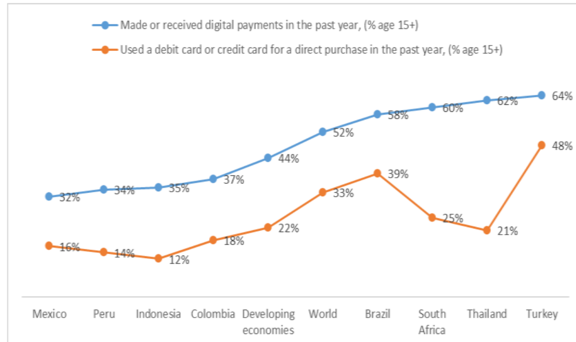
Figure 7. Colombia: Selected Financial Inclusion and Access to Finance Indicators

Account ownership, international comparison



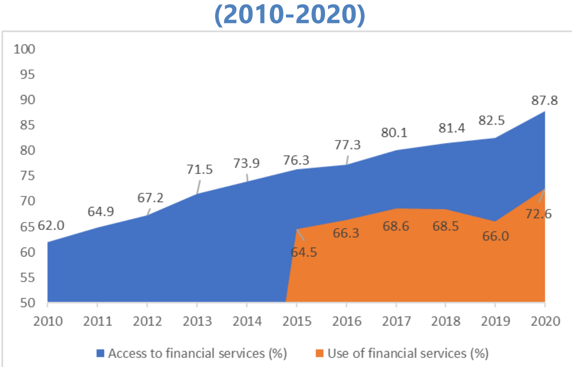
Source: Global Findex database 2017

Use of transaction accounts, international comparison



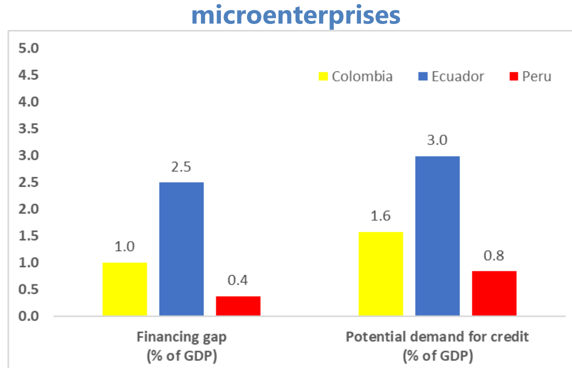
Source: Global Findex database 2017

Access to financial services in Colombia (2010-2020)



Source: BdO and SFC, "Reporte de Inclusión Financiera", July 2020

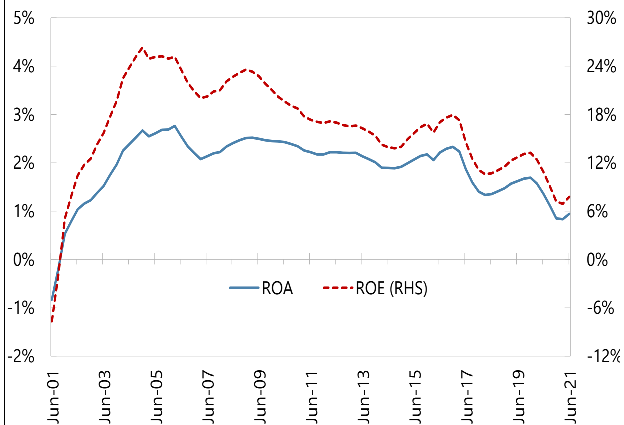
Financing gap and demand for financing by microenterprises



Source: World Bank Group. 2018. MSME financing gap

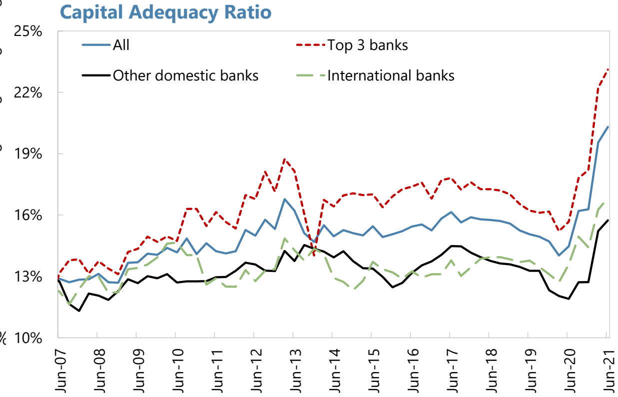
Figure 8. Colombia: Selected Banking Indicators

Profitability



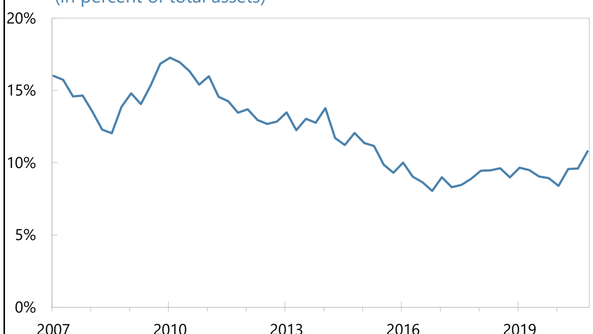
Solvency

Capital Adequacy Ratio



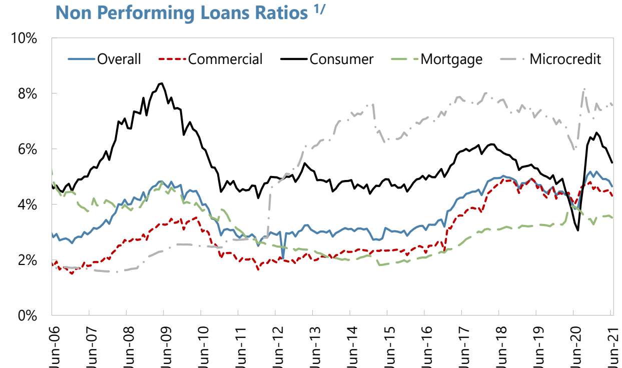
Sovereign exposures

Share of sovereign exposures
(in percent of total assets)



Credit quality

Non Performing Loans Ratios 1/

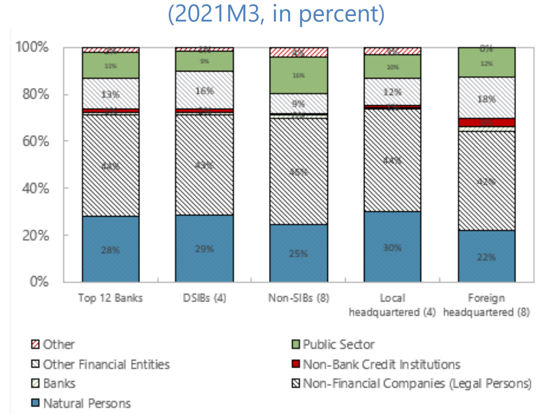


Source: SFC; IMF staff calculations.
1/ NPL ratios for consumer, commercial, and microcredit segments reflect 30 days or more past due and for mortgages 120 days or more past due.

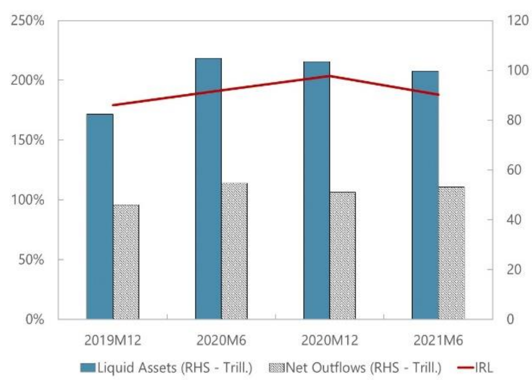
Figure 9. Colombia: Selected Banking Indicators: Liquidity

Top 12 Banks:
Sources of Funding by Bank Type
(2021M3, in percent of total funding)

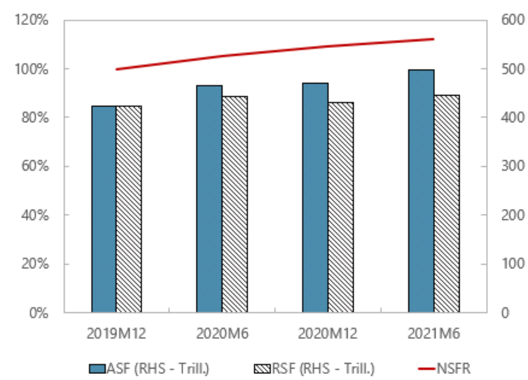
Top 12 Banks:
Deposits by Counterparty
(2021M3, in percent)



Top 12 Banks:
Liquidity Coverage Index (IRL) [1]



Top 12 Banks:
Net Stable Funding Ratio



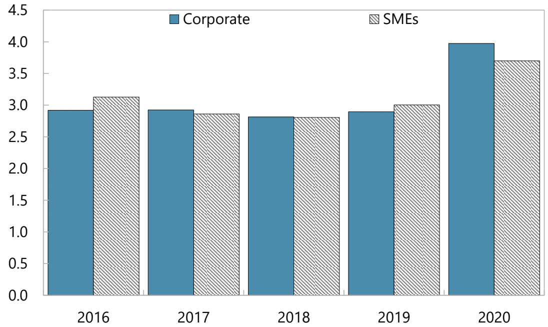
Source: SFC and IMF staff calculations.

1/ IRL is a national implementation of BASEL III Liquidity Coverage Ratio focusing on the short-term liquidity risks.

Figure 10. Colombia: Firms' Financial Ratios

Firms increased their liquidity positions in 2020…

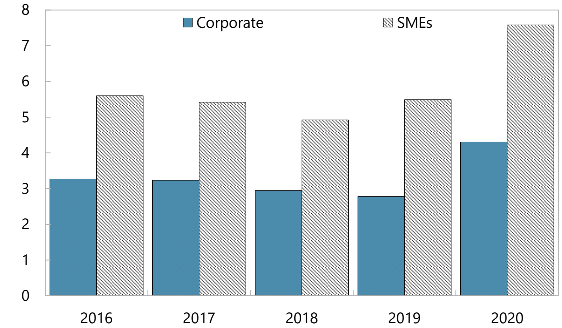
Cash-to-Total Assets Ratio
(Median of the distribution; in percent)



Sources: Supersociedades. IMF staff calculations.

…pushing up their cash available ratio.

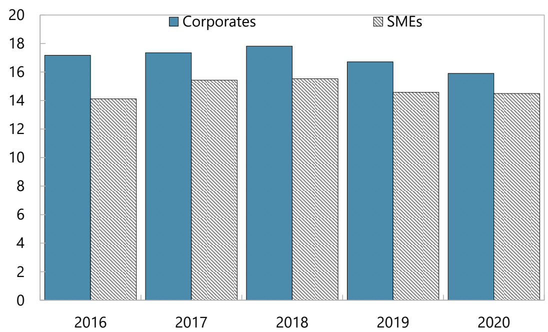
Cash Available Ratio
(Cash + receivables - short-term liabilities), excluding short-term debt



Sources: Supersociedades. IMF staff calculations.

A slight decline of leverage in 2020 for corporates but almost similar levels for SMEs.

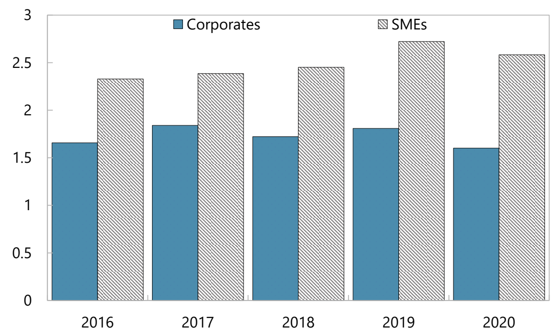
Debt-to-Assets Ratio
(Median of the distribution; in percent)



Sources: Supersociedades. IMF staff calculations.

While still above 1, ICR declined in 2020…

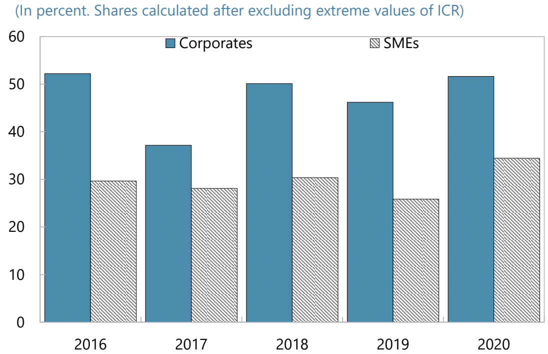
ICR
(In percent. Median of the distribution after excluding extreme values)



Sources: Supersociedades. IMF staff calculations.

…and the debt share increased.

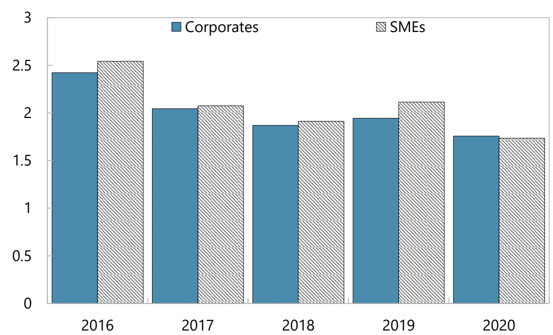
Debt Share of Firms with ICR<1
(In percent. Shares calculated after excluding extreme values of ICR)



Sources: Supersociedades. IMF staff calculations.

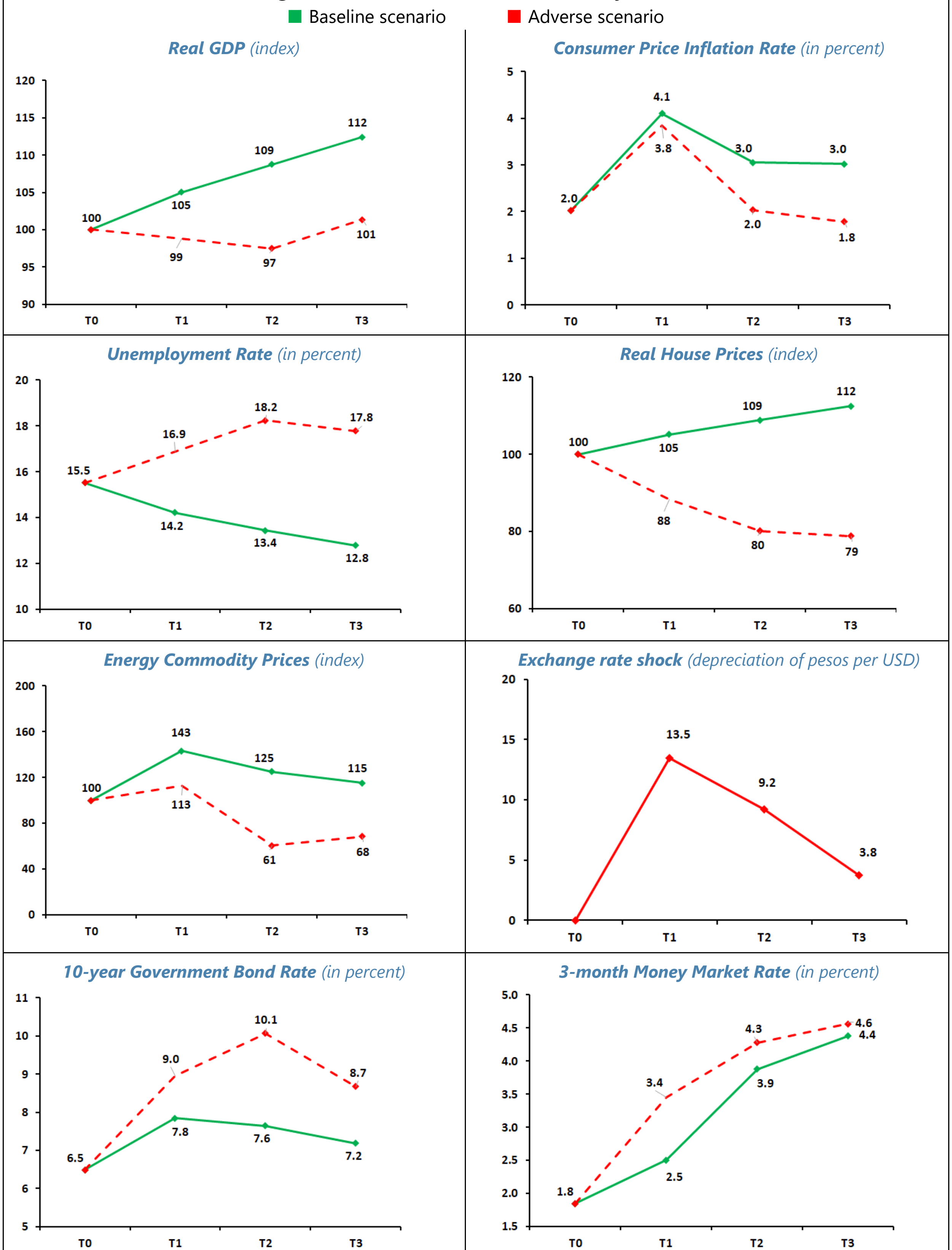
Profitability measures also declined in 2020.

ROA
(Median of the distribution; in percent)



Sources: Supersociedades. IMF staff calculations.

Figure 11. Colombia: FSAP Macro Projections



Source: World Economic Outlook; IMF staff calculations

Table 2. Colombia: Financial Sector Structure
(At end-2020)

	Assets (billion, COP)	Assets (% of GDP)	Percent of total financial sector assets	No. of entities
Credit institutions	**768,724**	**76.2**	**34.9**	**46**
Commercial banks	701,990	69.6	31.9	24
State-owned bank	27,851	2.8	1.3	1
Other	38,883	3.9	1.8	21
Pension funds	**383,761**	**38.1**	**17.4**	**5**
Pension funds	325,138	32.2	14.8	
Other retirement funds	47,927	4.8	2.2	
Prima media	10,696	1.1	0.5	
Mutual funds	**135,027**	**13.4**	**6.1**	**279**
Collective investment funds	76,039	7.5	3.5	
Private equity funds	19,412	1.9	0.9	
Other	39,577	3.9	1.8	
Insurance	**94,820**	**9.4**	**4.3**	**45**
Life	58,358	5.8	2.7	20
General	33,137	3.3	1.5	25
Other	3,326	0.3	0.2	
State-owned Financial Institutions[1]	**88,120**	**8.7**	**4.0**	**11**
Other	**69,191**	**6.9**	**3.1**	
Trust services	**660,546**	**65.5**	**30.0**	**23,680**
Management and Payment	179,000	17.8	8.1	11,986
Social Security Resources	88,000	8.7	4.0	103
Real Estate Development	76,000	7.5	3.5	8,572
Secured Finance and Collateral Mgmt	72,000	7.1	3.3	3,010
Investment	15,000	1.5	0.7	404
Securities custody	222,173	22.0	10.1	
Other	8,373	0.8	0.4	
TOTAL FINANCIAL SYSTEM	**2,200,188**	**218**	**100**	

[1] This category includes only nonbanks and does not include the state-owned bank (Banco Agrario), which is reflected under credit institutions.
Source: SFC.

Table 3. Colombia: Overview of SOFIs Assets

Institution	Total Assets (USD bn)*	Type of Institution	Market Segment/Mandate
Banco Agrario	8.2	Commercial Bank	Agricultural sector and provision of financial services in rural areas
Bancoldex	2.5	Development Finance Institution	EXIM and SMEs
Finagro	3.4	Development Finance Institution	Agricultural credit
Findeter	3.1	Development Finance Institution	Credit to municipalities, focus on infrastructure projects
FNA	2.6	Development Finance Institution	Housing credit with focus on lower income households
FDN	1.4	Development Finance Institution	National infrastructure projects
Icetex	0.002	Development Finance Institution	Student loans
Enterritorio	0.2	Development Finance Institution	Infrastructure project structuring. No longer providing finance
Caja Honor	1.8	Development Finance Institution	Housing loans and savings products to the military and police
FNG	1.0	Guarantee fund	Promotes access to financing for Colombian companies through the granting of guarantees, with an emphasis on SMEs.
Fidu Agraria	0.02	Asset Manager	Agriculture and rural development related funds
Fidu Coldex	0.02	Asset Manager	Public funds promoting trade an innovation
Fidu Previsora	0.1	Asset Manager	Social sectors funds (teachers) and special programs
Positiva	1.4	Insurance Company	Focus on occupational hazards and underserved segments
Previsora	0.7	Insurance Company	Focus on MTPL, Civil Liability and Vehicles

**Calculated using 3,850 COP / USD. Data as of June 2021. Source: SFC*

Table 4. Colombia: Financial Soundness Indicators

(In percent, unless otherwise indicated; end-of-period values)[1]

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Capital Adequacy 2/											
Regulatory capital to risk-weighted assets	17.3	16.9	18.1	17.0	17.0	16.9	17.5	18.6	18.5	16.9	19.9
Regulatory Tier 1 capital to risk-weighted assets	13.0	13.4	13.7	12.0	11.7	11.4	11.4	12.4	12.7	11.7	14.8
Capital (net worth) to assets 3/	14.2	14.3	14.7	14.8	14.9	14.1	16.2	16.1	16.6	17.0	16.3
Asset Quality and Distribution 4/											
Nonperforming loans to gross loans (30-day)	NA	NA	NA	NA	NA	2.9	3.2	4.3	4.6	4.3	5.0
Nonperforming loans to commercial loans (90-day)	NA	NA	NA	NA	NA	1.6	1.8	3.0	3.8	3.4	3.8
Provisions to nonperforming loans	175.0	182.0	163.9	160.7	151.3	155.5	153.5	134.7	137.5	142.4	152.8
Gross loans to assets	67.9	70.4	69.6	68.2	69.3	70.2	69.3	70.1	70.5	69.2	64.4
Earnings and Profitability											
ROAA	3.4	3.3	3.1	2.8	2.9	2.7	3.0	2.2	2.6	2.9	1.7
ROAE	23.7	23.0	21.2	19.5	19.8	18.9	18.3	13.7	16.0	17.3	10.4
Interest margin to gross income	55.6	58.4	58.7	61.3	60.6	58.7	53.7	59.2	57.3	56.4	57.0
Noninterest expenses to gross income	47.0	49.3	47.2	47.0	44.6	43.4	41.2	43.9	41.9	40.4	42.1
Liquidity 2/											
Liquid assets to total assets 5/	22.1	21.5	21.6	21.4	19.8	18.9	18.0	18.6	19.2	17.7	20.3
Liquid assets to short-term liabilities 5/	42.7	43.7	43.6	41.9	40.3	39.9	39.9	42.6	43.0	40.0	41.5
Deposit to loan ratio	93.5	91.4	94.7	96.3	91.6	93.2	92.6	92.7	92.0	91.2	100.3
Other											
Foreign-currency-denominated loans to total loans	6.9	7.7	7.5	7.3	8.4	8.3	6.9	6.1	5.9	5.0	4.4
Foreign-currency-denominated liabilities to total liabilities	9.8	11.5	10.5	11.9	13.5	13.9	11.8	11.0	11.6	11.4	10.9
Net open position in foreign exchange to capital 6/	0.6	1.0	0.6	0.5	0.7	1.3	5.5	6.4	7.1	0.7	0.9

Source: Superintendencia Financiera.

1/ Unlike the FSI data referred to in the main text, this table covers both regular credit institutions and so-called second-tier banks, which include national development banks among other institutions.

2/ Over CY2020, Basel III risk weights came into force, resulting in a rise of about 1 to 1.5 percentage points in average CARs.

3/ Large increase in 2016 due to a change to IFRS in January 2016 where deposit insurance that used to be recorded as a liability is now recorded as capital.

4/ Implementation of emergency measures (Circulars 7 and 14) and the PAD make that series are not fully comparable across time.

5/ Data after 2011 refers to broader definition of liquid assets in line with international standards.

6/ Since January 2016, goodwill and retained earnings started to be recorded in foreign currency. Before January of 2016, they were recorded in Colombian pesos and weren't included in the foreign exchange position.

Table 5. Colombia: Risk Assessment Matrix

<table>
<tr><th rowspan="2">Nature (Source) of Main Threats</th><th colspan="2">Overall Level of Concern</th></tr>
<tr><th>Likelihood of Realization of Threat in the Next 1–3 Years
(high, medium, or low)</th><th>Expected Impact on Financial Stability if Threat is Realized
(high, medium, or low)</th></tr>
<tr><td>Uncontrolled COVID-19 local outbreaks and global resurgence of the pandemic</td><td>High/Medium
• Outbreaks of lethal and highly contagious Covid-19 variants lead to subpar/volatile growth, with increased divergence across countries. Rapidly increasing hospitalizations and deaths, due to low vaccination rates or caused by vaccine-resistant variants, force lockdowns and increased uncertainty about the course of the pandemic.
• Policies to cushion the economic impact are prematurely withdrawn or for many EMDEs, constrained by lack of space. In addition to declines in external demand, a reassessment of growth prospects triggers capital outflows, financial tightening, currency depreciations, and debt distress in some EMDEs, with spillovers to AEs, leading to growing divergence of economic recovery paths</td><td>High
• Renewed or more stringent containment efforts and resulting uncertainty jeopardize economic recovery, reducing growth and straining government resources.
• With limited policy space, further extension of relief initiatives to support the economy is either impossible or insufficient, triggering capital outflows, depreciation, and inflation pressures.
• Household and corporate vulnerabilities worsen, affecting banks' asset quality.</td></tr>
<tr><td>De-anchoring of U.S. inflation expectations and rise in global risk premia</td><td>Medium
• De-anchoring of inflation expectations in the U.S. and/or advanced European economies. A fast recovery in demand amid a lagging supply-side response leads to a rapid de-anchoring of inflation expectations, which prompts central banks to tighten policies abruptly.
• The resulting sharp tightening of global financial conditions and spiking risk premia lead to currency depreciations, asset market selloffs, bankruptcies, sovereign defaults, and knock-on effects (e.g., lower commodity prices and possible contagion across EMDEs).</td><td>High
• Risk asset prices fall sharply and volatility spikes, leading to significant losses in major nonbank financial institutions.
• Higher risk premia generate financing difficulties for leveraged firms (including those operating in unviable activities) and households, and a wave of bankruptcies erode banks' capital buffers.
• Increased cost of sovereign financing further raises the stakes for continuing the support programs to mitigate the impact of pandemic on the economy at the expense of fiscal sustainability.</td></tr>
<tr><td>Widespread social discontent and political instability, including from the region</td><td>Medium
• Social tensions erupt as a withdrawal of pandemic-related policy support results in unemployment, and amid increasing prices of essentials, hurts vulnerable groups (often exacerbating pre-existing inequities).
• Spillovers from regional social tensions reduce capital inflows to Latin America for a sustained period.</td><td>Medium
• Rising unemployment and re-imposition of lockdown measures could increase public discontent, amplifying the negative impacts of the pandemic on labor markets and firms.
• Economic activity is disrupted. Growing political polarization and instability weaken policymaking and confidence.
• Reversals of capital flows, exchange rate depreciation and fragile recovery would</td></tr>
</table>

		adversely impact banking system through rise in funding costs, liquidity shortfalls and declining asset quality.
Disorderly transformations	**Medium** • COVID-19 triggers structural transformations, albeit facing labor market rigidities, debt overhangs, and inadequate bankruptcy resolution frameworks. • This, coupled with a withdrawal of COVID-19-related policy support, undermines growth prospects, and increases unemployment, with adverse social/political consequences. Significant uptake of relief initiatives by borrowers indicates reliance on these temporary measures and make policy exit risky. • Financial conglomerates' sizeable cross-country exposures similarly impacted by scarring and policy reversals in host states.	**High** • Weak economic activity and high unemployment as well as sizeable exit from labor force hinder repayment capacity when support programs are withdrawn. • Banks face a surge in NPLs, especially those exposed more to vulnerable sectors (households, SMEs, etc.), eroding bank capital. • Profitability and solvency of banks come under significant distress, tightening lending conditions and making it difficult to support the economic recovery. • Corporate credit spreads widen further. Regional spillovers further weaken the balance sheet of financial conglomerates.
Increasing fiscal pressures and/ or loss of fiscal credibility	**High** • Lack of confidence about structural and fiscal sustainability and weakening of debt profile leads to further downgrades triggering a major sell-off event for sovereign bonds and Investment Grade corporates. **Medium** • Shortfalls in mobilizing revenue leads to large cuts in public investment and social spending, adversely affecting growth and poverty reduction.	**High** • Stress in public finances spill over into the financial system given the strong home bias. • Banks are negatively impacted through higher funding costs and valuation losses on government debt holdings. • Valuation losses on other financial institutions' assets, in particular pension funds.
Build-up of climate-related risks	**Medium/Low** • As the effects of climate change become more visible and frequent, stronger policy responses are needed for transitioning towards a low-carbon economy (carbon prices/taxes, change in subsidies, etc.)	**Medium** • Increase in carbon tax affects profits and balance sheets of nonfinancial corporates. • Banks are negatively affected since the asset quality suffers (higher NPLs) due to the financial health of corporate borrowers.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 percent and 50 percent). Non-mutually exclusive risks may interact and materialize jointly.

Table 6. Colombia: FSAP Macro Projections—Baseline and Adverse Scenarios

(In percent)

		2020Q3-2021Q2 (T0)	2021Q3-2022Q2 (T1)	2022Q3-2023Q2 (T2)	2023Q3-2024Q2 (T3)
Real GDP growth	*Baseline*	*1.2*	*5.0*	*3.6*	*3.3*
(percent)	*Adverse*		*-1.2*	*-1.3*	*4.0*
Nominal GDP growth	*Baseline*	*4.2*	*6.3*	*8.1*	*6.1*
(percent)	*Adverse*		*-1.1*	*-0.4*	*3.7*
Inflation rate	*Baseline*	*2.0*	*4.1*	*3.0*	*3.0*
(percent)	*Adverse*		*3.8*	*2.0*	*1.8*
Unemployment rate	*Baseline*	*15.5*	*14.2*	*13.4*	*12.8*
(percent)	*Adverse*		*16.9*	*18.2*	*17.8*
Interbank lending rate	*Baseline*	*1.8*	*2.5*	*3.9*	*4.4*
(percent)	*Adverse*		*3.4*	*4.3*	*4.6*
1-year government bond yield	*Baseline*	*2.3*	*3.8*	*4.7*	*5.0*
(percent)	*Adverse*		*4.2*	*4.8*	*4.7*
10-year government bond yield	*Baseline*	*6.5*	*7.8*	*7.6*	*7.2*
(percent)	*Adverse*		*9.0*	*10.1*	*8.7*
Housing price	*Baseline*	*100.0*	*105.1*	*108.9*	*112.5*
(index)	*Adverse*		*88.2*	*80.2*	*78.8*
Equity price	*Baseline*	*100.0*	*106.3*	*114.9*	*121.9*
(index)	*Adverse*		*83.0*	*79.0*	*87.7*
Energy commodity prices	*Baseline*	*100.0*	*143.0*	*124.9*	*115.3*
(index)	*Adverse*		*112.9*	*60.6*	*68.3*
Non-energy commodity prices	*Baseline*	*100.0*	*110.3*	*107.7*	*107.2*
(index)	*Adverse*		*100.9*	*79.5*	*81.9*

Table 7. Colombia: SOFIs Selected Financial Soundness Indicators

(as of June 2021)

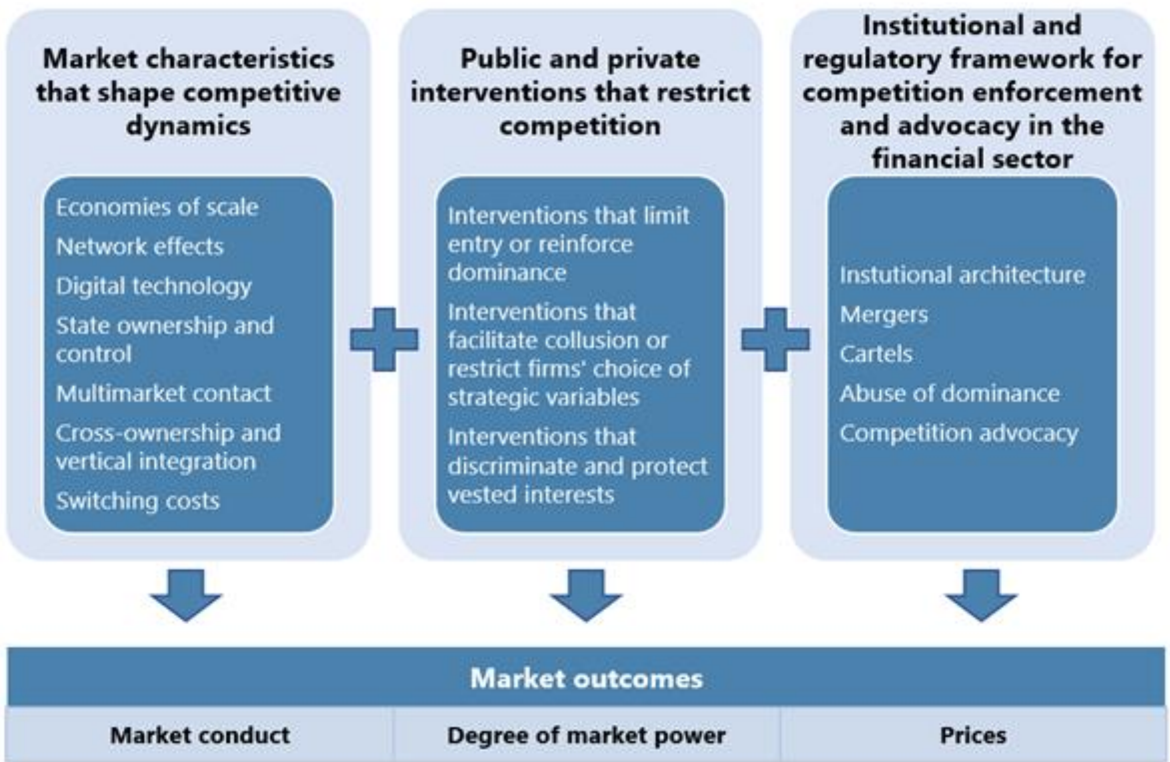
Institution	Solvency (%)	NPLs (%)	Provisioning (%)	ROE (%)
Banagrario	15.7	6.8	77	32.8
Bancoldex	18.5	2.4	53	4.0
Findeter	33.1	0.4	179	3.5
FDN	77.4	0.0	709	4.2
Finagro	31.8	0.0	44,307	6.4
Fondo Nacional Del Ahorro	81.4	5.4	68	4.8
Caja De Vivienda Militar	11.8	0.01	16,718	2.3
Icetex			0	1.9
Enterritorio			100	2.2
All Private Banks	20.3	4.6	70	10.8

Source: SFC

Box 1. Methodology for Assessment of Competition in the Financial Sector

The assessment of competitive dynamics and potential regulatory/institutional constraints to competition in Colombia's financial sector contains both a quantitative and a qualitative approach. The quantitative assessment explores market characteristics and dynamics, including market structure and concentration, cross-ownership and vertical integration, network effects and customer conditions/consumer power. The quantitative assessment is complemented by a qualitative analysis of the regulatory and institutional framework to understand how private and public interventions shape market dynamics and result in specific market outcomes, including efficiency, degree of market power and consumer mobility (Figure 12). In the case of Colombia, the assessment note focuses primarily on the retail banking sector as well as payment systems and discuss competitive dynamics in other parts of the financial sector only to the extent that they affect these two areas, for example in the context of financial conglomerates.

Figure 12. Assessing Competition in the Financial Sector



Source: adapted from Calice, P. ''Guidance Note on Assessing Competition in the Financial Sector Assessment Program'' building on the WBG MCPAT