GETTING THE DEAL THROUGH

Banking Regulation

in 26 jurisdictions worldwide

2014

Contributing editor: David E Shapiro

Published by
Getting the Deal Through
in association with:

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Banking Regulation 2014

Contributing editor: David E Shapiro Wachtell, Lipton, Rosen & Katz

Getting the Deal Through is delighted to publish the seventh edition of *Banking Regulation*, a volume in our series of annual reports, which provide international analysis in key areas of law and policy for corporate counsel, cross-border legal practitioners and business people.

Following the format adopted throughout the series, the same key questions are answered by leading practitioners in each of the 26 jurisdictions featured. New jurisdictions this year include Canada and Russia.

Every effort has been made to ensure that matters of concern to readers are covered. However, specific legal advice should always be sought from experienced local advisers. *Getting the Deal Through* publications are updated annually in print. Please ensure you are referring to the latest print edition or to the online version at www.gettingthedealthrough.com.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We would also like to extend special thanks to contributing editor David E Shapiro of Wachtell, Lipton, Rosen & Katz for his continued assistance with this volume.

Getting the Deal Through
London
April 2014

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Law Business Research

THE QUEEN'S AWARDS FOR ENTERPRISE: 2012

Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 7908 1188
Fax: +44 20 7229 6910

First published 2008
Seventh edition
ISSN 1479-3210

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

CONTENTS

Colombia

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The government is responsible for regulating activities related to management, use and investment of funds raised from the public, including financial and insurance activities. The following guide governmental and regulatory purposes and criteria that must be followed when carrying out such activities:

- performance of activities in accordance with public interest;
- performance of activities adequately safeguarding users' interests, in particular the interests of savers, depositors, policyholders and investors;
- appropriate equity levels of entities carrying out such activities, in order to safeguard their solvency;
- operations being performed with adequate safety and transparency;
- entities carrying out such activities promoting competition and efficiency;
- credit being democratised, avoiding unlimited access to credit and risk concentration;
- financial institutions' solidarity being protected and promoted;
- the financial system's regulatory framework promoting equal conditions for healthy market competition; and
- poor, small and medium-sized enterprises' access to financial and insurance services.

In addition, entities under Colombian Financial Superintendency's (CFS) surveillance, their managers, directors, legal representatives, auditors and other officials, must carry out their duties and obligations in good faith and promoting public interest.

When these duties are breached, sanctions may be imposed by the CFS on supervised entities, their managers, administrators, statutory auditors or other employees, in accordance with the following principles:

- contradiction, in order to secure due process to the sanctioned parties;
- proportionality, in order to use the right sanctions in accordance with the seriousness of the sanctioned conducts;
- exemplary sanction;
- relevance.

In general, all of the CFS's administrative actions and decisions must comply with the principles of speed, efficiency, impartiality, economy, publicity and contradiction.

2 Summarise the primary statutes and regulations that govern the banking industry.

Colombia's banking industry's general regulatory framework is based in the Constitution, which sets out the principles, faculties and specific responsibilities of the entities carrying out such activities. In turn, these principles give way to the creation of a broad and complex structure of financial regulation

Colombia's Constitution also establishes a particularly rigorous procedure for the enactment of laws related to financial activities, which is that of 'master laws' passed by the Colombian congress. These are laws that set out general aims, principles and regulations that are not only designed and promoted by the government, but that must be subsequently developed by Colombia's president and Ministry of Finance and Public Credit through specific and more practical regulations, in accordance with their constitutional duty to intervene in financial activities. Some of these laws include:

- Law 45 of 1990 (establishing rules for financial intermediation and insurance activities, inter alia);
- Law 35 of 1993 (setting out the aims and criteria to be considered by the government when regulating any activity related to management, use or investment of publicly raised funds, including financial and stock market activities);
- Law 510 of 1995 (establishing provisions in relation to the financial, insurance and stock market system);
- Law 964 of 2005 (including aims and criteria for the governmental regulation of activities of management, use and investment of funds raised from the public through securities);
- Law 1328 of 2009 (establishes rules in financial, insurance and securities market matters);
- Decree 2555 of 2010 (mainly a compilation of the financial, insurance and securities market regulations); and
- Decree-Law 663 of 1993 (enacted by the president, with congressional approval, and known as the Financial System Organic Statute (FSOS), containing basic regulation of the financial system, including financial institutions, authorisations, transactions and sanctions.

The Ministry of Finance and Public Credit is responsible for regulating the CFS's activities and faculties. In turn, the CFS has issued two main regulations that determine the legal, financial and accounting structures of entities operating in Colombia's financial and securities markets: Basic Legal Circular 007 of 1996 and Basic Finance and Accounting Circular 100 of 1995, which have been amended from time to time.

Colombia's Central Bank (the CCB) is a public entity that was given legal, administrative, financial and technical autonomy by the Constitution of 1991 as the supreme monetary, foreign exchange and credit authority in Colombia. The CCB's board of directors may issue 'external resolutions' to regulate, inter alia, mandatory bank reserves, limits to active credit operations allowed for financial entities and interbank lending operations. Relevant resolutions include:

- DCIN 83 and External Resolution 8 of 2000 on foreign exchange;
- DODM 144 on derivatives transactions;

- DODM 317 on trading systems and foreign currency registration; and
- External Resolution 5 of 2008 and DODM147 of 2009 on bank reserves.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The CFS and the CCB are, primarily, the Colombian regulatory authorities responsible for overseeing banks.

The CFS has the following duties:

- granting authorisation for the incorporation of Colombian financial institutions, stockbrokers or insurance companies, pension or severance funds, and branches of foreign financial or insurance institutions;
- authorising certain activities or fundamental changes to financial institutions such as mergers, acquisitions, offshore investments, incorporation of affiliates, opening new offices, banking hours, etc;
- issuing regulation on accounting standards, unsafe or unauthorised practices and information reporting requirements;
- visiting financial institutions for in situ supervision;
- receiving from and providing the market with all necessary information to promote transparency and to protect the interests of savers, depositors and investors;
- exercising limited jurisdictional capacities;
- establishing the maximum that interest rate financial institutions can collect or pay; and
- investigating unlawful or unethical behaviour and imposing sanctions on financial entities and their officers (or both).

The CCB governs:

- mandatory bank reserves;
- limits on active credit operations allowed for financial entities; and
- interbank lending operations.

The CCB is also responsible for providing a network of electronic services (SEBRA) for interbank clearing checks, a network for interbank clearing of low-value electronic payments (CENIT), and a Central Securities Depository (DCV) for keeping and electronically negotiating government securities (SEN).

In connection with foreign exchange markets, one of the CCB's main responsibilities is the registration of foreign investments in Colombia.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits in registered financial institutions are insured by the Financial Institutions' Guarantee Fund (Fogafin) against liquidation or government takeover. The following are subject to such insurance:

- deposits (ie, savings accounts, checking accounts);
- fixed-term deposits (CDTs);
- mortgage bonds;
- payable documents;
- collection banking services; and
- capitalisation securities.

The maximum amount insured by Fogafin per person in each financial institution is 20 million Colombian pesos, regardless of the number of products each individual may have in each institution.

In the late 1980s and early 1990s, the Colombian government initiated a privatisation process of almost all of its companies, including its financial institutions. Later, during the financial crisis of 1998 and 1999, it had to intervene in a number of financial institutions and, as a result, acquired the ownership of most of such entities, only to restructure, strengthen and resell soon after. Since then, the government has shown no interest in having ownership interests in the financial sector. The only exceptions are (i) the Banco Agrario de Colombia,

established in June 1999 and aimed at supporting agriculture, livestock, fisheries and forestry through accessible loans to the vulnerable populations that carry out these activities and have no other access to financial services; it is the only commercial bank currently owned by the government; and (ii) Bancoldex, a second-tier financial institution dedicated to financing Colombian exports and imports, through commercial banks.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

Affiliates are entities directly controlled by, or subject to, the will or decision of their parent or controller company. If the control is exercised with the assistance of or through subordinates of the parent company, the company is considered a 'subsidiary' rather than an affiliate.

Transactions with affiliates and subsidiaries, including investments, are subject to certain rules. For example, the aggregate amount of the equity investments in affiliates and subsidiaries may not exceed 100 per cent of the aggregate amount of the equity and the patrimonial reserves of the investor (Tier I equity).

Depending on the type of company – the parent company or the subsidiary – certain restrictions may apply.

Subsidiaries are not allowed to:

- acquire shares issued by the parent company or its affiliates; or
- acquire or negotiate securities that have been issued, guaranteed, accepted, or managed by the parent company or its subsidiaries.

Administrators and legal representatives of the subsidiary are not allowed to occupy any positions of power in the parent company.

Parent companies are not allowed to:

- acquire assets from the subsidiary, except for purposes of liquidation of the subsidiary;
- carry out active credit transactions with their affiliate trust companies, stockbrokers, or severance or pension fund managing companies (with certain exceptions); or
- carry out operations subject to conflict of interest; these arise when a person faces various conduct alternatives with regard to incompatible interests, none of which can be privileged in response to legal or contractual obligations.

Banks are generally authorised to:

- take funds from the public by means of demand deposits, checking accounts, saving accounts, time deposits (with or without issuing time-deposit certificates) and savings time deposits (with or without issuing savings time deposit certificates);
- issue securities;
- take loans in Colombian pesos from other local financial institutions through interbank lending or from the CCB as lender of last resort for liquidity purposes;
- take loans in foreign currency;
- act as underwriters of public debt securities;
- act as market makers for public debt securities;
- participate in the derivatives and money markets;
- perform leasing operations;
- act as dealers in the securities market (with certain limitations);
- act as depositaries and as transfer agents;

- act as non-fiduciary managers of loan portfolios for other financial institutions; and
- lend funds for the acquisition of companies different from financial institutions.

It is important to highlight that, according to Decree 2838 of 2013, the regime dealing with financial entities and insurance companies established in Colombia applies to branches of banks and foreign insurances companies, except for the special provisions related to equity and permanence requirements, as well as to special authorisations required from the CFS.

6 What are the principal regulatory challenges facing the banking industry?

Within the framework of the market liberalisation strategy adopted by Colombia in recent decades, commitments to the liberalisation of financial services have been made and continue to take place. For example, Colombia has agreed to complete, within a reasonable period of time, the implementation of regulatory adjustments related to risk-management systems for financial institutions (see question 7). Partly in response to the Basel III guidelines, and pursuant to Decree 1771 of 2012, the Colombian government fixed new equity adequacy requirements and solvency ratios for banks, financial, lease and saving institutions. Thus, since 1 August 2013, these institutions have been required to comply with a minimum total solvency ratio of 9 per cent, and a minimum core solvency ratio of 4.5 per cent; however, being below 11 per cent implies more close surveillance by the CFS. Additionally, a structured plan for the compliance of the new ratios as for 31 January 2014, were submitted by each bank before the CFS during 2013. Decree 1771 of 2012 also modified the legal definitions of market, operational and credit risk in order to incorporate the standards set for these concepts in Basel III.

From a broader perspective, foreign trade agreements recently entered into by Colombia with large-scale economies such as the United States have brought about new obligations regarding the openness and accessibility of banking and financial services in Colombia. One of the main challenges, for example, is to increase banking facilities in Colombia to provide further financial services to the poorest population and enhance its development.

In 2006, 48 per cent of Colombia's adult population owned at least one banking product, which was low even by Latin American standards. The government has addressed this issue by including a legal framework to foster the creation of new service channels, creating incentives to expand coverage in places where there was no banking presence, establishing the requirement of opening electronic accounts in order to receive certain governmental subsidies and welfare benefits, among other efforts to improve the level of bank ownership products. An interesting example of these efforts was the adoption of legislation on non-banking correspondents (Article 33 of Law 1328 of 2009), which are small banking stands located in commercial establishments such as supermarkets, convenience stores and bakeries. These efforts paid off as, by June 2013, the level had risen to 69.2 per cent. Nonetheless – and although there has been a trend of augmenting bank account ownership over the past decade – the percentage is still low in comparison with other Latin American economies.

Colombia faces, in the future, the challenge of gradually implementing the complete guidelines of Basel III in its banking industry. Although the Basel III equity and solvency ratio requirements were fully adopted, as has been mentioned before by legislation in 2013, market reaction to this new standard is yet to be shown.

7 How has regulation changed in response to the recent crisis in the banking industry?

The recent crisis did not have a significant effect on Colombia's banking industry, in part because of the measures taken during the previous crisis. For example, when different macroeconomic factors led to the 1982 crisis, Decree 2920 of 1982 allowed the Colombian government to intervene in terms of the equity of financial entities affected by the crash, and aimed at punishing the activities that threatened the financial system's stability. Special emphasis was then placed on the creation and promotion of risk-management strategies relating mainly to the management of credit and market risks.

During the 1998–1999 mortgage loans financial crisis, new and stricter regulations related to housing financing were enacted. Law 510 of 1999 introduced amendments to the FSOS that provided stricter entry conditions to the financial system, the ability of the government to intervene, the equity investment regime and the applicable regimes of various types of financial intermediaries. To adequately respond to the challenges posed by this crisis, existing risk-management institutions were bolstered, and new risk-management systems were created, such as the Money Laundering and Terrorism Financing Risk Management System and the Credit Risk Management System (SARC), inter alia.

The CFS's External Circular 11 of March 2002 is a good example of the regulation that resulted from the governmental efforts to face and prevent future crisis; it required all supervised institutions to produce their own credit risk administration systems, or SARCs, in accordance with a set of guidelines set forth therein. Basically, the Circular foreshadowed the credit risk and supervisory components of Basel II. Although it did not directly address the cornerstone of equity requirements, Circular 011 placed the burden on individual institutions, defined calculations for provisions and highlighted the responsibilities of both the regulator and the management team with respect to credit risk (Pillar II and III).

As a result of the aforementioned efforts, Colombia was not severely affected by the recent financial crisis, but the crisis did affect large European and American economies, triggering important changes for policymakers around the world including in Colombia. Requirements relating to higher equity levels, better control and supervision, and limits on universal banking schemes are examples of this.

In addition, Law 1314 of 2009 sought to make accounting regulations match high, comprehensible, applicable and accepted global standards such as International Financial Reporting Standards (IFRS). The transition period between the adoption and application of standards varies depending on the type of company structure and activity, and can be classified as follows:

- companies that must apply full IFRS standards; and
- companies that must apply simplified IFRS.

Transition periods and full implementation requirements are as follows. For companies that must apply full IFRS, the transition period started on 1 January 2014 and will last for one year. Pursuant to Decree 2784 of 2012, which regulates Law 1314 of 2009, the standards must be applied to the preparation of financial statements in 31 December 2015. Although the requirement applies only from December 2015 statements, companies have already started to apply the standards to 2014 statement preparation, which will allow them to prepare comparative financial statements by the end of 2015.

For companies that must apply a simplified version of IFRS (this includes all supervised entities by CFS) the transition period will start on 1 January 2015 and will last for one year.

Starting from 1 January 2016, all small and medium-sized entities will be required to adopt IFRS standards.

Following the developments initiated by Circular 011 of 2002, during recent years operational, market and liquidity risk

management has advanced towards Basel II and Basel III standards. As mentioned in question 6, pursuant to Decree 1771 of 2012, the Ministry of Finance has moved towards the alignment of requirements related to equity adequacy and solvency ratios to the standards of Basel III, though their impact in Colombian market is yet to be shown.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

As was explained in question 7, regulation resembling that adopted by Decree 1771 of 2012 is likely to continue, as it is expected that recent equity adequacy and solvency ratios will lead the way to full adoption of the Basel III standards.

Future regulatory policies in Colombia are also expected to focus on risks such as environmental risks (ie, global warming), catastrophes such as natural disasters or reputational risks (ie, links to illegal activities). The regulation on ways to prevent, manage and remedy these types of non-financial risks that, nonetheless, may seriously affect the stability of the market, is to be expected in the future.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The CFS's risk supervision system is based on early detection and evaluation; thus, it seeks to identify those activities that represent a higher risk to an entity's solvency while, at the same time, evaluating the way such risks are managed by the institution.

This is done through the Comprehensive Monitoring Framework (CMF), a structured process that allows the CFS to carry out a consolidated and integrated risk and solvency evaluation in order to design the most effective and efficient supervision strategy, focusing the CFS's efforts on taking actions where and when most necessary. The CMF includes both a system to evaluate risks (Risk Measurement and Evaluation System) and a system to carry out supervision (Monitoring Process).

The CFS also has submission requirements for reporting different types of information, which change in accordance with the nature of said information:

- exchange rates must be submitted daily;
- financial reports must be submitted weekly;
- information on management of assets and liabilities) must be submitted monthly;
- the total active credit operations must be submitted quarterly;
- transaction and operation reports must be submitted every six months; and
- information regarding minimum equity must be submitted annually.

In order to facilitate the CFS's supervision, on 31 January 2013, financial, lease and saving corporations were compelled to deliver a plan to implement relevant measures by August 2013 in compliance with new equity adequacy ratios.

10 How do the regulatory authorities enforce banking laws and regulations?

The CFS is in charge of supervising the Colombian financial system, in order to achieve the following aims:

- preserving stability and security;
- fostering, organising and developing the securities market; and
- protect investors, depositors and policyholders.

Within this framework, the CFS has the power to sanction supervised institutions, their managers, administrators, statutory auditors and other employees.

The CFS carries out continuous monitoring of financial institutions through annual and occasional visits, as well as through the analysis of the information it periodically receives from them. From such visits and using the information received, the CFS verifies compliance with financial regulations and, if any breach is detected, the following may be carried out:

- a warning or reprimand;
- a monetary penalty in favour of the treasury;
- a suspension or disqualification for up to five years for performance of positions in entities supervised by the CFS;
- the removal of managers, directors, legal representatives or statutory auditors; and
- the administrative takeover for administration or liquidation of the financial institution.

As was mentioned in question 1, the CFS's actions and sanctions have to be carried out and imposed in accordance with the principles of contradiction, proportionality, exemplary sanction and relevance.

Due to the recent internationalisation of Colombian financial system (with parties being located in Colombia or Colombian institutions investing abroad), the CFS has sought cooperation and understanding agreements with other supervisory authorities around the world and has implemented colegio de supervisores to jointly carry out comprehensive visits to multinational financial institutions.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

The most common enforcement issues in the past few years (2007 to 2012) are related to non-compliance with the reporting of information to the CFS regarding various matters, and to the breach of the duty to comply with certain requirements and regulations (such as minimum equity requirements, financial statements obligations, risk management and foreign exchange statements).

These issues are normally handled by first issuing a warning or reprimand to the entity that is not complying with the requirements; then, if the situation continues, a monetary penalty will be imposed.

12 How has bank supervision changed in response to the recent crisis?

As stated in question 7, the regulation has not actually changed in response to the recent crisis, because it had already done so in response to the crisis in Colombia in the late 1990s. In part, this shielded Colombia's economy from the effects of the recent crisis.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

The FSOS provides 13 scenarios in which the CFS may take over financial institutions. Their occurrence does not automatically lead to a takeover; the CFS decides on a case-by-case basis whether such a measure is really necessary. The scenarios provided by the FSOS are the following:

- suspension of obligation payments;
- refusal to submit to the CFS its records, accounting books and other documents necessary to assess its financial stability;
- the legal representative's refusal to be questioned under oath before the CFS;

- repeated failure to comply with orders and instructions given by the CFS;
- continuous violation of its by-laws or any applicable law;
- continuous conduction of business in an unauthorised or unsafe manner;
- decrease in net assets below 50 per cent of subscribed equity;
- inconsistencies or inaccuracies in the information provided to the CFS that hinder its ability to evaluate the actual standing of the financial institution;
- failure to comply with minimum equity requirements;
- failure to comply with a recovery plan instructed by the CFS;
- failure to comply with a CFS order of exclusion of assets and liabilities; and
- failure to comply with CFS's progressive clearance programme.

The FSOS also provides for two scenarios in which taking over a financial institution is mandatory:

- when its technical equity decreases below 40 per cent of the minimum levels provided for by applicable equity regulation; and
- when the term for presenting a recovery plan before the CFS expires, or when the aims included in an adopted recovery plan are not met.

The CFS maintains stringent supervision and control of financial entities, yet takeovers are not frequent. This does not mean, however, that when required, the CFS will not take such measures without hesitation, as it did back in 1980s and, more recently, with the largest stockbroker. Nonetheless, it is a last-resort measure aimed at the protection of stakeholders' interests and the stability of the financial system.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

There is no general rule or legislation on the role of a financial entity's administrators and directors in the event of failure. As explained in question 13, failure will lead to a takeover by the CFS, and so the direction and administration of the institution is its responsibility, as well as determining the relevance of the former management and directors during this process in accordance with any future plans it has for the institution. Therefore, the CFS decides, on a case-by-case basis, the scope and degree of involvement of the bank's management and directors in the execution of new business plans and decisions, even if it means taking no part at all.

15 Are managers or directors personally liable in the case of a bank failure?

The failure of the bank is itself not a reason for personal liability, as many factors may lead to such an event. The key factor to determining the existence of liability, in the event of failure as in any other case, is the director's compliance with ethical and legal standards. Thus, the FSOS provides for specific situations in which sanctions are applicable to financial institution's managers and directors, including:

- failure to comply with legal obligations or duties;
- authorisation, performance or failure to prevent actions in violation of relevant governmental regulations, the bank's by-laws or any other legal or corporate rule to which they must adhere to in the course of their duties; and
- failure to comply with rules, orders, requests or instructions issued by the CFS.

Specific sanctions are provided for by the FSOS, but they do not preclude the relevance of other sanctions under other regimes that may also be applicable, but which must be determined on a case-by-case basis.

Sanctions range from a written warning to penalties, to a lifetime ban on working in the financial sector.

In addition to this, a bank's directors, managers, legal representatives, or employees are personally liable for any monetary losses caused by their failure to comply with legal regulations, or for the failure to prevent detrimental actions taking place. Other general civil and criminal sanctions may also be imposed on civil or criminal proceedings if relevant to the case.

16 How has bank resolution changed in response to the recent crisis?

As was previously mentioned, there have been no relevant changes or recent developments regarding bank resolution, as the Colombian financial system was not significantly affected by the 2008 global financial crisis.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Pursuant to Decree 1771 of 2012, deposit-taking institutions must comply with the following two types of solvency ratio:

- total solvency ratio, defined as the value of regulatory equity divided by the value of credit and market risk-weighted assets; and
- core solvency ratio, defined as the regular core asset value net of deductions, divided by the value of credit and market risk-weighted assets.

Both ratios are expressed as percentages: the total solvency ratio of a deposit-taking institution should be at least 9 per cent, and the core solvency ratio should be at least 4.5 per cent.

Even though regulation demands a 9 per cent solvency ratio, this is a practice based on the prudential supervisory policy that when banks get close to or below 11 per cent, closer supervision is put in place by the CFS.

Compliance with solvency ratios is based on the technical equity that each deposit-taking institution has, which is calculated through the sum of deducted basic ordinary equity, basic ordinary additional equity and additional equity, which are calculated as follows.

Deducted basic ordinary equity

Basic ordinary equity includes:

- subscribed and paid-up equity that complies with the following conditions:
  - it has been effectively subscribed and paid up;
  - its subordination is qualified and is not the object of a guaranty, insurance or part of any arrangement that increases their level of subordination;
  - it is perpetual;
  - its dividends do not involve payment of preferential or obligatory dividends;
  - it is not financed by a regulated entity; and
  - it is capable of absorbing losses.
- the value of dividends decreed regarding subscribed and paid-up equity that comply with requirements mentioned above;
- additional paid-in equity;
- legal reserve constituted by net income appropriations;
- irrevocable grants;
- the total value of the cumulative translation adjustment account of the financial statements;
- advances for equity increase;
- shares that represent guaranty equity; and
- subordinated bonds subscribed or endorsed by Fogafin.

Basic ordinary equity must include the following deductions:
- accumulated losses from previous years;
- value of equity investments and subordinated debt instruments;
- net deferred income tax, when positive;
- intangible assets recorded as of 23 August 2012; and
- value of unamortised pension liabilities.

Basic ordinary additional equity

Basic ordinary additional equity includes:
- subscribed and paid-up equity that complies with the following conditions:
  - it has been effectively subscribed and paid-up;
  - its subordination is qualified and is not the object of a guaranty, insurance or part of any arrangement that increases their level of subordination;
  - it is perpetual;
  - its dividends do not involve payment of preferential or obligatory dividends;
  - it is not financed by a regulated entity; and
  - it is capable of absorbing losses; and
- the value of dividends decreed with respect to subscribed and paid-up equity that comply with the requirements mentioned above.

Additional equity

Additional equity includes:
- the current year's profits;
- occasional reserves;
- 50 per cent of the mandatory fiscal reserve;
- 50 per cent of the valuations or non-executed gains on securities' investments;
- 30 per cent of the non-executed appreciations;
- bonds obligatorily convertible into shares that have been already subscribed and paid; and
- the value of general provisions that are mandatory for credit institutions.

18 How are the capital adequacy guidelines enforced?

Banks are required to submit information at different moments in time to the CFS, as indicated in question 9:
- on a weekly basis, a financial report must be sent;
- on a monthly basis, the evolution of the solvency ratio must be sent, as well as the management of assets and liabilities (liquidity); and
- on a yearly basis the minimum equity for entities must be sent.

19 What happens in the event that a bank becomes undercapitalised?

As explained in question 13, a financial entity's undercapitalisation is one of the scenarios in which the CFS is authorised to take control of it. Although this decision depends exclusively on the CFS's evaluation, the CFS generally only takes control when it has previously ordered the financial institution to take measures to increase its equity, and they have not been adopted or applied. Thus, in event of undercapitalisation and before taking control, the CFS will supervise the financial institution's activities and recommend the adoption of preventive or remedial measures.

Measures ordered by the CFS before deciding to take control over a financial entity in the event of undercapitalisation include the following:
- determining conditions to be met in order to remedy the circumstances that led to the undercapitalisation;
- ordering the corresponding recapitalisation;
- promoting the management of the financial entity's assets and businesses by another authorised financial entity;
- ordering total or partial transfer of assets, liabilities, agreements and commercial establishments to other authorised financial institutions;
- ordering a merger with another financial institution (if the latter agrees); and
- approving recovery programmes presented by the financial entity in order to restore its equity.

Other measures include:
- restriction of asset transfer and asset exclusion, aimed at protecting public confidence in the financial system; and
- disassembly programme, which is the transfer of assets and
- liability when the financial entity foresees that it may not be able to comply with the legal requirements for its adequate the operation.

As was mentioned before, the CFS will only take control when such measures are not adopted or do not work. The purpose of this action is to determine whether the financial entity should be liquidated, whether it is possible to get it into a position where it can adequately continue its main purpose, or whether it is possible to perform other operations that will allow depositors, savers and investors to obtain the full or partial payment of their credit.

As previously mentioned, the CFS does not wait until the bank faces an undercapitalisation situation before suggesting measures to directors and administrators to overcome the difficulties, based on the close supervision in the previous stages.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

As explained in question 13, the CFS is obliged to take control of a bank or any type of financial entity if technical equity falls below 40 per cent of the minimum level provided by relevant equity regulations.

With prior consultation with Fogafin, the CFS has a two-month period, which may be extended by two additional months, to determine whether the financial entity should be liquidated, whether it is possible to place it in a position to adequately carry out its main purpose, or whether it is possible to perform other operations that will allow depositors, savers and investors to improve the chances of obtaining full or partial payment of their credits.

The decision to liquidate a bank cannot be taken as an independent action; it must be taken within the framework of the CFS having taken control of the bank.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

As previously explained in questions 7 and 17, equity adequacy guidelines were substantially modified as part of Decree 1771 of 2012. As for the near future, no major changes are expected.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Under Colombian law, there are no legal or regulatory limitations on the types of entity that may own a controlling interest in a bank, but the suitability of shareholders and their financial capacity to carry out the investment may be verified. On no account will the CFS accept the nomination of persons that have committed certain felonies or criminal offences, have been subject to a right of property termination procedure, have violated credit risk limitations, or have been responsible for the mismanagement of a financial institution.

Further, the CFS has discretionary powers to authorise an investor (including all beneficial owners) to hold 10 per cent or more of any supervised entity. These discretionary powers are exercised to obtain reassurance about the identity and suitability of the last-resort beneficial owners of the investment, along with their financial capacity to make the investment and further, in a possible crisis, their ability and willingness to recapitalise the entity.

A company is considered subordinated or controlled when its power of decision is subject to the will of a third party or parties, as explained in question 5.

In Colombia, there is a series of factual corporate situations that, by virtue of law, are deemed as constituent of a corporate subordination:

- when over 50 per cent of a company's equity belongs directly to a company or a person, or indirectly through one or more of its own subsidiaries; or
- when a person or a company directly, or jointly with other subsidiaries, or through agreements, has the voting majority at the shareholders' meeting, holds the number of votes required to appoint the majority of members of the board of directors, or both.

23 Are there any restrictions on foreign ownership of banks?

No. Nevertheless, there are two main requirements to acquire a Colombian bank:

- prior CFS approval for acquisition of 10 per cent or more of the bank's share equity (a condition also applicable to Colombian residents); and
- registration of the foreign investment with the CCB by filing a form 4, with a foreign exchange market intermediary.

24 What are the legal and regulatory implications for entities that control banks?

The legal and regulatory implications for entities that control banks are as follows:

- Any of the situations of control or subordination (described in question 22) must be disclosed by the parent or controlling company by filing, before the Chamber of Commerce located at the domicile of the subordinated local company, a private document evidencing its name, domicile, nationality and corporate purpose, together with a declaration of the situation that gives rise to the formal declaration of control.
- The parent company, regardless of whether it is under the permanent supervision of the CFS, may have to consolidate its financial information with that of its subsidiaries in order to facilitate the CFS's monitoring of the management of conglomerates and corporate governance standards.
- The controlling entity can be held responsible for the insolvency of the controlled entity (see question 26).
- The subsidiary or controlled company is forbidden to have shares or a participation in its parent or controlling company (see question 5).
- Special conflict of interest rules apply.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

An entity or an individual that controls a bank must follow the duties and responsibilities outlined in question 5.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

When a company is insolvent or is undergoing mandatory liquidation (including through an administrative takeover) as a result of the decisions or actions of the parent or controlling company, in connection with the subordination, in the sole interest of the latter or of any of its subordinated companies and against the interests of the affected company, then the parent company or controlling entity will be held liable (in the absence of sufficient assets) for the obligations of the company undergoing reorganisation or liquidation.

Responsibility for the resulting liquidation or insolvency is presumed, and it must be proven otherwise by the parent company or controlling company.

In any case, Colombian law provides for independent sanction regimes applicable to natural persons and institutions. In both cases, sanctions vary depending on the gravity of the CFS's judgment and could be a warning or reprimand, a monetary fine, a suspension or disqualification for up to five years, the removal of managers, directors or legal representatives, or the closure of the financial institution's representative office.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

As mentioned above, regulatory approvals are needed to acquire or become the beneficial owner of 10 per cent or more of the subscribed shares of an entity under the permanent supervision of the CFS (whether listed or non-listed), including the CFS's prior approval of the transaction (including the purchase or subscription of mandatorily convertible bonds). There are no limits on the maximum shareholding that may be held by a foreign entity or foreign investor in a Colombian bank. It is important to note, however, that any person, either a Colombian resident or a foreign national, may have no more than 95 per cent of the outstanding shares of a joint-stock corporation (that is the usual way of incorporation of a bank in Colombia); furthermore, this is a reason for a financial entity's dissolution.

The CFS's main concerns in these types of transaction include the following:

- the personal and professional background of the people responsible for the administration of entities part of an ownership chain (this includes the CFS's verification of the absence of criminal records with Interpol);
- the direct investor's financial capacity and solvency;
- th ecorporate governance policies of the group, decision-making mechanisms and possible changes in them;
- anti-money laundering and anti-financing of terrorism policies, as well as general surveillance policies;
- changes in operations or in other policies; or
- the place of residence or incorporation of the direct investor, because tax havens or other jurisdictions without adequate supervision may be excluded or may pose particular challenges in terms of consolidated supervision by competent authorities.

This information must be filed before the CFS by the acquiring entity in order to receive approval for the change of control. If the transaction is completed without such prior authorisation, it shall be considered ineffective for all purposes.

An investor is not required to obtain the CFS's prior approval if it has been authorised to conduct a similar transaction within the three preceding years, but financial capacity needs to have been previously documented unless the investor is acquiring more than 50 per cent of the subscribed shares, in which case the investor has to file a new request for authorisation.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The regulatory authorities are receptive to foreign acquirers. In the past five years there has been an increase in the participation

of foreign institutions in the subscribed shares of entities under the CFS's permanent supervision.

The regulatory process is no different in the case of foreign acquirers, but when a foreign investor files a request for authorisation with the CFS, the request may need additional information to that summarised in question 30; for example, a summary of the financial regulations of the foreign investor's country of operations, or evidence of the consolidated supervision of the foreign investor, along with cooperation agreements subscribed to by the other supervisory authority.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

In order to obtain the corresponding CFS authorisation, the acquiring entity must file a request, accompanied by the information included in the answer to question 30. The CFS will, inter alia, review and verify that the acquiring entity, its directors and main shareholders, comply with its standards of responsibility, competence and solvency. In order to review the acquiring entity's solvency, the CFS requires that its equity (or that of its ultimate beneficiary owner) be 1.3 times the equity that it intends to invest in the acquired Colombian entity. It is also for at least one-third of the resources intended for the transaction to be owned and not derived from credit or other debt operations.

Additionally, the CFS has discretionary powers to authorise an investor (including all beneficial owners) to hold 10 per cent or more of any supervised entity. These discretionary powers are exercised to obtain reassurance about the identity and suitability of the last-resort beneficial owners of the investment.

30 Describe the required filings for an acquisition of control of a bank.

To obtain regulatory approval from the CFS, the investor shall file a request for authorisation containing, at least, the following information:

- the acquiring entity's complete name, nationality, identification type and number;
- the amount of shares to be transferred and the stake (percentage) that they represent with respect to the outstanding shares of the acquired entity;
- the number of shares of which the acquiring entity or any of its affiliates or subsidiaries is already beneficiary in the acquired entity, if any, and the price at which they were acquired;
- the complete name of the entity that is transferring the shares relevant to the transaction;
- the consideration to be paid for the shares and their market price;
- the terms of payment;
- any preference rights to which the shares to be transferred are subject;
- the source of the funds to be used in the transaction;
- the investments held by the acquiring entity in other Colombian companies (financial or non-financial) either directly or through a parent or subsidiary of the parent company;
- details of any outstanding debt of the acquiring entity to Colombian financial entities;
- details of any type of common interest that the acquiring entity has, either directly or indirectly, with the other shareholders of the acquired entity;
- a certificate of existence and good standing or equivalent document of the acquiring entity, and of each of the beneficiaries of the transaction;
- the curriculum vitae of each director, legal representative and shareholder holding at least 5 per cent of the outstanding shares of the acquiring entity, as well as of each of the beneficiaries of the transaction;
- the acquiring entity's annual financial statements with notes and auditors' reports, for the last three financial years;
- the acquiring entity's annual income tax returns, with notes and auditors' reports for the last three accounting years;
- a letter to the CFS indicating:
  - that the acquiring entity has the legal capacity to complete the transactions resulting in the share's change of control;
  - whether the acquiring entity requires any regulatory approval or authorisation from any internal corporate body to complete the transaction; and
  - copies of any regulatory approval or corporate authorisation required;
- list or chart of shareholders of the acquiring entity, its parent and affiliates;

Update and trends

On an informal basis, we have become aware that the CFS is aiming to consolidate the operational (SARO), market (SARM), liquidity (SARL) and credit (SARC) risks into a comprehensive and integral legal framework of financial risk management. Its purpose is to unify general instructions such as the applicable entities, principal rules and elements, the roles of the corporate and control bodies, the technological platform, the minimum disclosure information and guidelines of the documents and manuals regarding financial risks. Although there is as yet no public regulation issued, the CFS is working to present an integral legal framework of financial risk management that will be made public in the coming days.

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- if the acquiring entity is a foreign financial institution, a document indicating the rules and regulations under which the acquiring entity is monitored in its country of domicile, showing evidence of the consolidation of the regulatory surveillance and explaining the type and scope of supervision;
- a document confirming whether, pursuant to applicable laws, the acquiring entity requires any authorisation issued by the foreign regulatory authorities to consummate the transaction;
- with regard to the shareholders of the acquiring entity, the applicable rules in their domicile regarding the constitution of affiliates abroad; and
- any other information that the CFS may deem appropriate.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Once the investor submits the information outlined in question 30, the CFS conducts a 'fit-and-proper test' of the investor, and decides whether to approve the investment within three to four months of delivery of the completed documentation. In practice, a decision usually takes six to eight months.

 ISSN 1479-3210