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Junko Oguri
*Yale Program on Financial Stability*

Manuel León Hoyos
*Yale Program on Financial Stability*

# Colombia: FOGAFIN Capitalizations of 1999 and 2001[1]

*Junko Oguri[2] and Manuel León Hoyos[3]*

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**Abstract**

In 1998, Colombia entered a severe recession. GDP contracted by 4.2% in 1999, and the unemployment rate surpassed 20%. Political turmoil exacerbated trade and fiscal imbalances. The economic downturn led to credit contractions, particularly in the mortgage market. The nonperforming loan (NPL) ratio increased from 8% in December 1997 to 16.1% in November 1999. The NPL ratio for residential mortgages grew from 6% in December 1997 to 19.8% in January 2000.

In 1999, due to the continuous deterioration of credit institutions, the government, through FOGAFIN (the Financial Institutions Guarantee Fund—the state agency for bank resolutions and deposit insurance), initiated rescue policies to restore public confidence and solvency in the financial system. The government implemented a three-year economic recovery program that, among other measures, included capitalization of credit institutions. This authority was given through Resolution 006 of 1999, in which FOGAFIN granted loans to the shareholders of institutions to be used exclusively to recapitalize their institutions. Resolution 006 of 2001 gave the authority to further capitalize credit institutions specialized in mortgage lending.

**Keywords:** capital injections, Colombia, financial crisis, FOGAFIN, recapitalizations

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[1] This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering broad-based asset capital injections programs.
Cases are available from the *Journal of Financial Crises* at https://elischolar.library.yale.edu/journal-of-financial-crises/.

[2] Research Associate, YPFS, Yale School of Management.

[3] Research Associate, YPFS, Yale School of Management.

# Colombia: FOGAFIN Capitalizations of 1999 and 2001

## At a Glance

In the late 1990s, Colombia's economy weakened. Political turmoil exacerbated trade and fiscal imbalances. The Asian and Russian financial crises contributed to the deterioration in market confidence. The economic downturn led to credit contractions, particularly in the mortgage market. In 1998, Colombia entered a severe recession (IMF 2001). In 1999, GDP contracted by 4.2%, while the unemployment rate surpassed 20% (FOGAFIN 2009). The nonperforming loan (NPL) ratio increased from 8% in December 1997 to 16.1% in November 1999. The NPL ratio for residential mortgages grew from 6% in December 1997 to 19.8% in January 2000 (IMF 2001).

In November 1998, Colombia declared a "Social and Economic State of Emergency" through Decree 2330, followed with the announcement of the first set of measures in support of the financial sector through Decree 2331 that included support mechanisms for mortgage debtors from institutions facing liquidation (Decree 2330 1998; Decree 2331 1998).

In 1999, due to the continuous deterioration of credit institutions, the government, through FOGAFIN (the Financial Institutions Guarantee Fund—the state agency for bank

| Summary of Key Terms | |
|---|---|
| Purpose: The government capitalization was a line of credit provided to the shareholders of credit institutions to exclusively strengthen their capitalization ratios. | |
| Announcement Date | June 30, 1999 (first line)<br>August 10, 2001 (second line) |
| End of Issuance Window | December 31, 1999, last day to apply (first line)<br>July 31, 2002, last day to apply (second line) |
| Legal Authority | Resolution 006 of 1999 (first)<br>Resolution 006 of 2001(second) |
| Program Size | Unspecified |
| Total Utilization | COP 1.09 trillion[4]<br>COP 492.8 billion in 1999<br>COP 599.9 billion in 2001 |
| Participants | 14 financial institutions: 10 in 1999 and four (specialized in mortgage lending) in 2001 |
| Administrator | FOGAFIN (Financial Institutions Guarantee Fund) |
| Notable Features | Institutions had to write off NPLs before the capitalization process. Then, FOGAFIN granted loans to institutions to be used exclusively for capitalization.<br>The 2001 resolution was specifically targeted for institutions specialized in mortgage lending. |

[4] Exchange rate in June 1999 was Colombian pesos (COP) 1,693 = $1 (FRED 2021).

resolutions and deposit insurance), initiated rescue policies to restore public confidence and solvency in the financial system. It aimed to avoid systemic risk, control moral hazard, minimize direct government administration in the financial sector, and reduce fiscal costs (FOGAFIN 2009). The Colombian government launched a three-year economic recovery program supported by the International Monetary Fund (IMF), the World Bank, the Inter-American Development Bank, and the Development Bank of Latin America (CAF) that included capitalization of credit institutions, resolution and restructuring measures for unviable banks and other financial institutions, and other various rescue measures related to debtor law and housing reform (FOGAFIN 2001; IMF 2001; Morrison 2000). In June 1999, to provide capitalization for both public and private credit institutions, the Colombian government passed Resolution 006 of 1999.

In regard to public banks, to preserve financial stability, strengthen their equity, recover their viability, reduce fiscal costs of cleaning up, and minimize government participation in the financial sector, the government decided to privatize all public banks with the exception of Banco Agrario, which remained the only public bank, given its importance to provide financing to small and medium-sized farmers in the country (FOGAFIN 2009).

The capitalization process for public banks was composed of five stages: clean-up, capital strengthening, disposal of NPLs, administrative restructuring, and sale of the institution (FOGAFIN 2000). For private banks, the capitalization process was composed of three stages: clean-up, capital strengthening, and signing of a performance agreement (FOGAFIN 2000).

A total of 10 institutions were capitalized through Resolution 006 of 1999 for a total of COP 652,821 million, of which COP 492,788 million were FOGAFIN loans and COP 160,033 million were contributions by shareholders (FOGAGIN 2009; see Figure 1).

**Figure 1: Use of Capitalization Line of 1999 (Millions of Colombian Pesos—COP)**

| | | FOGAFIN Loans | | | Shareholders | | |
|---|---|---|---|---|---|---|---|
| **Institution** | **Date** | **Short-Term** | **Long-Term** | **Total** | **(Cash and 1-Year Term)** | **Total Capitalization** | **% Shareholders/ Total Capitalization** |
| Colpatria | Aug/1999 | 38,110 | 174,001 | 212,111 | 57,454 | 269,565 | 21.3% |
| Banco Superior | Jul/1999 | 8,806 | 85,047 | 93,853 | 25,041 | 118,894 | 21.1% |
| Banco de Credito | Dec/1999 | — | 59,965 | 59,965 | 14,992 | 74,957 | 20% |
| Interbanco | Oct/1999 | 1,016 | 42,181 | 43,197 | 15,441 | 58,638 | 26.3% |
| Banco Union | Jul/1999 | 1,803 | 25,525 | 27,328 | 5,371 | 32,699 | 16.4% |
| Corfinorte | Dec/1999 | — | 19,752 | 19,752 | 27,942 | 47,694 | 58.6% |
| Coltefinanciera | Oct/1999 | 9,104 | 19,348 | 28,452 | 11,254 | 39,706 | 28.3% |
| Multifinanciera | Nov/1999 | — | 2,863 | 2,863 | 1,939 | 4,802 | 40.4% |
| Credinver | Feb/2000 | 88 | 2,050 | 2,138 | 599 | 2,737 | 21.9% |
| Confinanciera | Nov/2000 | — | 3,129 | 3,129 | — | 3,129 | 0% |
| **Total** | | **58,927** | **433,861** | **492,788** | **160,033** | **652,821** | **24.5%** |

Note: Banco Selfin and Banco Findesarrollo requested access to the line. However, their shareholders did not capitalize their corresponding portion, and the banks therefore were liquidated.

*Sources: FOGAFIN 2000; FOGAFIN 2009.*

Four out of the five private banks specialized in mortgage lending received capitalization through Resolution 006 of 2001. These were Colpatria, AV Villas, Colmena, and Conavi. The other bank, Davivienda, did not request access. The total capitalization amounted to COP 716 billion, of which COP 599.9 billion were FOGAFIN loans granted and COP 116 billion were contributions by shareholders, 16.2% of the total capitalization (FOGAFIN 2009; see Figure 2).

**Figure 2: Use of Capitalization Line of 2001 (Billions of Colombian Pesos—COP)**

| | FOGAFIN Loans | | | | | | |
|---|---|---|---|---|---|---|---|
| **Institution** | **Short-Term** | **Long-Term** | **BOCAS** | **Total** | **Shareholders** | **Total Capitalization** | **% Shareholders/Total Capitalization** |
| Colpatria | — | 40 | 25 | 65 | 35 | 100 | 35% |
| AV Villas | 52 | 156 | 52 | 260 | — | 260 | 0% |
| Colmena | — | 120 | — | 120 | 30 | 150 | 20% |
| Conavi | — | 113.7 | 41.2 | 154.9 | 51 | 206 | 24.8% |
| **Total** | **52** | **429.7** | **118.2** | **599.9** | **116** | **716** | **16.2%** |

*BOCAS were bonds optionally convertible into shares.

*Source: FOGAFIN 2009.*

Overall, FOGAFIN granted loans through both capitalization lines of 1999 and 2001 for COP 1.09 trillion to 13 credit institutions. Colpatria was the only institution to access both. Shareholders contributed COP 276 billion (20.2% of the total capitalization). The total amount of capitalizations was COP 1.37 trillion (FOGAFIN 2009; see Figures 1–3).

**Figure 3: Use of Capitalization Lines of 1999 and 2001 (Millions of Colombian Pesos—COP)**

| Resolutions | Number of Institutions | FOGAFIN Loans | Capitalization by Shareholders | Total Capitalization | % Shareholders/ Total Capitalization |
|---|---|---|---|---|---|
| Resolution 006 of 1999 | 10 | 492,788 | 160,033 | 652,821 | 24.5% |
| Resolution 006 of 2001 | 4 | 599,911 | 116,089 | 716,000 | 16.2% |
| Total | 13* | 1,092,699 | 276,122 | 1,368,821 | 20.2% |

*Colpatria was the only institution to access both capitalization lines.

*Source: FOGAFIN 2009.*

By 2008, the government recovered COP 1.7 trillion from the payment of capital and interest on the FOGAFIN loans granted to shareholders of private institutions. Thanks to the financial recovery, they were able to pay in advance. Of the 13 institutions capitalized, all except Interbanco paid their obligations to FOGAFIN in full, and before the agreed term.

All paid in cash, with the exception of Multifinanciera, which delivered assets as a payment to FOGAFIN. Two institutions— Interbanco and Corfinorte—were intervened and liquidated, and two others—Credinver and Multifinanciera—were voluntarily dismantled. All the other institutions recovered and continued in operation (FOGAFIN 2009).

**Summary Evaluation**

By 2001, Colombian economic indicators of solvency, profitability, portfolio quality, and portfolio coverage showed positive trends in the banking system (Heenan et al. 2007). The average capital adequacy ratio improved from 11.2% in December 1999 to 13.8% in December 2000, and the average NPL ratio declined from 13.5% to 11.1%. However, it is hard to identify how much improvement can be attributed to the capitalizations as Colombian macroeconomic conditions improved (IMF 2001). The capitalizations of 1999 and 2001 did not represent any cost to the government, owing to the good financial performance of the institutions that accessed them.

Given that the Colombian government underwent various reforms simultaneously, there are few evaluations of the capitalization process. For instance, in terms of capital injections to private banks, the IMF evaluated that "[w]hile this scheme was generally successful in improving the capital adequacy ratios of the institutions that were supported, it does subject FOGAFIN to losses should the banks fail but not to the gains that would accrue if the banks' fully recover." The IMF also implied that capital adequacy ratios were improved as a result of the combination of write-offs of impaired assets prior to the capital injection and the capitalization (IMF 2001).

| Colombia Context 1998-1999 | |
|---|---|
| **GDP<br>(SAAR, nominal GDP in LCU converted to USD)** | $98.4 billion in 1998<br>$86.2 billion in 1999 |
| **GDP per capita<br>(SAAR, nominal GDP in LCU converted to USD)** | $2,566 in 1998<br>$2,210 in 1999 |
| **Sovereign credit rating (five-year senior debt)** | Data for 1998:<br><br>Fitch: N/A<br>Moody's: Baa2<br>S&P: N/A<br><br>Data for1999:<br><br>Fitch: N/A<br>Moody's: Baa2<br>S&P: BBB+ |
| **Size of banking system** | Data not available for 1998<br>Data not available for 1999 |
| **Size of banking system as a percentage of GDP** | 34.2% in 1998<br>32.6% in 1999 |
| **Size of banking system as a percentage of financial system** | 96.3% in1998<br>93.7% in 1999 |
| **Five-bank concentration of banking system** | 76.9% in 1998<br>83.8% in 1999 |
| **Foreign involvement in banking system** | 6% in 1998<br>22% in 1999 |
| **Government ownership of banking system** | 37% in 1998<br>18% in 1999 |
| **Existence of deposit insurance** | Yes in 1998<br>Yes in 1999 |
| *Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset; Cull, Martinez Peria, and Verrier 2018.* | |

## Key Design Decisions

1. **Part of a Package: In 1999, the Colombian government initiated rescue policies to restore confidence in the financial system and implemented a three-year economic recovery program including capitalization lines for credit institutions, resolution and restructuring measures for unviable banks and other financial institutions, as well as other various rescue measures related to debtor law and housing reform.**

In 1999, due to the continuous deterioration of credit institutions, the government, through FOGAFIN (the Financial Institutions Guarantee Fund—the state agency for bank resolutions and deposit insurance), initiated rescue policies to restore public confidence and solvency in the financial system. It aimed to avoid systemic risk, control moral hazard, minimize direct government administration in the financial sector, and reduce fiscal costs (Botero Garrido 2006). The Colombian government launched a three-year economic recovery program supported by the International Monetary Fund (IMF), the World Bank, the Inter-American Development Bank, and the Development Bank of Latin America (CAF) that included capitalization lines for credit institutions, resolution and restructuring measures for unviable banks and other financial institutions, as well as other various rescue measures related to debtor law and housing reform (FOGAFIN 2001; IMF 2001; Morrison 2000).

In June 1999, to provide capitalization for both public and private credit institutions, the Colombian government passed Resolution 006 of 1999. Two years later, Resolution 006 of 2001 gave the authority to further capitalize credit institutions specialized in mortgage lending (Resolution 006 1999; Resolution 006 2001). The capitalization process for public banks was composed of five stages: clean-up, capital strengthening, disposal of nonperforming loans (NPLs), administrative restructuring, and sale of the institution. For private banks, the capitalization process was composed of three stages: clean-up, capital strengthening, and signing of a performance agreement (FOGAFIN 2000).

2. **Legal Authority: Resolution 006 of 1999 provided the authority for the capitalization of credit institutions. This was later expanded in 1999 through Resolution 011 of 1999, and furthermore in 2001 with another capitalization line through Resolution 006 of 2001.**

On November 16, 1998, Colombia declared a "Social and Economic State of Emergency" through Decree 2330, followed the same day with the announcement of the first set of measures in support of the financial sector through Decree 2331 that included support mechanisms for mortgage debtors from institutions facing liquidation (Decree 2330 1998; Decree 2331 1998).

In June 1999, Resolution 006 of 1999 gave the authority for capitalizations of credit institutions through FOGAFIN. Resolution 011 of 1999 allowed for institutions that received a first FOGAFIN loan to receive a second one by June 30, 2000 (FOGAFIN 2000). In

August 2001, Colombia passed Resolution 006 of 2001 that gave the authority for capitalizations of credit institutions specialized in mortgage lending (Resolution 006 1999, Resolution 006 2001).

3. **Administration/Governance: FOGAFIN, with the assistance of the Banking Superintendency, was in charge of the capitalization process of credit institutions.**

FOGAFIN was created in 1985 to deal with a previous financial crisis in the 1980s and help with capitalization efforts of the financial system. For the Colombian crisis that started in the late 1990s, FOGAFIN executed the government's rescue plan, focused on the banking system (FOGAFIN 2021).

4. **Size: There was no announced limit on the total size of the recapitalizations announced in 1999 and 2001.**

There was no announced limit on the total size of the recapitalizations announced in 1999 and 2001. Overall, FOGAFIN granted loans through both capitalization lines of 1999 and 2001 for COP 1.09 trillion to 13 credit institutions. Colpatria was the only institution to access both. Shareholders contributed COP 276 billion (20.2% of the total capitalization). The total amount of capitalizations was COP 1.37 trillion (FOGAFIN 2009; see Figures 1–3).

A total of 10 institutions were capitalized through Resolution 006 of 1999 for a total of COP 652,821 million, of which COP 492,788 million were FOGAFIN loans and COP 160,033 million were contributions by shareholders (FOGAGIN 2009; see Figure 1). Of the five private banks specialized in mortgage lending, four accessed the capitalization through Resolution 006 of 2001. These were Colpatria, AV Villas, Colmena, and Conavi. The other bank, Davivienda, did not request access. The total capitalization amounted to COP 716 billion, of which COP 599.9 billion were FOGAFIN loans granted and COP 116 billion were contributions by shareholders, 16.2% of the total capitalization (FOGAFIN 2009; see Figure 2).

5. **Funding Source: Funding for capitalization of credit institutions came from the issuance of FOGAFIN bonds and the collections of the tax on financial transactions established in 1998.**

The funding for the capitalization of public banks came from the issuance of FOGAFIN bonds and the collections of the tax on financial transactions established in 1998. Initially, FOGAFIN issued COP 3 trillion in bonds to cover the costs of the capitalization of public banks. However, due to higher than expected costs by more than COP 1.2 billion, a second issuance of FOGAFIN bonds was performed (FOGAFIN 2000).

The capitalization process for private banks was financed through the issuance of FOGAFIN bonds (backed by the Deposit Insurance Reserve) subscribed by the institutions being capitalized. The service of the bonds was covered with the recovery of the FOGAFIN loan granted to shareholders, so that it did not generate a fiscal cost to the government. FOGAFIN charged additional percentage points to the DTF[5] rate, to cover the cost of potential default, in which case, FOGAFIN enforced the guarantees provided by the institution (Botero Garrido 2006; Resolution 006 1999; Resolution 006 2001).

6. **Eligible Institutions: All credit institutions, both public and private, were eligible in 1999, and later in 2001, only credit institutions specialized in mortgage lending were eligible.**

Both public and private credit institutions were eligible for the capitalization process under Resolution 006 of 1999 announced in June 1999. Credit institutions had until December 31, 1999 (about six months) to apply for access (Resolution 006 1999). This line was extended through Resolution 011 of 1999 to allow institutions that received a first FOGAFIN loan to apply for a second one by June 30, 2000 (FOGAFIN 2000). For the 2001 capitalization line launched to support credit institutions specialized in mortgage lending, eligible institutions included those that had at least 50% of their portfolios in mortgage loans as of December 31, 2000. They had until July 31, 2002 to apply (Resolution 006 2001).

In regard to public banks, to preserve financial stability, strengthen their equity, recover their viability, reduce fiscal costs of cleaning up, and minimize government participation in the financial sector, the government decided to privatize all public banks with the exception of Banco Agrario, which remained the only public bank, given its importance to provide financing to small and medium-sized farmers in the country (FOGAFIN 2009).

As part of the process and a pre-requisite for capitalization, credit institutions were required to write off their nonperforming loans in such a way that it reasonably reflected their true economic value (Resolution 006 1999). If, after the provision and amortization of the NPLs, the credit institution's technical equity dropped below zero (0), its shareholders had to capitalize the institution with their own resources to bring its technical equity to at least zero (0).

7. **Individual Participation Limits: The capitalization was set to restore a solvency margin of 9% for public banks and 10% in the case of private banks.**

For public banks, to perform the second stage of capital strengthening, FOGAFIN capitalized institutions until reaching a solvency margin of 9%. For private credit institutions, to perform the second stage of capital strengthening, institutions were capitalized to restore a solvency margin of 10%. For this purpose, FOGAFIN granted loans to shareholders of institutions to be used exclusively to capitalize their institutions. FOGAFIN provided long-term loans for up to 90% of the amount necessary, but the long-term loans could not exceed 80% of the total capitalization. To ensure a long-term loan, shareholders had to grant shares of the institution as collateral at a minimum value of

[5] The DTF (fixed-term deposit rate) is calculated as the weighted average of interest rates on 90-day certificates of deposit (CDs) offered by Colombian banks and financial institutions (Rowland 2006).

133% of the loan, according to the valuation carried out by the international financial advisors (FOGAFIN 2000; FOGAFIN 2009; Resolution 006 1999; see Figure 5).

Resolution 011 of 1999 allowed for institutions that received a first FOGAFIN loan to apply for a second one by June 30, 2000 (FOGAFIN 2000). The resolution also stipulated that FOGAFIN could grant loans to shareholders for up to 100% of the resources required by the institution. An operation with Confinanciera's shareholders was the only one carried out under the new conditions (FOGAFIN 2009).

Under Resolution 006 of 2001, the difference was that the amount of capitalization required was determined by the adjustments ordered by the Banking Superintendency, while in the 1999 regulation, it was the result of a reorganization process that was specified in the resolution (FOGAFIN 2009). Under the 2001 regulation, FOGAFIN could invest in bonds optionally convertible into shares (BOCAS) up to 80% of the resources required by the institution so that its solvency ratio reached 10%. In this case, the investment was made once the shareholders had capitalized their institution, at least in an amount equivalent to the difference between the capital necessary to achieve a 10% solvency ratio and the value of the investment (Resolution 006 2001).

Shareholders and credit institutions that requested access could do so one or more times, as long as they complied with the provisions of the resolution and the total amount of the operations did not exceed 80% of the global value of the adjustments required by the Banking Superintendency (Resolution 006 2001).

**8. Capital Characteristics: FOGAFIN granted four types of assistance to capitalize credit institutions: public bank capitalizations, bridge loans to shareholders, loans to capitalize private banks, and loans to capitalize credit institutions specialized in mortgage lending.**

FOGAFIN granted four types of capitalization assistance: (a) public bank capitalizations, (b) bridge loans to shareholders, (b) loans for private bank capitalizations, and (d) loans for credit institutions specialized in mortgage lending.

(a) Public bank capitalizations

After the write-off of nonperforming assets, to perform the second stage of capital strengthening, FOGAFIN issued bonds or invested proceeds from the financial transactions tax to capitalize the institution until reaching a solvency margin of 9% (FOGAFIN 2000).

In the third stage, nonperforming assets were transferred to Central de Inversiones S.A. (CISA). In September 2000, FOGAFIN acquired a CISA, a public special purpose vehicle for the management and disposal of bad assets (FOGAFIN 2001; Heenan et al. 2007; Resolution 006 1999; also see the YPFS case study on CISA, Engbith and León Hoyos 2021).

In the fourth stage, institutions went through administrative restructuring in preparation for their sale. The main objectives were to reduce administrative and personnel costs, avoid the deterioration of the institutions' assets, and reduce the upward pressure exerted by public institutions on the market deposit rates. The restructuring was carried out with the assistance of specialized external consultants. In the fifth and final stage, the institutions were sold. FOGAFIN hired investment banking firms to privatize the healthy banks (FOGAFIN 2000).

(b) Bridge loans to shareholders:

In the first stage of clean-up, institutions had to write off their NPLs in a way that reasonably reflected their true economic value. If, after the write-offs, the institution's technical equity was negative, its shareholders had to capitalize the institution with their own resources to bring its technical equity to at least zero (0). Shareholders had to contribute, with their own resources, at least 20% of the amount necessary to strengthen the technical equity of the institution (FOGAFIN 2009; Resolution 006 1999).

In 1999, it was in many cases unfeasible for shareholders to capitalize immediately. To facilitate the disbursement of resources corresponding to shareholders, FOGAFIN granted shareholders a six-month bridge loan that allowed financing 50% of this capitalization, and the Banking Superintendency extended the term to 12 months for the remaining 50%.

**Figure 4: Characteristics of FOGAFIN Bridge Loans under Resolution 006 of 1999**

| | Bridge Loans | FOGAFIN Bonds |
|---|---|---|
| Term | Up to 6 months | 270 days |
| Interest rate | DTF* + 2% | DTF |
| Amortization | At maturity | At maturity |
| Interest payment | Semiannual | Semiannual |
| Guarantees | 133% of the FOGAFIN loan | FOGAFIN |

*The DTF (fixed-term deposit rate) is calculated as the weighted average of interest rates on 90-day certificates of deposit (CDs) offered by Colombian banks and financial institutions (Rowland 2006).

*Source: Resolution 006 1999.*

(c) Loans for private bank capitalizations:

In the second stage of capital strengthening, it was necessary to capitalize the institution to restore a solvency margin of 10%. For this purpose, FOGAFIN granted loans to shareholders of institutions to be used exclusively to capitalize their institutions. FOGAFIN provided long-term loans for up to 90% of the amount necessary, but the long-term loans could not exceed 80% of the total capitalization. To ensure a long-term loan, shareholders had to grant shares of the institution as collateral at a minimum value of 133% of the loan, according to the valuation carried out by the international financial advisors (FOGAFIN 2000; FOGAFIN 2009; Resolution 006 1999; see Figure 5). FOGAFIN disbursed the loans directly to the participating institution receiving the capitalization, to its account at the central bank. Once the payment was posted, the institution recorded the new level of capitalization and immediately invested an equal amount in bonds that FOGAFIN issued for the capitalization (Resolution 006 1999; see Figures 4–7).

**Figure 5: Characteristics of FOGAFIN Loans under Resolution 006 of 1999**

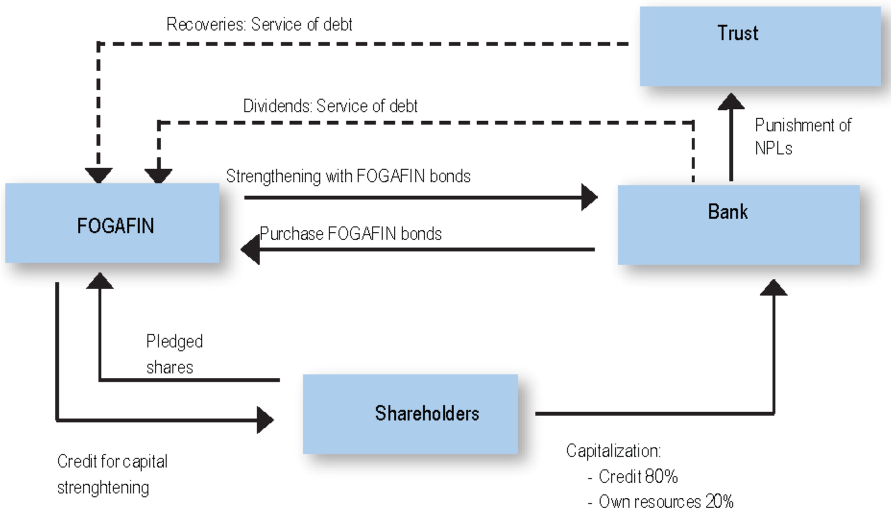
| | Loans to Shareholders | FOGAFIN Bonds |
|---|---|---|
| Term | 3 to 7 years; expanded to 9 years | 7 years (average) |
| Grace period for interest | 1 year; expanded to 2.5 years | None |
| Grace period for capital | 3 years; expanded to 4 years | N/A |
| Interest rate | DTF* + 2% (first 3 years) | DTF |
| | DTF + 3% (last 4 years) | |
| Amortization | Biannual | At maturity |
| Interest payment | Quarterly or semiannual | Quarterly |
| Guarantees | 133% of the FOGAFIN loan | FOGAFIN |

*The DTF (fixed-term deposit rate) is calculated as the weighted average of interest rates on 90-day certificates of deposit (CDs) offered by Colombian banks and financial institutions (Rowland 2006).

*Sources: Botero Garrido 2006; Resolution 006 1999.*

In any case, shareholders had to sign an adjustment plan with the Banking Superintendency to guarantee with solid and sufficient sources of payment (letters of credit from a first-level foreign bank or resources coming from the execution of irrevocable commercial trust contracts that had as their objective the sale of assets, for commercial value of at least 133% of the loan) (FOGAFIN 2000; Resolution 006 1999; see Figure 5). Additionally, FOGAFIN established mechanisms to ensure that at least 78% of the political rights of the total outstanding shares of the institution were immediately transferred to FOGAFIN, in case of default. Notwithstanding, FOGAFIN's Board of Directors could authorize guarantees other than those indicated.

**Figure 6: General Mechanism of Capitalization Line under Resolution 006 of 1999**




*Source: FOGAFIN 2009, 120.*

(d) Loans to credit institutions specialized in mortgage lending:

In 2001, Colombia passed Resolution 006 of 2001, which allowed for capitalizations of credit institutions specialized in mortgage lending (Botero Garrido 2006; Resolution 006 2001). FOGAFIN granted loans to shareholders of credit institutions and/or the subscription by FOGAFIN of bonds optionally convertible into shares issued by the institutions (FOGAFIN 2009). Institutions could issue BOCAS, as long as such bonds strengthened the equity of the institution, stated the irrevocable condition of being subordinated debt, and met the following requirements:

i. That the portfolio purchased by the shareholders corresponded exclusively to a portfolio rated C, D, or E or to a written-off portfolio, registered as of December 31, 2000;

ii. That the purchase value of the portfolio C, D, or E in no case was less than the net value plus provisions of said portfolio, including interest and other items associated with it;

iii. That the purchase value of the written-off portfolio was in no case less than the value recorded in memorandum accounts, including interest and other items associated with it; and

iv. That the respective credit institution did not enter into repurchase agreements on the portfolio referred, directly or indirectly, during the validity of the loans (FOGAFIN 2009; Resolution 006 2001).

**Figure 7: Characteristics of FOGAFIN Loans under Resolution 006 of 2001**

| | Long-Term | Short-Term | BOCAS* | FOGAFIN Bonds |
|---|---|---|---|---|
| Term | Up to 9 years | Up to 1 year | Up to 9 years | Up to 10 years |
| Amount | Up to 80% of the adjustment determined by the Superintendency to reach a solvency ratio of 10% | Up to 20% of the adjustment determined by the Superintendency to reach a solvency ratio of 10% | | |
| Grace period | Up to 2.5 years for interest and 4 years for capital | N/A | Up to 2.5 years for interest and 4 years for capital | |
| Interest rate | DTF* + 3% | DTF + 2% | DTF + 3% | DTF + 1% |
| | | | | Capitalization up to the first 5 semesters |
| Amortization | Biannual | At expiration | Biannual | At expiration |
| Interest payment | Biannual | At expiration | Biannual | At expiration |
| Guarantees | 133% of the value of the loan in shares pledged | 133% of the value of the loan in shares pledged | 133% of the value of the loan in shares pledged | |

*The DTF (fixed-term deposit rate) is calculated as the weighted average of interest rates on 90-day certificates of deposit (CDs) offered by Colombian banks and financial institutions (Rowland 2006).

*BOCAS were bonds optionally convertible into shares.

*Sources: Botero Garrido 2006; Resolution 006 2001.*

(1) Fate of Existing Board and Management: There is no information on whether the existing board and management at the participating banks were removed or replaced.

Research did not reveal information regarding this Key Design Decision.

(2) Allocation of Losses for Existing Stakeholders: Prior to capitalizations, NPLs were written off and shareholders had to capitalize their institution to bring its technical equity to at least zero.

For private institutions, in the first stage of clean-up, institutions had to write off their NPLs in a way that reasonably reflected their true economic value. If, after the write-offs, the institution's technical equity was negative, its shareholders had to capitalize the institution with their own resources to bring its technical equity to at least zero (0). Shareholders had to contribute, with their own resources, at least 20% of the amount necessary to strengthen the technical equity of the institution (FOGAFIN 2009; Resolution 006 1999).

It was agreed with the shareholders that all of the distributable dividends should be used to pay remaining balances of the loans granted by FOGAFIN to the institution (Botero Garrido 2006; Resolution 006 of 2001).

**9. Exit Strategy: There does not seem to have been a solid exit strategy.**

Research did not reveal information regarding this Key Design Decision.

**10. Changes in Relevant Regulation: There do not seem to have been any relevant changes in the regulation.**

Research did not reveal information regarding this Key Design Decision.

**11. Debt Restructuring Plan: As part of the capitalization process, private credit institutions had to sign a performance agreement.**

As part of the capitalization process of private credit institutions, in the third and final stage, institutions signed a performance agreement that included the goals that they had to meet to guarantee their solvency and the payment of the long-term loan. These goals were defined by FOGAFIN, the financial institution, and the Banking Superintendency, with the support of international consultants. Additionally, in each capitalized institution, an internal control office was installed to ensure compliance with the signed agreements, without actually comanaging the institution (FOGAFIN 2000). The control office reported the results of its management to FOGAFIN, and its operating costs were borne by the institution being capitalized.

Institutions capitalized had to authorize FOGAFIN and external consultants hired by suggestion of FOGAFIN to determine and quantify the assets that should be provisioned to determine the economic value of their shares (Resolution 006 1999).

In the fourth stage of the capitalization of public banks, institutions went through administrative restructuring in preparation for their sale. The main objectives were to reduce administrative and personnel costs, avoid the deterioration of the institutions' assets, and reduce the upward pressure exerted by public institutions on the market deposit rates. The restructuring was carried out with the assistance of specialized external consultants (FOGAFIN 2000, 10). In the fifth and final stage, the institutions were sold. FOGAFIN hired investment banking firms to privatize the healthy banks (FOGAFIN 2000).

**12. Other Conditions: Institutions capitalized agreed to authorize FOGAFIN and external consultants to set the economic value of the shares that maintained the value of the guarantees.**

Institutions had to authorize FOGAFIN, and external consultants hired under the responsibility of the institution capitalized, to establish the economic value of the shares of the institution and any other requirement that FOGAFIN deemed necessary. Institutions had to contract with consultants the periodic reviews of the economic value of the shares to maintain the value of the guarantees. The costs generated by hiring external consultants or any other concept associated with the operations was fully assumed by the institution or shareholders. Credit institutions had to authorize the statutory auditor and the internal auditor to provide the information required at any time by FOGAFIN. The cost arising from these requests was to be covered by the respective institution (Resolution 006 2001).

For Resolution 006 of 2001, when the request for loans corresponded to shareholders of an institution capitalized under Resolution 006 of 1999, FOGAFIN, with approval of its board of directors, could authorize that some of the conditions initially granted be modified, based on the adjustments or precautionary measures arranged or ordered by the Banking Superintendency to the institution (Resolution 006 2001).

# References and Key Program Documents

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