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USAID SUPPORT FOR FINANCIAL DEVELOPMENT IN COLOMBIA 2004-2013

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LIST OF ACRONYMS AND ABBREVIATIONS

ADAM	USAID Municipal Alternative Development Program (initials in Spanish)
AFS	Agricultural Financial System
AGF	Agricultural Guarantee Fund <i>Fondo Agropecuario de Garantías</i> (The state credit guarantee provider for loans in the agricultural sector)
AMV	<i>Autorregulador del Mercado de Valores</i> (Colombian Securities Industry Self-Regulatory Organization) (initials in Spanish)
ATM	Automatic Teller Machine
BAC	<i>Banco Agrario de Colombia S.A.</i> (Only bank owned by Colombian government)
BCS	<i>Banco Caja Social</i>
BdO	<i>Banca de las Oportunidades Program</i> (A program sponsored by the GoC to promote use of banking services by the population)
BMC	<i>Bolsa Mercantil de Colombia</i> (Colombian Mercantile Exchange) (initials in Spanish)
BVC	<i>Bolsa de Valores de Colombia</i> (Colombian Securities Exchange) (initials in Spanish)
CAF	<i>Corporación Andina de Fomento</i> (Multilateral Development Bank for Latin America) (initials in Spanish)
BA	Banking Agent
CCT	Conditional Cash Transfers
CD	Certificate of Deposit
CIFIN	<i>Central de Información Financiera</i> (a private credit reporting service provider in Colombia) (initials in Spanish)
CRCC	<i>Cámara de Riesgo Central de Contraparte</i> (Colombian Central Counterparty Risk Clearinghouse) (initials in Spanish)
CRR	Certified Reference Rates (interest rates for consumer lending and separately for microcredit lending periodically that are certified by the SFC as the market reference rates)
CSEDP	Companies Specialized in Electronic Deposits and Payments (<i>Sociedades Especializadas en Depósitos y Pagos Electrónicos</i>)
CSR	Corporate Social Responsibility
DPS	<i>Departamento para la Prosperidad</i> (formerly <i>Acción Social</i>) (an executive agency of the GoC charged with promoting social welfare) (initials in Spanish)
EAR	Effective Annual Rate
ESA	Electronic Savings Accounts
FI	Financial Institutions
FINAGRO	<i>Fondo para el Financiamiento del Sector Agropecuario</i> (The national development bank for the agricultural sector) (initials in Spanish)
FNG	<i>Fondo Nacional de Garantías</i> (The public credit guarantee provider for loans in the commercial and services sectors) (initials in Spanish)
FOGACOOP	<i>Fondo de Garantías de Depósitos de las Cooperativas de Ahorro y Crédito</i> (The GoC administrative entity that provides deposit insurance for the financial cooperatives)
FOGAFIN	<i>Fondo de Garantías de Instituciones Financieras</i> (The GoC administrative entity that provides deposit insurance for the financial services sector)
FTA	Free Trade Agreement
FTT	Financial Transaction Tax
GDP	Gross Domestic Product

GoC	Government of Colombia
KYC	Know Your Client
LA	Latin America
LADC	Latin American Developing Countries
MABS	USAID Micro-enterprise Access to Banking Services Program (MABS)
MIDAS	USAID Investment for Sustainable Alternative Development Program (initials in Spanish)
ML/TF	Money Laundering/Terrorism Financing
MoA	Ministry of Agriculture and Rural Development
MoF	Ministry of Finance
MSME	Micro, small and medium enterprises
MTIC	Ministry of Tourism, Industry and Commerce
NGO	Non Governmental Organization
OTA	Over the Air
PEB	Periodic Economic Benefits
PEF	Private Equity Funds
PFM	Pension Fund Managers
PoS	Point of Service
PPP	USAID Public Policy Program
SBSA	Small Balance Savings Accounts
SCG	Savings and Credit Groups
SEDPESES	Sociedades Especializadas en Depósitos y Pagos Electrónicos (New type of FI recently created to offer electronic deposits only) (initials in Spanish).
SES	<i>Superintendencia de la Economía Solidaria</i> (GoC administrative agency that oversees financial cooperatives)
SFC	<i>Superintendencia Financiera de Colombia</i> (GoC administrative agency that oversees the financial sector)
SME	Small and medium enterprises
SSA	Simplified Savings Account
TA	Technical Assistance
TAP	Technical Assistance Provider
TCBS	USAID Trade Capacity Building Support Program
TDA	<i>Títulos de Desarrollo Agropecuario</i> (Agricultural Development Securities) (initials in Spanish)
TES	National debt instruments (initials in Spanish)
UARIV	<i>Unidad para la Atención y Reparación Integral a las Víctimas</i> (Unit for Comprehensive Victims' Assistance and Reparations) (public entity, initials in Spanish)
UMIC	Upper Middle Income Countries (World Bank Classification)
VB	Village Banking
WDI	World Development Indicators (World Bank)
WEF	World Economic Forum
WOCCU	World Council of Cooperatives

I. INTRODUCTION

The document presents the support provided by the United States Agency for International Development – USAID to the Colombian Government to promote financial development in the country during the period of 2004 – 2013.

USAID Support for Financial Development in Colombia began during the Free Trade Agreement negotiations (FTA) between the United States Government and the Colombian Government (GoC) in May 2004.¹ Its objective was to help stimulate basic fundamentals in order to increase financing available to the productive sector, primarily for SMEs, and to increase and expand financial inclusion. USAID cooperation focused on supporting needed reforms in regulatory framework, strengthening institutionalization, developing policy instruments and the financial intermediaries' ability to serve low-income sectors.

USAID cooperation was provided through four programs: Trade Capacity Building Support – TCBS (*Programa de Apoyo al Fortalecimiento de la Capacidad Comercial – FCC*) (2004-2006); More Investment for Sustainable Alternative Development-MIDAS (*Programa Más Inversión para el Desarrollo Alternativo Sostenible – MIDAS*) (2006 – 2009); Program for Municipal Alternative Development-ADAM (*Programa Áreas de Desarrollo Alternativo Municipal – ADAM*) (2006 – 2009) and the Public Policy Program-PPP (*Programa de Políticas Públicas – PPP*) (2010-2013).

This document was created at the end of 2013 under the *Public Policy Program* and was completed under the contract with Olgoonik. It was written based on the reports produced under the four cooperation programs, primarily using quarterly and annual reports and presentations. It was also based on a report contracted for with Marulanda Consultores, which report documents part of the history of USAID cooperation. Further, it was based on studies carried out by USAID for the GoC and results provided by the *Banca de las Oportunidades Program* (BdO). Finally, outside statistics and sources were also consulted, primarily from Asobancaria, the World Bank and the World Economic Forum.

This is an appropriate point to express thanks for the valuable information provided by the Colombian Government, through the *Banca de las Oportunidades*, as well the review and comments to this document made by Marulanda Consultores and Miguel Arango, who led the GoC support for the promotion of financial development through the USAID cooperation programs.

Following this introduction, this document is organized into six additional chapters. Chapter 2 explains the background events that gave rise to USAID's cooperation for financial development in Colombia. The Diagnostic in Chapter 3, presents the state of financial development in 2005 in order to put the principal bottlenecks that needed to be addressed into context. Chapter 4 presents the strategy that USAID implemented through the four programs to support the GoC. Chapter 5 presents the advances in financial development obtained in the areas of regulation and institutionalization, financial infrastructure and product supply. The Pending Agenda in Chapter 6 presents the issues that require further effort in order to continue improving financial development in Colombia. Finally, Chapter 7 presents the principal conclusions. Detailed information about certain results can be found in the annexes at the end of the document.

¹ Negotiations were carried out between May 2004 and February 2006. Thereafter, it was submitted to the two countries' respective congresses for ratification.

2. BACKGROUND

Negotiations for the FTA with the United States, as well as the negotiations for other trade agreements (European Union, MERCOSUR, among others) brought to the forefront the importance of Colombia implementing a series of specific and consistent actions towards creating a definitive and significant increase in its competitiveness. Indeed, only to the extent that Colombia's productive sector could rely on an environment that allowed it to be productive and competitive would it be possible to take maximum advantage of opportunities and minimize any negative impact that liberalizing commerce in Colombia might have.

During the US-Colombia FTA negotiations, the obstacles requiring resolution in order to improve Colombia's competitiveness were identified. Lack of access to financing, primarily for SMEs, which impacted SMEs' productivity and investment decisions was among those obstacles. Additionally, the areas where the United States Government would support the GoC through cooperation projects financed by USAID with non-reimbursed funds were identified. Further, in the "Roundtable for Trade Capacity Building" ("Mesa de Fortalecimiento de Capacidades Comerciales") cooperation projects were agreed to with the objective of supporting Colombia's financial development.

Additionally, it was agreed that these cooperation projects would focus on supporting the areas considered critical to enable the financial sector to mobilize financing resources. Thereby, these financing resources could become a true support for increasing competitiveness, primarily by strengthening the regulatory and institutional framework of the financial system (capital markets, financial intermediaries and risk management) and also by expanding infrastructure and products available.

3. DIAGNOSTIC

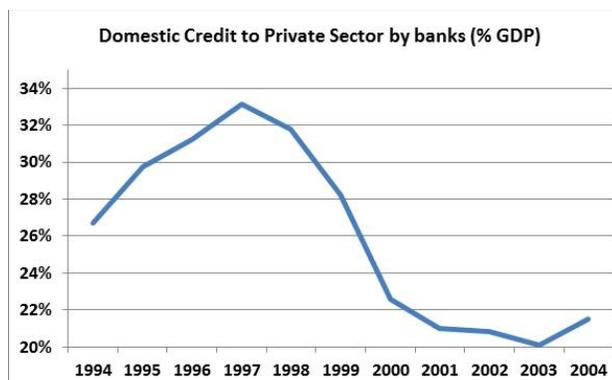
In 2005, the World Bank published a memorandum regarding the basics for competitiveness in Colombia. This memorandum highlighted lack of access to financing as one of the factors affecting competitiveness. This report summarized the state of the Colombian financial system as follows:

"The Colombian financial system is now better provisioned, better capitalized, more profitable, and more liquid than during the crisis of the 1990s. But the recovery has not helped to increase loans to parts of the private sector without access to international banks, nor to develop and deepen capital markets. Between 1998 and 2002, loan portfolios declined in real terms and banks increasingly invested in government securities. Since 2003, lending portfolios have been growing in real terms in all segments except housing finance. Private capital markets have developed somewhat, but continue to be characterized by low liquidity and insufficient depth, while the government debt market has developed substantially. Colombia has one of the longest local currency government bond yield curves in Latin America, second only to Mexico. The government is, by far, the biggest domestic bond issuer, representing about 80 percent of the total volume negotiated in the markets. The domestic credit to the private sector in Colombia, as a percentage of GDP, is at very low levels, only slightly higher than Guatemala but one-third that of Chile and one-seventh that of China. The lack of access to financing, especially longer term, forces domestic firms to obtain financing through the

use of supplier credit and short-term financing, which limits their growth and expansion.”²

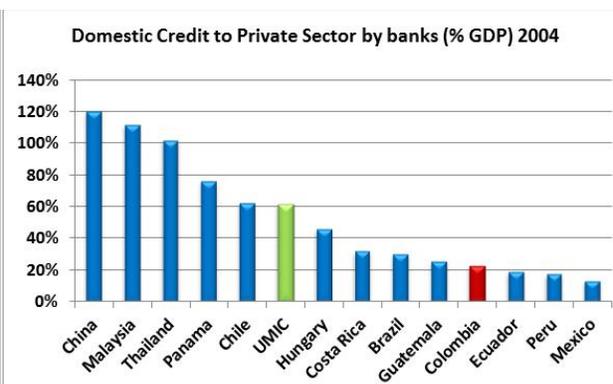
Indeed, the domestic credit to the private sector as a percentage of GDP was around 21.5 per cent in 2004 (Graphic 1), among the lowest when comparing Colombia to other Upper Middle Income Countries (UMIC) (Graphic 2).

Graphic 1 Domestic Credit to the Private Sector in Colombia



Source: Banco de la República

Graphic 2 Domestic Credit to the Private Sector, Upper Middle Income Countries (UMIC)



Source: World Bank

In 2005, business financing through the capital markets (bonds, corporate shares) did not reach 2 per cent of the total resources required to finance activities³ and there were very few investors willing to invest in venture capital such as private equity funds and angel investors. As a result, equity-financing opportunities were very limited. On the other hand, bank loans represented 40 per cent of received financing resources, followed by supplier purchase loans and the reinvestment of profits⁴, limiting long term financing, primarily for SMEs.

Procedural requirements to issue financial instruments in the capital markets were complex, slow and costly and as a result created a negative incentive to issue investment instruments. This hindered foreign investment in the market. At the institutional level, the Superintendence of Securities held supervisory control of the capital markets, and the Superintendence of Banking held supervisory control of financial intermediaries. This created information asymmetries and increased transaction costs.

In the case of financial intermediaries, financial institutions (FI) maintained an infrastructure with little to null coverage in remote municipalities with low population density. This was based on branches concentrated in large urban municipalities and medium to high-income zones (73 per cent of banking branches were located in municipalities with more than 100,000 inhabitants). In 2006, 309 of the 1,102 municipalities in Colombia (28 per cent of the total) had no financial coverage (Graphic 3). Banco Agrario de Colombia – BAC, the only government owned bank, primarily served those municipalities that did have coverage. Private banking only had a presence in 281 municipalities whereas BAC had a

² World Bank (2005), Pág. 50.

³ Fedesarrollo (2004).

⁴ Fedesarrollo, Business Opinion Survey (*Encuesta de Opinión Empresarial*).

presence in 689 municipalities. As a result, in 2006 there were only four Points of Service (PoS) for every 10,000 adults and 9.7 PoS for every 1.000 Km² (Table 1).

Graphic 3 Coverage of Bank's Branches 2006

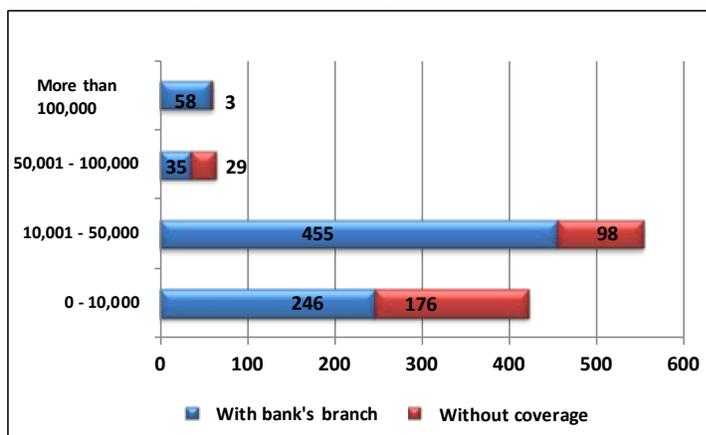


Table 1 Coverage Indicators 2006

COVERAGE INDICATORS	2006
% Municipalities with financial coverage	72%
# Municipalities without financial coverage	309
Points of Service for every 10.000 adults	4,0
Branches	1,5
Banking Agents	0,0
ATM	2,5
Points of Service for every 1.000 km ²	9,7
Branches	3,7
Banking Agents	0,0
ATM	5,9

Source: BdO with information of Superintendencia Financiera de Colombia. Data at June 2006.

The supply of financial products for the low-income populations was limited. In 2006, only 51 per cent of the adult population (14 million persons, 18 years of age or more) had at least one financial product, primarily savings accounts⁵ (Table 2). The number of savings accounts was 13.4 million.⁶ However accounts with balances of less than US \$2,600 demonstrated a 50 per cent inactivity rate. The principal regulatory barriers for small balance savings accounts were the compulsory investments the FI were required to make, the legal requirements governing money laundering and terrorism financing (ML/TF), and the introduction of the Financial Transactions Tax (FTT) (Box 1). The first two generated high operational costs which were passed through to clients by imposing higher initial minimum balances, higher balances to earn interest, higher fixed account maintenance fees and transaction fees. This made offering small balance savings products financially unviable. The FTT was a cost that must be assumed by the client, and as a result increased the preference for cash.

With respect to financing, interest rates controls and limits on the assets available to be offered as collateral (Box 1) restricted the availability of small loans from regulated FIs. As a result, financing for micro-enterprises was primarily served by microfinance NGOs, limited to urban areas and with low penetration rates. This is due to funding difficulties for non-regulated FIs. Indeed, in 2006 only 191,299 micro-entrepreneurs received first time loans and only 533,000 microloans were disbursed, totaling USD \$857 million (Table 2). Microfinance NGOs disbursed 63 per cent of the microloans (Graphic 4).

Moreover, the availability of insurance for low-income populations and micro and informal enterprises was practically non-existent and populations that were vulnerable and in extreme poverty had no access to financial services.

⁵ Asobancaria (2011).

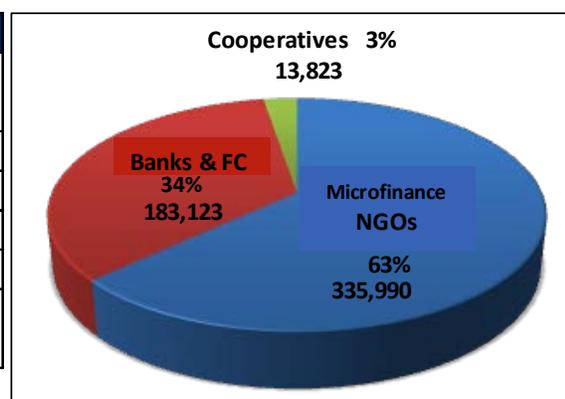
⁶ Ibid.

Table 2 Indicators for Access to Financial Services
2006

COVERAGE INDICATORS	2006
% Adult Population with at least one financial product	51%
# Adults with Savings Accounts	13.438.110
# Microentrepreneurs with loans	612.509
# Microentrepreneurs with first time loans	191.299
# Disbursements of microloans	533.415
Amount of microloans disbursements (in millions of USD)	\$857

Source: BdO, Asobancaria (2011).

Graphic 4 Disbursements of Microloans by type of Financial Institution in 2006



Although in 2005 Colombia already had a definition of microcredit⁷, this definition was very restrictive because it defined microloans as loans up to US \$8,000. Thus, the micro-entrepreneurs with greater needs had to seek credit through traditional credit lines whose requirements did not match the micro, small business sector's characteristics, which are largely informal.⁸ Additionally, the Superintendence of Finance (SFC) certified only one interest rate ceiling that did not distinguish between consumer and microloans, thereby creating a lower interest rate ceiling that restricted access to credit for micro-entrepreneurs.

Difficulties accessing formal financing created the exclusion of activities and populations for purposes of receiving credit, leaving informal credit as the only alternative, at an average 275 per cent effective annual rate (EAR) as the only alternative.⁹ This limited small businesses' progress and fed a vicious cycle of poverty.

In the case of the agricultural sector, access to financing and other financial services was even more precarious. Financing operated through the National Agricultural Credit System (*Sistema Nacional de Crédito Agropecuario*) (SNCA), created in 1990. This system, currently still in effect, involves a development bank (*Finagro*) that grants second tier loans to financial intermediaries so that they in turn can provide financing to agricultural producers. *Finagro's* resources came from the compulsory investments that the financial intermediaries were required to make (Box 1); financial intermediaries were also required to grant loans with subsidized interest rates to clients. Further, a state credit guarantee, provided by the Agricultural Guarantee Fund (*Fondo Agrícola de Garantías*), was created as a loan guarantee in which the borrower knows and pays the premium cost of the guarantee, and the risk covered was very high (up to 80 per cent), incentivizing adverse risk selection and the risk of default. As a result, the availability of agricultural credit was almost limited to the Colombian Agricultural Bank (*Banco Agrario de Colombia*) (BAC), the only existing government bank and the principal user of *Finagro* resources and the state credit guarantees. The loans benefited commercial farmers more than small-scale farmers and the policy focused on agricultural credit, excluding the rural and other financial

⁷ Law 590/2000.

⁸ Such as the registration in chambers of commerce and financial statements audited and supervised by an accountant.

⁹ *Econometría* (2007)¹⁰ Decree 4327 /2005.

services. In addition to the foregoing, state subsidies for the agricultural were linked to loans, such that the only farmers who could access the subsidies were those that had access to credit.

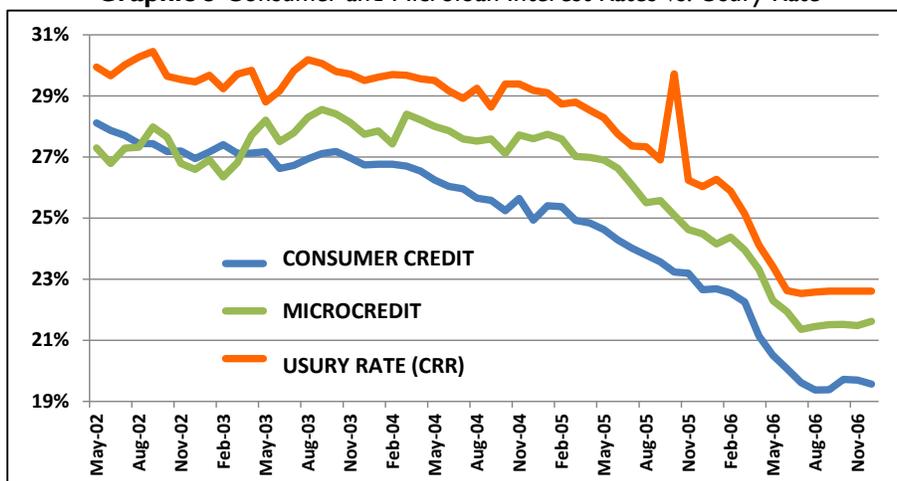
Inadequate and inefficient risk management was added to the above resulting in further obstacles to financing, particularly for the agricultural sector. Hedging instruments to cover price, exchange rate and climate risks, such as derivatives in the basic product markets, and agricultural insurance were only just beginning to be being developed and promoted, or as yet not developed at all.

In conclusion, flaws in the capital markets, in financial intermediation and in risk management made obtaining financing on terms that could assure a constant flow for their businesses difficult for MSME's and agricultural producers. A high percentage of the population was excluded from the financial system. It was necessary to resolve these flaws in order to build adequate financing and promote access to a complete portfolio of financial services.

Box I: Principal Bottlenecks in the Colombian Financial System

Interest Rate Ceilings. The Colombian Commercial Code has established since 1971 that there must be maximum limits on interest rates for debt transactions and those limits are established by the GoC through the Certified Reference Rates (CRR) (*interés bancario corriente*). In 2005, the maximum interest rate for microloans was 27per cent EAR, which does not allow the FI, particularly regulated FI, to cover costs and risks of granting small amount loans.

Graphic 5 Consumer and Microloan Interest Rates vs. Usury Rate

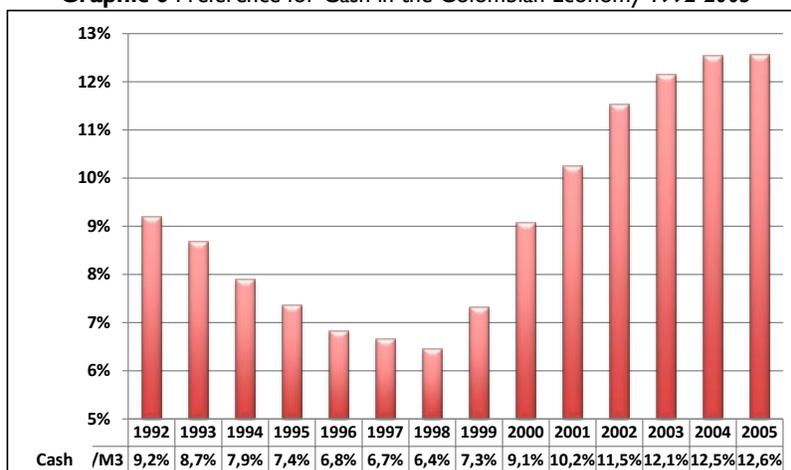


Source: Marulanda Consultores (2013).

Financial Transactions Tax - FTT. Created in 1998 as one of the measures to control the financial crisis, it began as a transitory measure but become permanent. The rate was fixed at 2 x 1.000 (0.2per cent) of all transactions, but increased in 2003 to 0.3per cent and again in 2004 to 0.4per cent. This tax has increased the preference for using cash to make financial transactions (Graphic 6).

Box I: Principal Bottlenecks in the Colombian Financial System (Cont.)

Graphic 6 Preference for Cash in the Colombian Economy 1992-2005



Source: Marulanda Consultores (2013).

Compulsory Investments. In order to direct resources to financing for the agricultural sector, since 1990 the FI must invest in Agricultural Development Securities (*Titulos de Desarrollo Agropecuario*) (TDA) 7per cent of sight deposits, 5per cent of savings deposits and 4per cent of CDs. These investments create costs and inefficiencies in the management of assets and liabilities for banks, increase intermediation margins and hinder the supply of low balance savings accounts.

Restrictions on Pension Fund Investments. Resources accumulated by the Pension Fund Managers (*Administradoras de Fondos de Pensiones*) (PFM) during the years 1995-2006 were almost 17per cent of GDP such that the PFM became the party in interest with the greatest capacity for seeking resources from the capital markets. However, PFM investment portfolios were limited by restrictions on permitted risks and, as a result, a large percentage of those resources (47per cent) were invested in GoC debt instruments (TES) as opposed to serving as sources of funding for the private sector.

Limited and Inefficient Legal Framework for Secured Transactions that restricted the assets susceptible of being granted as collateral mainly to real property; hindering access to credit for MSMEs and small-scale farmers. Additionally, the absence of a well-functioning and unified collateral registry and the slow and costly procedures to enforce security rights in the event of a default by the debtor increased the risk and costs of lending for FIs. This resulted in a ranking of 83 out of 175 for Colombia among the countries in which micro-enterprises experience difficulties in getting credit (Table 3).

Table 3 Ease of Doing Business Colombia

Doing Business	Rank 2007*
Ease of Doing Business Rank	79
Getting Credit	83

Source: World Bank, Doing Business Report 2007.

* Among 175 economies

Operational and Money Laundering Risk Requirements were so disproportionate that they rendered offering low cost products unviable for regulated FI, even savings and transactional products and services.

FI Lack of Knowledge about the market at the pyramid base and how to serve it: how to structure appropriate products for this population and how to evaluate risk for informal clients with no credit history or collateral to offer.

4. ESTRATEGY

With the goal of supporting financial development in Colombia, USAID's strategy consisted of supporting the GoC in the development and implementation of public policy because it is under the direct control of the governmental authorities. Thus, such cooperation was focused on supporting the agenda of key pending reforms in the financial sector and in supporting the implementation of policy instruments that would facilitate the implementation of reforms. This strategy was complemented by technical assistance (TA) to the FI in the expansion of infrastructure and in the implementation of adequate financial products targeted for the unbanked population's needs.

The strategy focused on three levels:

- Regulation and institutionalality
- Infrastructure
- Products

Regulation and institutionalality consist of the development of an adequate regulatory framework with solid institutions and coherent long-term policies regarding financial development. It involves all stakeholders: GoC (policy makers), finance sector (capital markets and financial intermediaries) and end users (investors and clients).

The infrastructure refers to expansion of the FIs' coverage, primarily through innovative low-cost channels, such as Banking Agents (BA) and Mobile Banking.

The products are the availability of financial products structured around the characteristics and needs of small businesses and the unbanked population, using appropriate methodologies, based on best practices, that are reflected in simple, low-cost financial products.

During the 2004-2013 period, USAID implemented the strategy through four cooperation programs with non-reimbursable resources:

- Trade Capacity Building Support Program - TCBS (December/04 - December/06).
- Investment for Sustainable Alternative Development Program – MIDAS (2006 – 2009) – Microfinance Program.
- Areas for Municipal Level Alternative Development Program – ADAM (2006 – 2009) - Microfinance Program.
- Public Policy Program – PPP (2010-2013) – Access to Finance Component.

The support strategy for each program was agreed to with the GoC and was based on joint work with the GoC, complementing its actions and focusing on the areas where cooperation would yield higher added value.

Box 2 USAID Cooperation Support Instruments

The strategy was implemented using the following instruments:

Studies and Diagnostics were made and were used by the GoC to make informed decisions.

International and Local Experts were engaged to support the process of drafting proposals and making policy recommendations, as well to provide TA to the FI and the GoC.

Pilot Programs were implemented to promote the expansion of infrastructure and the supply of innovative financial products. Lessons learned were useful to the GoC and other market participants.

Strategic Alliances were created between the public and private sectors that facilitated bringing in the private sector and leveraged resources.

Research and Knowledge Management to adopt best practices and lessons learned from international experiences, recommending adaptations to the Colombian context through research, study missions and international seminars.

Synergies with other Government Programs focused on marginalized populations living in poverty as a priority such as *Familias en Acción*, *Red Juntos*, and assistance for victims in order to introduce new products and distribution channels.

Synergies with other USAID Programs to carry out pilot programs and strategic alliances that benefit the populations USAID serves, such as ethnic groups.

Host Sessions to Present and Discuss Proposed Reforms to interested parties - GoC, congress and civil society - in other to build consensus.

5. RESULTS

This chapter sets forth the advances in Colombia's financial development for the 2004 – 2013 period, achieved with the support of the four cooperation programs. Results are divided into: regulation and institutionality, infrastructure and products.

The regulation and institutionality results refer to: i) capital markets, those sources of financing other than the extension of credit; ii) supervised financial intermediaries (banks, finance companies and cooperatives) and non-supervised financial intermediaries (NGO micro financing entities); and iii) risk management. These results consist primarily of laws, decrees and resolutions, as well as policy documents developed with USAID cooperation.

The results in infrastructure refer to the expansion of financial coverage thanks to the development of required regulation and the implementation of policy instruments that permitted the FIs to provide services through innovative channels such as Banking Agents (BA) and Mobile Banking. The results are reflected in the implementation of such channels and the advances in coverage expansion.

The results in products refer to the achievements in financial product implementation and diversification focused on improving financial inclusion.

5.1. REGULATION AND INSTITUTIONALITY

The support for reforms to promote financial development was the principal focus of the USAID cooperation for the GoC. Such support was provided primarily to the Ministry of Finance (MoF) and the Superintendence of Finance (SFC) because they are the institutions responsible for the regulation and supervision of the financial system. The reforms were intended to increase flows and sources of financing for productive activities through the capital markets, the FI and the strengthening of the risk management.

5.1.1. CAPITAL MARKETS

USAID efforts were concentrated on supporting institutional strengthening and the development of a regulatory framework that would allow invigoration of the capital markets.

5.1.1.1. STRENGTHENING INSTITUTIONS

Promotion of the capital markets would require a new institutionality that was capable of carrying out the necessary reforms and adequately supervising the market. Between 2005 and 2006 USAID supported the MoF with the creation of the Superintendence of Finance (SFC)¹⁰ and of the Securities Self Regulatory Entity *Autorregulador del Mercado de Valores* (AMV)¹¹, as well as in the strengthening of the supervisory capabilities of the recently created SFC.

The new SFC was the result of the merger of the Superintendence of Banking with the Superintendence of Securities. In addition to the merger, a new framework for a supervisor that would respond to new realities of the Colombian financial system was created. Its mission was to preserve public confidence and the stability of the financial system, maintain the integrity, efficiency and transparency of the capital markets, and safeguard respect for the rights of financial consumers and the due provisions of service. With the AMV, a self-regulation model was implemented whereby the AMV functions as an independent regulator to supervise participants in the capital markets.

To strengthen supervisory capacity, between 2006 and 2008, USAID provided TA to the new SFC with respect to strengthening market supervision and supervision of the agents participating in the market, incorporating supervisory best practices. As a result, monitoring and vigilance of the capital markets was strengthened. The following should be highlighted:

- ❖ Creation of a Market Monitoring Unit within the SFC.
- ❖ Regulations related to the improper use of insider trading, market manipulation using false and misleading information and protection of client investors in the capital markets was issued.¹²

¹⁰ Decree 4327 /2005.

¹¹ Decree 1565 /2006.

¹² Decree 1121 /2008.

Additionally, supervisory practices aimed at preventing and detecting these occurrences were implemented.¹³

- ❖ Vigilance capabilities were introduced for the capital markets within respect to conducts such as the improper use of client assets and monies, improper advice, improper sales practices, non-secure or unauthorized practices that could affect the integrity of the markets.
- ❖ Regulation of broker and capital market intermediary activities were issued.¹⁴

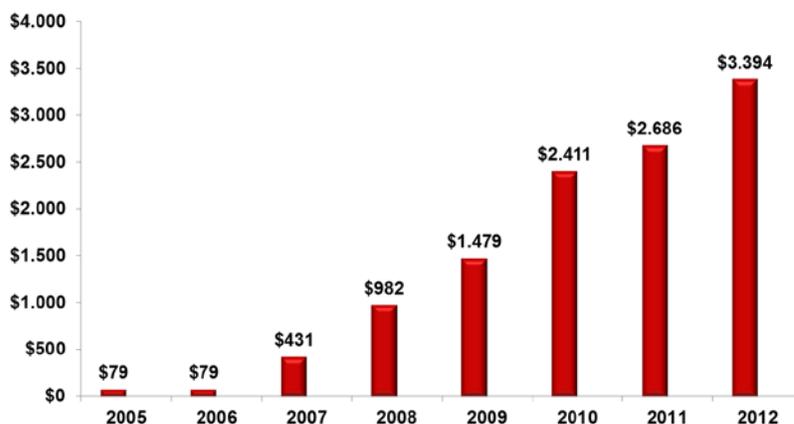
5.1.1.2. STRENGTHENING OF THE CAPITAL MARKETS

USAID supported the issuance of legal requirements to promote Private Equity Funds (PEF), to make permitted investments by pension funds more flexible and to stimulate the equity markets in order to increase liquidity in the capital markets and allow for the development of long term financing instruments to facilitate providing financing for SMEs.

Promoting Private Equity Funds

In 2007 the decrees facilitating the development of PEFs by simplifying their creation and promoting foreign direct investment through them were issued^{15,16}. As a result, resources invested in PEFs went from US\$79 million in 2006 to US\$3,394 million in 2012¹⁷ (Graphic 7). Additionally, the GoC promoted the creation of a “fund of funds” called the Co-investment Fund (*Fondo de Coinversión*) with US\$30 million earmarked to invest in venture capital funds that themselves invested in small and medium businesses; and *Fomipyme*, a fund earmarked to promote entrepreneurship through the investment of venture capital and seed capital with US\$1.5 million. At August 2013, 41 were registered with the SFC and various SMES have obtained financing through PEFs.

Graphic 7 Resources Invested in PEFs in Colombia
(in millions of USD)



¹³ Decree 1802 /2007.

¹⁴ Ibid.

¹⁵ Decree 2175 /2007.

¹⁶ Decree 2466 /2007.

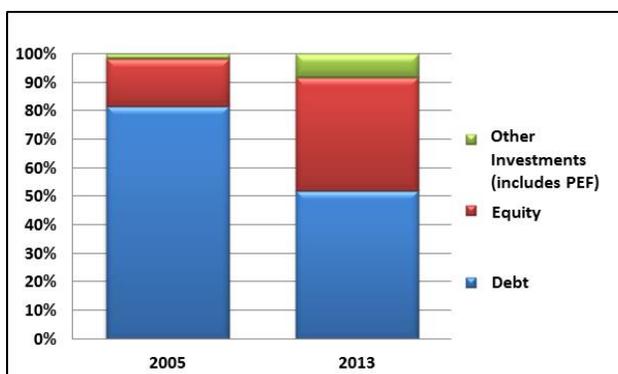
¹⁷ Bancoldex (2012).

Making Pension Fund Investments More Flexible

In 2008 and 2009 USAID supported the development of the regulation that allowed the Pension Fund Managers (PFM) to take greater risk and further diversify Pension Fund portfolios, investing a greater portion of their resources in the capital markets¹⁸ (Box 1). The *Financial Reform Law*¹⁹ allowed the PFM to invest in the capital markets through a “Multifondos” framework.²⁰

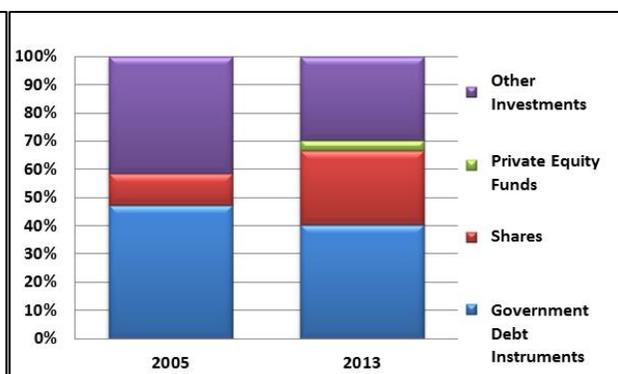
Thanks to this new regulation, financing sources available from the capital markets increased. This is reflected in the change in composition in pension fund portfolios: equity investments made by PFM regarding obligatory pension funds²¹ increased from 17per cent of their portfolios in 2005 to 40per cent in 2013 (Graphic 8); the percentage invested in corporate shares increased from 11per cent in 2005 to 26per cent in 2013; and investments in national and international PEFs was 4per cent of their portfolio in 2013. Percentage of portfolio investments in government debt instruments (TES) was reduced from 47.3per cent in 2005 to 40.5per cent in 2013 (Graphic 9).²²

Graphic 8 Obligatory Pension Funds Investments In Debt and Equity 2005 vs. 2013



Source: Calculations made with information of the SFC.

Graphic 9 Obligatory Pension Funds Investments in Government Debt Instruments, Corporate Shares and PEF 2005 vs. 2013



Source: Calculations made with information of the SFC.

Development of Corporate Shares Market

Requirements for investing in corporate shares were relaxed for the foreign capital PEFs, promoting the development of a market in Colombian corporate shares.²³ Also, requirements to list on the Colombian

¹⁸ Circular 5 /2008, SFC.

¹⁹ Law 1328 /2009.

²⁰ The Multi-Fund Framework (*Esquema de Multifondos*) allows the PFMs to manage the different pension funds in accordance with the ages and risk profiles of their respective affiliates.

²¹ An “obligatory” pension is a compulsory payment that every worker, whether salaried or independent, must make throughout his or her life prior to retirement. The savings resulting from such compulsory payments will allow said worker to receive a monthly payment upon reaching retirement age.

²² Calculations performed with information from the SFC “Obligatory Pension Funds, Investment Portfolio”, <https://www.superfinanciera.gov.co/jsp/loader.jsf?!Servicio=Publicaciones&Tipo=publicaciones&Funcion=loadContenidoPublicacion&id=9118>

²³ Decree 3264 /2008, amended by Decree 3913 /2008.

Securities Exchange (*Bolsa de Valores de Colombia*) (BVC)²⁴ and requirements for internal controls for corporate equity issuers²⁵ were also relaxed in order to facilitate listings for the SME.

5.1.2. FINANCIAL INTERMEDIARIES

In 2005 USAID supported carrying out a diagnostic regarding the state of access to financial services in Colombia, which was used by the GoC as one of the basis to design the financial inclusion policy. Afterwards, USAID supported the institutionalization of such policy and the development of regulation to facilitate expanding FI infrastructure, and the implementation/expansion of financial products targeted towards micro-enterprises and low-income sector, primarily, savings products, transfers/payments and credit, as explained below.

5.1.2.1. POLICY TO PROMOTE FINANCIAL INCLUSION

In 2006 the GoC's priority was to facilitate access to financial services, particularly to microcredit. Various alternatives were analyzed, including: the creation of a new bank, the creation of a company to operate the technological platform to support the operations of microfinance institutions (MFI) in Colombia, as well as the creation of an integral public policy to promote a favorable environment for the GoC and public and private FIs to operate actively. This was the most efficient and sustainable mechanism to achieve promotion of financial inclusion. The former alternative was that recommended by USAID and adopted by the GoC.

In September 2006, the Investment Program for the Opportunity Banking (*Programa de Inversión Banca de Las Oportunidades*) (BdO) was established as the executory program for the financial services access policy in Colombia²⁶. BdO's objective is to promote access to financial services, emphasizing low-income families to stimulate the country's development, always seeking social equality²⁷. Further, BdO made strategic alliances with the FI to expand access to financial services, for which the GoC made a commitment to create a sound regulatory environment and the FI made a commitment to expand their infrastructure and financial products. The principal goals of the alliance were the following:



- ❖ Achieve coverage in all municipalities in Colombia.
- ❖ Increase the number of persons with savings accounts by 3 million.
- ❖ Disburse 5 million loans to micro-enterprises.
- ❖ Increase the number of persons accessing the financial system for the first time.

During the 2007-2013 period, a large part of USAID cooperation was concentrated on providing TA to BdO in the structuring of the instruments through which policy was executed. Those instruments consisted in incentivizing the FI and they were structured under the following three modalities:

²⁴ Circular 28 /2009, BVC.

²⁵ Circular 38 /2009, SFC.

²⁶ Decree 3078 /2006.

²⁷ Banca de las Oportunidades, "Qué Somos",

<http://www.bankingdelasopportunidades.com/contenido/contenido.aspx?catID=298&conID=673>



- ❖ Subsidies for the expansion of infrastructure and supply of financial products
- ❖ Project co-financing
- ❖ Capacity building

The objective was to facilitate expansion towards new market niches for the FI. This would reduce the start-up costs and build capabilities and knowledge. The ultimate goal was to achieve sustainable long-term supply of financial products.

USAID also supported the organizational structuring and institutional strengthening of the recently created BdO. During the 2006-2013 period, USAID provided continuous support, transferring knowledge and creating solid institutional capabilities. The following should be highlighted:

- ❖ The initial years strategic and action plans.
- ❖ Regulations regarding statistical information provided by the FI, thanks to which timely and reliable statistics are available.
- ❖ The design of indicators to follow up on the financial inclusion policy's impact. As a result, since 2012, BdO publishes the Financial Inclusion Annual Report (*Reporte Anual de Inclusión Financiera*), using indicators that allow making international comparisons.

BdO ha tenido un impacto fundamental en la expansión del acceso a servicios financieros en Colombia y se ha convertido en una política reconocida internacionalmente como ejemplo a seguir, por sus logros y por el enfoque integral de intervención que ha utilizado (Box 3). Todos los instrumentos de política dirigidos a expandir la infraestructura y la oferta de productos que se presentan más adelante en este documento corresponden a los resultados de la ejecución de BdO.

Box 3 BdO, An Effective Policy that Generates Recognition

.... the **Banca de las Oportunidades** policy, together with the efforts of the finance sector, by improving and creating innovations in its distribution channels and by structuring products better adapted to the needs of the low-income population has increased the bancarization rate and the population's access to financial services: between July 2006 and March 2007, more than a million and a half Colombians accessed financial services for the first time, and among them, almost 550 thousand received loans (*Asobancaria, 2007*). Chap 5 "Availability of Financial Services and Effective Saving Allocation", "National Report on Competitiveness 2007 – 2008", *Colombia Compite*.

Cooperation..... A Colombian government program aimed at fostering financial inclusion known as "**Banca de las Oportunidades**" ("banking opportunities") successfully coordinated with the tax authority and the banking sector to exempt transactions between banks and their agents from a tax imposed on financial transactions. This avoids a double tax that would likely have rendered doing business through agents unprofitable or simply too complex for either agents or banks to be bothered with. Banca de las Oportunidades also successfully coordinated with the tax authority to exempt low-value financial transactions on simplified savings accounts, such as mobile phone-based accounts. This is an example of inter-authority coordination to overcome a specific, significant regulatory barrier. G20 Financial Inclusion Experts Group-ATISG Report, Innovative Financial Inclusion: Principles and Report on Innovative Financial Inclusion from the Access through Innovation Sub-Group of the G20 Financial Inclusion Experts Group, May 2010.

Principles of Direct Incentives to Offer Products

- ❖ Transparency: all incentives are assigned through open invitations to bid using quantifiable evaluation criteria.
- ❖ Sustainability: the FI contribute resources; make commitments to goals and to operational continuity.
- ❖ Synergies: with GoC programs directed to the poor population.

Box 3 BdO, An Effective Policy that Generates Recognition (Cont.)

“Colombia Incentivizes Banks to Expand Footprint to Rural Communities: Beyond leveraging public infrastructure and coordinating multisector efforts around financial access, targeted interventions to stimulate private-sector activity where market failure exists can be effective, but they must take great care in ensuring sustainability in its design. One promising case of such an approach is currently being implemented **by Banca de las Oportunidades**, a public-private alliance to increase financial inclusion in Colombia. Banca de las Oportunidades is spearheading an innovative program to incentivize banks to open agents in rural areas, where financial exclusion is most acute. Mireya Almazan, Bill and Melinda Gates Foundation, “Beyond Enablement: Harnessing Government Assets and Needs”, November 2010.

“Colombia and its Banca de las Oportunidades: the importance of a Comprehensive Vision - A successful strategy to promote access to microcredit should be a comprehensive and long term strategy. This is especially true for countries with underdevelopment of microfinance. The Banca de las Oportunidades Program of Colombia is a good example of such”. p 222, CAF, “Servicios Financieros Para El Desarrollo: Promoviendo el Acceso en América Latina”, April 2011.

Source: Marulanda Consultores (2013).

5.1.2.2. REGULATION TO FACILITATE INFRASTRUCTURE EXPANSION

USAID advised the GoC on the development of regulation to allow the FI to provide services through Banking Agents (BA) and Mobile Banking.

Banking Agents (BAs)

FI could only provide their services in Colombia through bank offices until 2006. This limited private FI coverage to large urban centers. Keeping in mind the BA’s potential to expand infrastructure, between 2006 and 2007 USAID advised on development of a regulatory framework to govern the implementation of the BA.²⁸ This framework authorizes the FI to provide their services through this channel and regulate their operation and monitoring.²⁹ In 2008, the elimination of the FTT was achieved for FI transactions carried out through BA, thereby reducing the BA transaction costs and promoting their usage.³⁰ In 2009, USAID advised on the issuance of additional legal norms to include the possibility of opening accounts through the BA³¹, and later in 2012, the authorization of another type of FI to utilize this channel³² (Investment Management

Dissemination of Best Practices

- ❖ USAID organized and co-financed two missions for GoC officials and FI executives to study the BA experience in Brazil in 2007 and two missions to study the successful mobile banking models in the Philippines (in association with the USAID MABS Program), and in South Africa in 2008.
- ❖ It engaged international and local experts to advise banks, transactional and payment networks in the implementation of BA and developed an operating manual.
- ❖ It supported the organization of seminars to demonstrate international experience with the mobile banking model and present its benefits among authorities, FI and cellular telephone companies.

²⁸ BAs are businesses, such as retail stores or drugstores that serve as distribution channels for the provision of financial services on behalf of the FI. In this case, the FI enters into an agreement with the business to act as its BA.

²⁹ Decree 2233/2006, External Circular 26/2006, SFC and Decree 3965 /2006.

³⁰ Decree 086/2008.

³¹ Decree 1121/2009.

³² Circular 26/2011 SFC

Companies (*Sociedades Administradoras de Inversión*), Securities Brokerage Companies (*Sociedades Comisionistas de Valores*), Pension Fund Manager Companies (*Sociedades Administradoras de Fondos de Pensiones*), Fiduciary Companies (*Sociedades Fiduciarias*) and foreign exchange market intermediaries.

This regulation has been fundamental to achieving infrastructure expansion. At December 2013, 23 FI provide their services through more than 49,181 BAs and financial coverage increased from 72 per cent of Colombian municipalities to 99.7 per cent. This can be observed in detail in section 5.2.1.

Bancolombia was the first bank to provide financial services through BAs in August /2006.



Photograph courtesy of the MIDAS Program.

Mobile Banking

Cellular telephones presented a great opportunity to expand access to financial services, especially in rural areas given that the penetration of cellular telephones in Colombia was almost one cellular telephone per inhabitant. Between 2010 and 2013, USAID advised on the adaptation of existing regulation to facilitate the development of mobile banking, primarily:

- ❖ The authorization to introduce “over the air” (OTA) products, which permit opening accounts in a mobile telephone without the need to go to a bank office. (Graphic 11)
- ❖ The authorization to use USSD technology for small amount transactions, which is fundamental for mobile banking penetration in low-income populations with basic cellular telephones.³³
- ❖ The introduction of rules for providing financial services through the BAs, utilizing the mobile banking channel.³⁴

As a result, three FIs, Davivienda, Bancolombia and AV Villas, are respectively offering the following products: *Daviplata*, *Ahorro a la Mano* and *Transfer Aval*, each especially structured to open accounts and process transactions through cellular telephones.

³³ External Circular 42/2012.

³⁴ External Circular 53, November/2009.

5.1.2.3. REGULATION TO FACILITATE DEVELOPMENT OF ADEQUATE PRODUCT SUPPLY

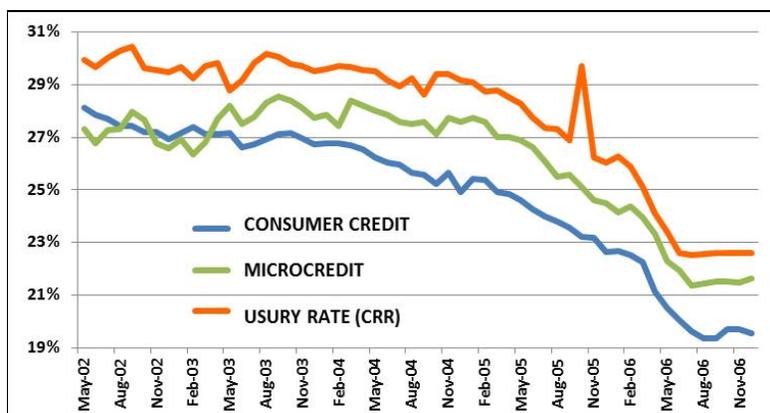
USAID’s efforts were focused on supporting the development of regulation that facilitated the supply of microcredit, small balance savings accounts and electronic deposits.

Microcredit

USAID supported the GoC in the implementation of several measures to stimulate microcredit lines: the certification of an interest rate limit for microloans, the improvement of the definition of microcredit, the availability of more credit guarantees and collateral and the facilitation of funding for Microfinance NGOs.

Microcredit Interest Rate Limit: In 2006 the Decree separating the certification of interest rates: one rate for consumer and commercial credit and one for microcredit was issued.³⁵ The microcredit interest rate certification has facilitated the progressive increase of this rate’s limit, from 22.6per cent in December 2006 to 53.5per cent in August 2013 (Graphic 10). This, in turn, has facilitated the expansion of microcredit. The average interest rate in the case of regulated FIs increased from 21.6per cent EAR in 2006 to 35per cent EAR in 2013.

Graphic 10 Behavior of Microcredit Interest Rate Limit and Average Interest Rates of FI (2007 – 2013)



Source: Marulanda Consultores (2013).

Improvement in the definition of microcredit: In 2008 regulation expanding the definition of microcredit from loans up to US \$8,000 to loans up to US \$38,000 was approved. This regulation also specified the income of the micro-enterprise as the source of payment for such loans. Also, micro-enterprises could be natural or legal persons.³⁶ This regulation widely expanded the number of micro-entrepreneurs able to access the microcredit lines and recognized that the purpose of these loans was to finance productive activities that generate income that can be looked to as a source of loan repayment.

³⁵ Decree 4090/2006, later modified by Decree 519/2007.

³⁶ Decree 919/2008 and Circular 10/2008, SFC.

Introduction of New Credit Guarantees and Collateral: Since 2007, the National Guarantee Fund (*Fondo Nacional de Garantías*) (FNG) grants credit guarantees of up to 70 per cent to those FI extending loans to clients who were first time users of the financial system for loans of up to US 900³⁷. The cost of this credit guarantee was co-financed by BdO.

Further, the modification of invoicing characteristics to facilitate invoice negotiation (factoring) was supported to facilitate MSME financing with such instrument.³⁸

Finally, in August 2013 the Secured Financing Law was approved. This law expands the scope of acceptable collateral for loans to include movable assets and establishes the creation of a single national registry, ensuring that the process of registering and publicizing claims against movable property are easily accessible, efficient and economical. It also allows out-of-court enforcement of collateral.³⁹ This was one of the most important bottlenecks that needed to be resolved in order to facilitate access to credit (Box 1).

Thanks to this new law Colombia made dramatic progress in its ranking for “ease of doing business”, moving from 53 in 2014 to 34 in 2015 among 189 economies and Colombia was the country with the most improvement in the “getting credit” category⁴⁰ (Table 4). During 2011 - 2013, USAID supported the GoC in generating advocacy in favor of the law.

Table 4 Ease of Doing Business Colombia

Doing Business	Rank	Rank
	2007*	2015**
Ease of Doing Business Rank	79	34
Getting Credit	83	2

Source: World Bank, Doing Business Reports 2007, 2015.

* Among 175 economies

** Among 189 economies

Increase in Funding for Microfinance NGOs: In 2007 the Central Bank of Colombia (*Banco de la República*) authorized foreign sourced loans for Microfinance NGOs⁴¹, thus facilitating the funding of NGOs with foreign debt.

Small Balance Savings Accounts

Between 2006 and 2010 USAID supported the GoC in the development of regulation governing small balance savings accounts (SBSA) with the objective of facilitating the informal low-income population to save and to increase savings levels in the economy. Every change to legal norms reflected a lesson learned and an improvement upon the prior (Graphic 11). As a result, Colombia has a modern legal framework that facilitates financial inclusion from savings since 2010, permitting the opening of savings accounts from cellular telephones at the client’s location, without need to go to a branch. At December 2013, two FI, Bancolombia and AV Villas, had developed a type of savings account that could be opened

³⁷ Circular Normativa Externa 011/2007, FNG, “*Garantía Banca de las Oportunidades*”.

³⁸ Conpes Mipyme 2007 and Law 1231/2008.

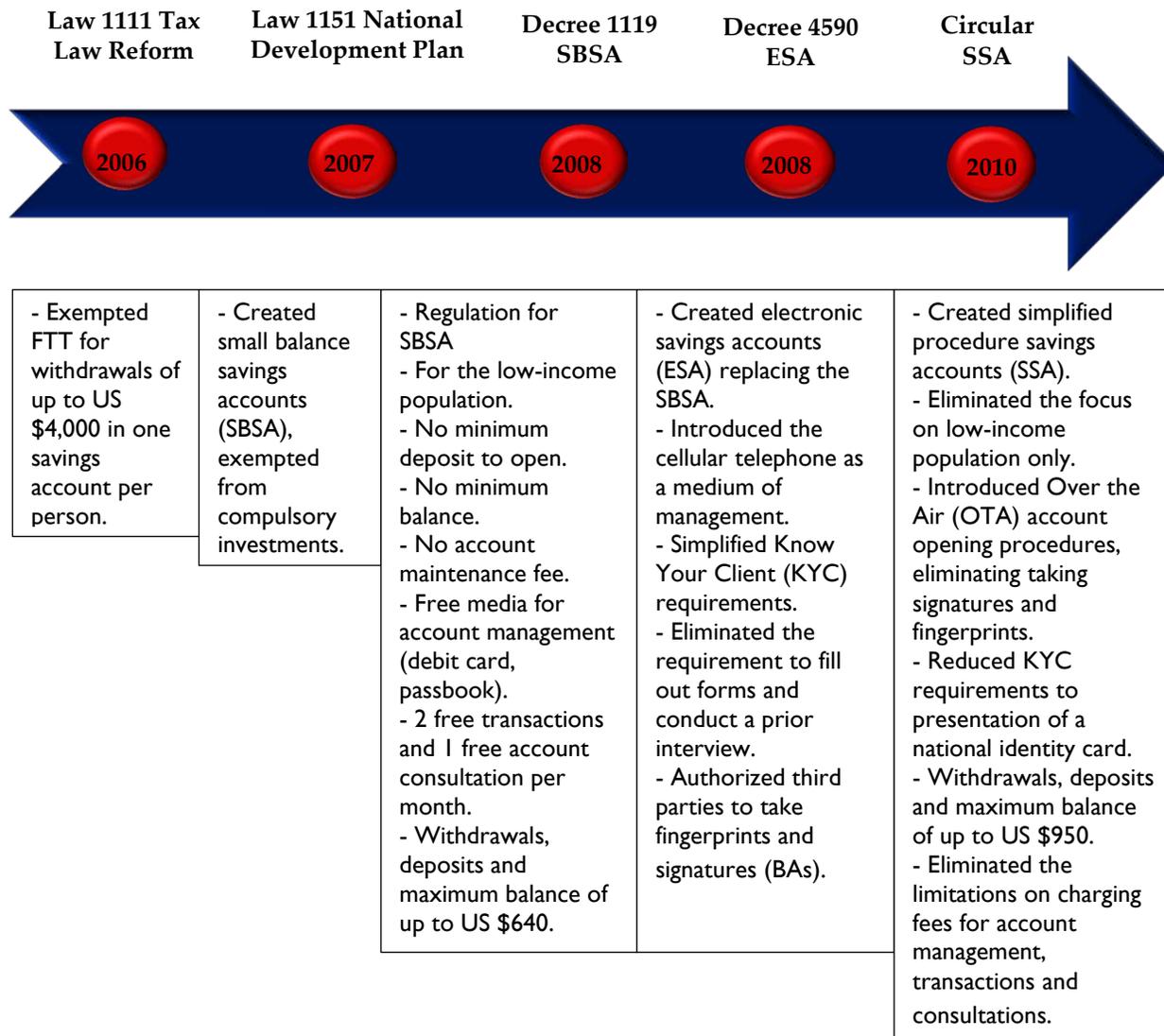
³⁹ Law 1676 2013.

⁴⁰ World Bank (2014).

⁴¹ Circular Reglamentaria Externa DCIN 83, August 31/2007, Central Bank, *Banco de la República*.

and managed through a cellular telephone, respectively: *Ahorro a la Mano* and *Transfer Aval*. The *cash in* and *cash out* points for these accounts are the BA and the FI's automatic teller machines (ATMs) the FI.

Graphic II Regulatory Changes for Savings Accounts



USAID also supported the structuring of a savings mechanism for retirement in the informal and low-income population given that this population does not have a pension in Colombia. The mechanism, called Periodic Economic Benefits (*Beneficios Económicos Periódicos*) (BEP), consists of incentivizing periodic savings such that when the person reaches retirement age, the GoC will contribute 20per cent of the amount saved in order to increase their pension. BEPs were developed in the Financial Reform Law of 2009.

Thanks to advances in the regulation, the number of adults with savings accounts increased from 13.4 million in 2006 to 22.2 million in 2013 (Table 5, Graphic 12). Savings accounts are the product that has contributed the most to bancarization, which rose from 51 per cent in 2006 to 71.5 per cent in 2013.⁴²

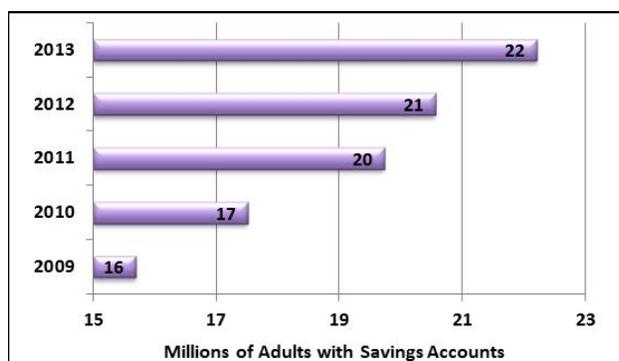
Table 5 Access Indicators 2006 vs. 2013

ACCESS INDICATORS	2006	2013
% Adults with at least one financial product	51%	71,5%
# Adults with Savings Accounts	13.438.110	22.200.000

Source: Asobancaria (2014) and BdO (2014).

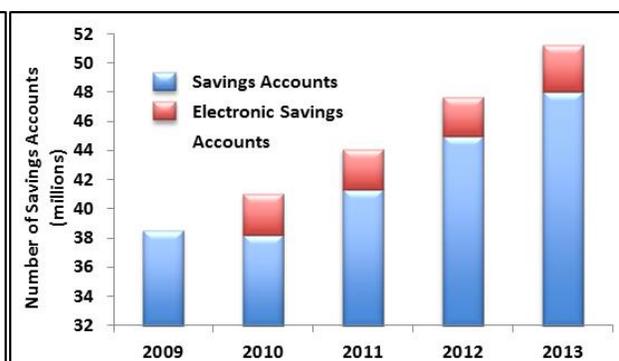
In 2013 3.2 million ESAs had been opened, primarily relating to the population benefiting from the More Families in Action Program (*Programa Más Familias en Acción*), and 102 thousand SSA. These accounts represented 6.2 per cent of all savings accounts (Graphic 13).

Graphic 12 Growth of Adults with a Savings Account



Source: Marulanda Consultores (2013), with information from BdO.

Graphic 13 Growth per Type of Account



Electronic Deposits

The GoC has promoted electronic transactions as the entry point to financial inclusion since 2010, given that they permit the population to carry out basic financial transactions, primarily in far flung municipalities, dispersed populations and marginalized urban populations.

Characteristics of Electronic Deposits

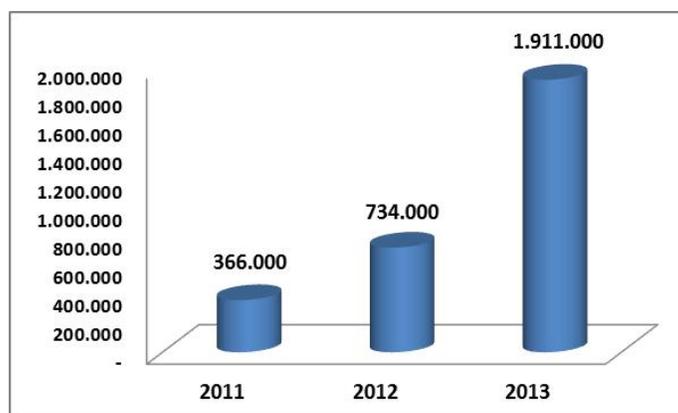
- ❖ Transactions: payments, transfers and withdrawals.
- ❖ Limit: US \$640/per month.
- ❖ Means of Management: Cellular Telephone, prepaid cards.
- ❖ Exempt from FTT.
- ❖ Deposit insurance from FOGAFIN, same as savings accounts.

⁴² Asobancaria (2014).

In 2011 the GoC developed the legal requirements for electronic deposits⁴³, as a financial product that would permit store low-value amounts and take advantage of mobile channels (cellular telephones). This facilitated the FIs' implementation of business models based on low cost transactional products and regulated electronic wallet products that were coming to market such as Davivienda's *Daviplata*. USAID provided advice to the GoC in the development of this regulation.

At December 2013, more than 1.9 million electronic deposits linked to cellular telephones had been opened through *Daviplata* (Graphic 14). The growth dynamic increased from the end of 2012 due to the payment of conditioned cash transfers (CCT) from the *Programa Más Familias en Acción* through *Daviplata* to almost 748,000 beneficiaries (see Section 5.2.2).

Graphic 14 Number of Persons with Electronic Deposits



Source: Asobancaria (2014)

Additionally, USAID supported the GoC in the development of the law that created the Companies Specialized in Electronic Deposits and Payments (*Sociedades Especializadas en Depósitos y Pagos Electrónicos*)(SEDPEs)⁴⁴, a new type of FI, with lower capital requirements and only authorized to offer electronic deposits and payments. The goal is to diversify the type of FI that can offer these services and promote competition in the supply of financial services. The expectation is that the cellular telephone and remittance companies with large client bases and national presence establish SEDPEs and begin to offer electronic deposits and payments. The SFC to protect client deposits and prevent money laundering will supervise the SEDPEs. It is hoped that this new law will jumpstart mobile banking and electronic payments.

5.1.3. RISK MANAGEMENT

Financial development required a strengthening of risk management to reduce financial costs and increase the economy's competitiveness. USAID contributed to the development of the regulation of risk coverage products, the strengthening of the SFC's risk based supervisory capacity, and to the strengthening of the credit registries.

⁴³ Decree 4687/2011.

⁴⁴ Law 1735, October 2014.

Risk Coverage Products

USAID provided TA to the GoC for the identification and elimination of regulatory barriers that increased costs for issuance and trading of financial derivatives. Also in the adoption of coverage regulations, credit derivatives, valuation of derivatives, swaps, European options (purchase and sale) and option valuations in order to facilitate coverage and mitigation of risks inherent to financing for capital markets participants and FIs.

Further, USAID also made recommendations regarding best practices for the accounting of derivatives, information exchange, financial derivative supervisory and control mechanisms, and market risk classifications associated with coverage of risks inherent in futures, forwards and long term debt securities. The result was the GoC's issuance of the regulation and the adoption of the financial derivatives program.⁴⁵

Strengthening the SFC's Supervisory Capacity

Between 2006 and 2009 USAID provided TA to the SFC to strengthen supervision based on risk, given that improving the ability of the SFC to implement risk based supervision over the FI, and to monitor the capital markets through the adoption of risk based transaction analysis was as important as developing risk coverage products. The following are highlighted:

- ❖ The implementation of the Central Counterparty Risk Clearinghouse (*Cámara de Riesgo Central de Contraparte* (CRCC) that makes the negotiation of derivatives possible in the capital markets by permitting the economic agents to cover risks and improve their long term financing alternatives.⁴⁶
- ❖ The structuring of the Liquidity Risk Management System (*Sistema de Administración para el Riesgo de Liquidez*) (SARL), as a central tool to manage this risk by the FI and supervision of the same by the SFC.⁴⁷
- ❖ The implementation of the Liquidity Reference Indicator (*Indicador de Referencia de Liquidez*) (IRL) that permits FI liquidity to be monitored.
- ❖ The creation of the Quality Management System (*Sistema de Gestión de Calidad*) designed to certify the SFC processes, thus improving the institution's transparency and solidifying supervision.⁴⁸

Strengthening Credit Bureaus or Registries

The adequate evaluation of risks by the FI requires that they have access to relevant, timely and reliable information through an effective credit reporting system. USAID supported the development of the *Habeas Data Law*⁴⁹ that provides incentives to report all borrowers, with good and bad credit scores.

⁴⁵ Decree 1796 /2008, Circulars 25, 40, 42, 49, 59 y 64 /2008, SFC; Resolution 1420 /2008, SFC.

⁴⁶ Resolutions 908 and 923 /2008, SFC.

⁴⁷ Circular 16 /2008, SFC.

⁴⁸ Resolution 1850 /2008, SFC.

⁴⁹ Law 1266 /2008.

5.2. FINANCIAL INFRASTRUCTURE

In a manner parallel to the support for the regulatory and institutional changes it was necessary to assist the FIs in expanding their coverage in order to achieve the goal of bringing financial presence to 1,102 Colombian municipalities (section 5.1.2.1). To that end, USAID supported the BdO in the design of policy instruments to promote infrastructure expansion. The strategy consisted of:

- ❖ Stimulate the expansion of branches of Microfinance NGOs, Cooperatives and Financing Companies given the focus of this kind of FI to serve micro-entrepreneurs and the low-income population.
- ❖ Stimulate the implementation of BAs authorized by the regulation.
- ❖ Promote the implementation of mobile banking.

5.2.1. BANKING AGENTS AND BRANCH EXPANSION

The stimulus measures were the co-financing of the expansion of infrastructure in low coverage municipalities. Between 2007 – 2013, BdO awarded winners of 8 competitive bids to increase branch infrastructure, 2 competitive bids to implement BAs in municipalities without coverage and 1 competitive bid to implement BA in marginal neighborhoods of principal cities. As a result, 30 FI (9 microfinance NGO, 20 cooperatives and 1 bank) opened 138 offices in 136 municipalities having less than 50,000 inhabitants; and two banks opened 209 BAs in 191 municipalities (Table 6).

Table 6 Results for Incentives to Open Branches and BAs

Population of Municipalities	Branches	Banking Agents
Less than 5,000		49
Between 5,000 and 10,000		99
Between 10,000 and 20,000		30
Between 20,000 and 30,000		1
Between 30,000 and 50,000	138	8
Marginal Neighborhoods of principal cities		22
Total	138	209

Fuente: BdO



BA of Banco Caja Social in a Marginalized Neighborhood of Bogotá. Photograph courtesy of BdO.



BA of BAC in Guachené, Cauca. Photograph courtesy of the MIDAS Program.

"I have been a BA for 27 months. Being a BA has been a blessing from my God. I feel proud to provide a service to the community. Now, I receive the payments of cellular telephone bills: before, the people had to pay \$15,000 (USD \$7) to up to \$20,000 pesos (US \$10) to send the bill for payment to Villavicencio (the nearest municipality). Additionally, the Familias en Acción mothers now can come on different days to withdraw their subsidy from their account (before the operation of the BA the beneficiaries of Familias en Acción had to wait in long lines to get the subsidy in only one payment day). I act as a BA with personal pride, the service that I am offering to my community is very enriching."

Mr. Nelson Orlando Alférez, owner of the micro-enterprise that acts as a BA in the Municipality of Calvario, Meta (2,205 inhabitants).

5.2.2. PROMOTION OF MOBILE BANKING

USAID supported the implementation of mobile banking through a pilot program with 9,666 mothers who were beneficiaries of the *Más Familias en Acción* Program in 16 municipalities with the objective of promoting *Government to People* (G2P) payments. The pilot program was developed in 2011 with 4 banks, *Davivienda*, *Banco Popular*, BAC and *AV Villas*, in association with 3 mobile telephone operators, *Comcel*, *Tigo* and *Movistar*. Two types of products were tested (electronic wallet and electronic savings accounts), as well as two types of technology (STK and USSD) and two cash-out mechanisms (ATMs and BAs).

The GoC used the lessons learned in this pilot program to design the request for proposals to award the payments of conditional cash transfers (CCT) to all beneficiaries of the *Más Familias en Acción* Program (2.6 million families). As a result, as of 2012, 748,000 families from 359 municipalities receive the CCT through their cellular telephone through *Daviplata*. This has also propelled the expansion of the BAs as a cash-out channel in rural municipalities given that *Davivienda* expanded its presence through BAs from 51 municipalities in 2012 to 675 municipalities in 2013⁵⁰.

⁵⁰ Asobancaria (2013).



Photograph: Beneficiary mother of *Más Familias en Acción* in Medellín learning how to use the savings account from AV VILLAS on her cellular telephone. Photograph Courtesy of *Marulanda Consultores*.

Más Familias en Acción Program

Más Familias en Acción is a GoC program that consists of granting conditional cash transfers (CCT) to poor and vulnerable families through a complement to the incoming cash flow. Its goals are contributing to poverty reduction, the reduction of inequality in income, the creation of human capital and the improvement of living conditions. The CCT is made subject to compliance with commitments to the healthcare and education of their children. The healthcare incentive is paid when and if the family complies with the children's attendance at growth and development appointments and the education incentive is paid when the children are enrolled in school and attend classes regularly.

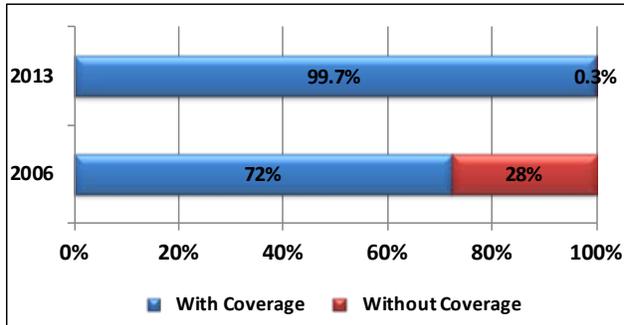
The program is the responsibility of the Department for Social Prosperity (*Departamento para la Prosperidad Social*) (DPS). It has a presence in the 1,102 municipalities of Colombia and serves the 2.6 million families that receive a bi-monthly average of US\$62.

Additionally, in 2013 USAID advised BdO in the structuring of a Challenge Fund to invite FI to present innovative projects to implement electronic transactions. Thanks to this initiative, US \$3 million in public and private resources were leveraged: US \$1.5 million that BdO earmarked for the Challenge Fund and US 1.5 million from the three winning proposals. The winning proposals were: the development of a mobile payment ecosystem in Ubaté, a small rural dairy municipality, by Bancolombia, using the mobile banking product “*Ahorro a la Mano*”; the execution of transactions with debit cards and electronic savings accounts via cellular telephone in 5 municipalities (3 of which were rural) by AV Villas; and the development of mobile banking in 7 rural municipalities by Bancamía. These three projects are currently in the execution phase.

5.2.3. ADVANCES IN COVERAGE EXPANSION

Thanks to institutionality strengthening, development of regulation that permits the provision of financial services through BAs and the implementation of policy instruments designed to facilitate expansion of infrastructure to small municipalities, financial coverage increased from 72 per cent to 99.7 per cent of Colombian municipalities (Graphic 15).

Graphic 15 Percentage of Municipalities with Financial Coverage 2006 – 2013



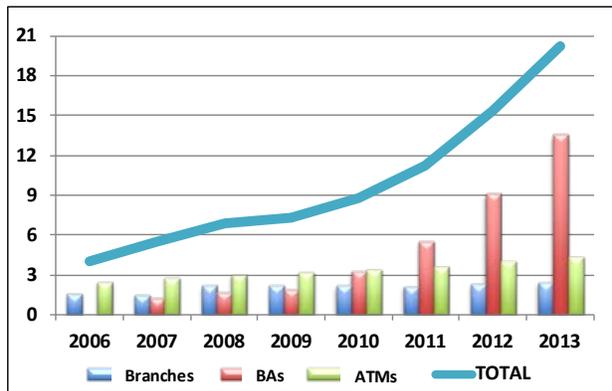
Source: SFC and BdO(2014).

Table 7 Coverage Indicators 2006-2012

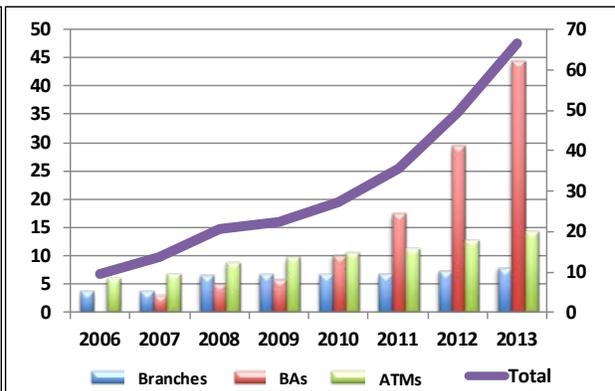
COVERAGE INDICATORS	2006	2013
% Municipalities with financial coverage	72%	99,7%
# Municipalities without financial coverage	309	3
Points of Service for every 10.000 adultos	4,0	20,2
Branches	1,5	2,4
Banking Agents	0,0	13,5
ATM	2,5	4,3
Points of Service for every 1.000 km2	9,7	66,6
Branches	3,7	7,9
Banking Agents	0,0	44,4
ATM	5,9	14,3

The number of PoS grew from 4.0 in 2006 to 20.2 for every 10,000 adults in 2013 and from 9.7 to 66.6 for every 1,000 Km² (Table 7, Graphics 16 and 17), primarily due to the implementation of BAs. Further, coverage was increased in rural zones (Graphic 18).

Graphic 16 Growth in PoS per 10.000 adults

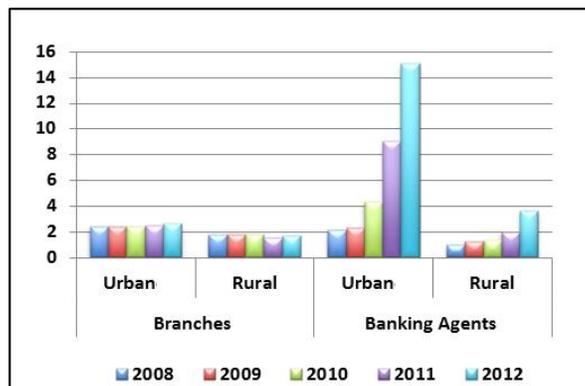


Graphic 17 Growth in PoS per 1,000 Km²



Source: Marulanda Consultores (2013), SFC and BdO (2014).

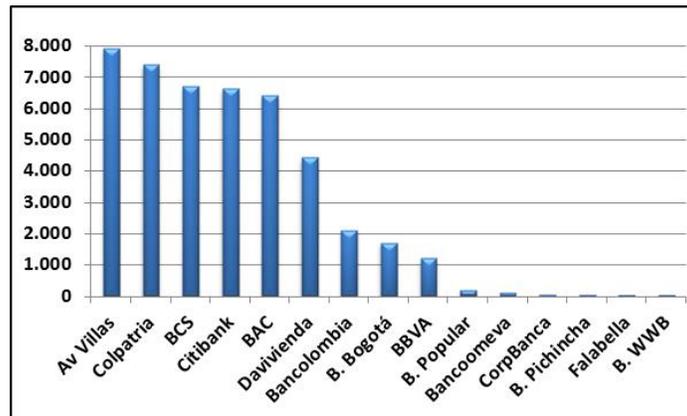
Graphic 18 PoS Branches and BAs per 10,000 inhabitants 2008 – 2012



Source: Marulanda Consultores (2013) with information from BdO and Asobancaria.

The BAs have experienced a dynamic expansion. As of December 2013, 23 FI provided financial services through 49,181 BA in 1,069 municipalities (97per cent of the total). Certain FI have implemented BA with the goal of reaching zones where there was no presence to expand their client base, such as Bancolombia and Davivienda which are the Banks with the widest geographic BA coverage (Bancolombia covers 756 municipalities and Davivienda covers 675); and others in order to complement their branch networks, such as Citibank and Colpatria (Graphic 19). The strategy to expand the BA’s network has been to link businesses that act as BA and/or establish alliances with network managers (G-Tech and supermarkets).

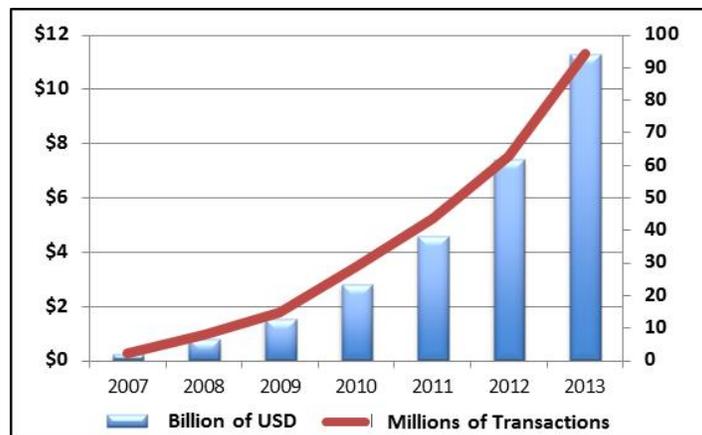
Graphic 19 Banking Agents at December 2013



Source: Asobancaria (2014).

The number of BA transactions grew from 2 million in 2007 to 94 million in 2013 and the amounts traded from US \$400 million to US \$11 billions (Graphic 20). The average transaction amount for BAs is US \$110. The principal transactions executed are collections (63per cent), cash deposits (13per cent) and cash withdrawals (13per cent). The case of BAC and BCS are highlighted. From inception, they included requests for credit and opening of savings accounts in the BAs that allows them to bring in new clients through this channel.

Graphic 20: Number and Amounts of BA Transactions (2007 - 2013)



Source: BdO, Asobancaria (2013).

5.3. SUPPLY OF FINANCIAL PRODUCTS

In addition to its support for regulatory and institutional changes, as well as for infrastructure expansion, USAID supported the development of supply of financial products structured for the base of the pyramid using two instruments: implementation of a Microfinance Program (*Programa de Microfinanzas*) and advice to BdO regarding the design of policy instruments. The objective was to achieve the expansion of credit supply for micro-enterprises, low-income populations, vulnerable populations and population living in extreme poverty; and afterwards achieve the expansion of supply for other financial services. The following presents the principals results regarding the supply of credit, savings and insurance.

5.3.1. CREDIT

5.3.1.1. MICROFINANCE PROGRAM

The *Microfinance Program* operated for 3 years (2006-2009) with the objective of building capacity in FI, particularly for regulated FI, in order to serve the low-income market. Indeed, as mentioned in the diagnostic, in addition to the regulatory and institutional bottlenecks, the FIs lack of knowledge about how to structure and implement products adaptable to the needs of the low-income population was another barrier for product supply (Box 1).

A demonstrative effect regarding the advantages of making alliances with the private sector to generate impact, results and sustainability was also sought. When USAID advised the GoC regarding the creation and startup of BdO, it recommended that BdO work in alliance with the finance sector to promote supply and BdO did work in alliance with the FI from the moment of its establishment, as discussed in section 5.1.2.1.

The *Microfinance Program* provided TA based on international microcredit best practices⁵¹ to 12 FI, eight of which were regulated⁵² and four that were unregulated.⁵³ The principal results were as follows:⁵⁴

- ❖ *Increase of Microloan Suppliers:* Microloan supply was expanded in the eight regulated FI. Three FI began to offer microloans as a new product in their respective portfolios (Banco de Bogotá, Giros y Finanzas and Financiera Compartir) and five FI consolidated their product supply (Bancolombia, Banco Agrario, Finamérica, Financiera Comultrasán and Cooperativa Utrahuilca).

⁵¹ The microcredit methodology consists of a non-traditional risk analysis, based on an analysis of the character and cash flow of the borrower (or of the borrower's household), rather than an automated credit scoring, that permits the FI to grant productive loans to informal micro-enterprises with low-income, despite having no credit history, financial information or collateral to offer. USAID financed the contracting of 12 international consultants and 4 local consultants with experience in the successful implementation of microfinance programs in other LA countries, and who trained 15 local consultants in order to build installed capacity in Colombia. The entire team of 31 consultants provided TA to the 12 FI in the structuring and implementation of microcredit products.

⁵² Bancolombia, Banco de Bogotá, Banco Agrario, Finamérica, Financiera Compartir, Giros y Finanzas, Cooperativa Comultrasán and Cooperativa Utrahuilca.

⁵³ Fundación Mundo Mujer Popayán, Contactar, Opportunity International (Agape) and Merquemos Juntos.

⁵⁴ Detailed results are found in Annex 8.1.

Due to the fact that these FI disburse the loans into savings accounts, it also promoted opening savings accounts.

- ❖ *Expansion of Access to Microcredit:* The 12 FI that received TA disbursed more than 1 million loans, with a value of US \$866 million during the 2007 – 2009 period, 438,750 of which were to micro-entrepreneurs obtaining credit formally for the first time (Table 8). Furthermore, 576,576 micro-enterprises renewed their loans and built a credit history within the financial system. In order to expand the supply of microcredit, the entities engaged 1,463 credit advisors.

Tabla 8 Results of the Microfinance Program

Results	2007 - 2009
Active Clients	487.559
Loans Disbursed	1.015.975
New Loans	438.750
Average of new loans (USD)	\$649
Renewed Loans	576.576
Average of Renewed Loans (USD)	\$937
Amount Disbursed (in thousands of USD)	\$866.395
New Loan Advisors Engaged	1.463
New Savings Accounts	145.312
Life Microinsurance Policies	5.269

Source: AECOM (2009).

- ❖ *Geographic Expansion:* microloan supply expanded from 207 municipalities in 2007 (19per cent of all municipalities in Colombia) to 500 in 2009 (45per cent of the total). Those municipalities include rural and remote zones and municipalities with a high percentage of vulnerable populations. The number of branches offering microloans grew from 326 to 674.
- ❖ *Product Diversification:* implementation of Village Banking and Micro-Agri loans. Village Banking was implemented in municipalities with high poverty rates in BAC and in two NGOs (Contactar and Merquemos Juntos). Micro-Agri loans were implemented in 3 regulated entities (BAC, Financiera Compartir and Giros y Finanzas).

Box 4 Micro-Agri Loans

Ms. Cecilia Montero, a Financiera Compartir client, is 50 years old. She received a micro-agri loan for \$ 2 million (US \$1,000) for her nursery specializing in reforestation plants in which she has over 10 years of experience. She works with her husband and two children in the rural area of the Municipality of Curití (Santander).

Photograph courtesy of the MIDAS Program.



- ❖ *Strategic Alliances:* These alliances allowed for the leveraging of resources and increased impact. The Bavaria/Sab Miller – Financiera Comultrasán alliance should be highlighted because through it microloans were granted to store owners that sell Bavaria products, as should the Financiera Compartir – Asociación Occicafé – USAID ADAM Program alliance to grant Micro-Agri loans to small specialized coffee producers in Huila.



Photograph courtesy of the MIDAS Program. First delivery of microcredit checks to small storeowners.

The *Microfinance Program* demonstrated that the FI were able to learn how to evaluate risk differently, to test the new products proposed to them and, if the pilot programs were successful, to incorporate those new products into their portfolios.

5.3.1.2. POLICY INSTRUMENTS

Between 2009 and 2013, USAID advised the BdO regarding the design and implementation of policy instruments that stimulate the supply of small amount loans from the FI. The principal policy instruments developed were incentives to offer microloans and TA financing.

Incentives to Offer Microloans

USAID advised the BdO regarding the structuring of an incentive to grant credit to the poorest micro-entrepreneurs. The incentive consisted of granting up to \$100,000 (US \$50) to the FI in order to cover the fixed costs of granting loans for under \$589,500 (US \$315) to micro-entrepreneurs that had not had access to the formal financial system. The incentive was given to those FI that requested the lowest amount to cover the costs. This incentive was complemented with an incentive for timely payment for the beneficiary micro-entrepreneur that consists of returning the last loan installment when and if the micro-entrepreneur has timely paid all installments to date. BdO co-financed this initiative in alliance with certain local governments and through four competitive bids it assigned the incentive to six FI.⁵⁵ Thanks to this incentive, 4,811 micro-entrepreneurs accessed credit for the first time.

⁵⁵ Bancamía, BAC, Finamérica, Fundación de la Mujer (FM), Fundación Mundo Mujer (FMM) and Comerciacoop.

Technical Assistance Financing

The results of the USAID Microfinance Program demonstrated that TA to the FI is very effective in achieving the expansion of access to financial services. Therefore, USAID advised BdO regarding the structuring of TA programs in order to empower the GoC to continue promoting capacity building within the FI. With such programs, stimulus measures for Village Banking and Micro-Agri loans were continued. Currently, TA financing is one of the BdO's principal policy instruments.

Village Banking: In 2010 BdO engaged a technical assistance provider (TAP)⁵⁶ to transfer the Village Banking methodology to seven FI with an investment of \$3,500 million (US \$1.8 million). As a result, during 2010 and 2012, seven FI received TA in granting credit and promoting saving through the creation of village banks. Access to the financial system was achieved for 40,921 vulnerable persons grouped among 2,145 village banks. Village Banking today is a part of the portfolio of products for the FI that received TA. Details of the results are set forth in Annex 8.2.



“This is the first loan that I have ever received. No one would lend to me previously because my work is not constant and I do not own any property. I am happy that they lent to me to be able to work without so many requirements. The bank gave us the opportunity, it believed in us and we are showing to them that, we can pay on time” María Marta, member of a village bank in Cundinamarca. She has two cows and makes a typical Colombian meal named tamales.

“The first amount that the FI lent to each village bank member was \$300 thousand (US \$150), then, \$500 thousand (US \$250); then, \$700 thousand (US \$350) and the fourth loan amounted \$1 million (US \$500)”. Village Bank member, “María Auxiliadora” from Pasto (Nariño).

Village Banking Groups in Chiriguaná, Cesar. Photographs and Testimonials Courtesy of BdO.

⁵⁶ AECOM International Development.

Micro-Agri loans: At the end of 2013 BdO invested COP \$3,565 million (US \$1.8 million) to hire a TAP to implement this product in 9 FI. The competitive bid was awarded to the World Council of Cooperatives (WOCCU) with a goal of 20,000 Micro-Agri loans and pilot programs in at least 18 municipalities. Currently, WOCCU is providing TA two four banks (Banco de Bogotá, Bancolombia, Davivienda and BAC), three Microfinance NGOs (Fundación de la Mujer, Fundación Mundo Mujer and Contactar) and two financial cooperatives (Financiera Comultrasán and Microempresas de Colombia).

In addition to providing TA to the FI, WOCCU will also train the SFC and the SES (the entities that supervise the banks and the financial cooperatives, respectively) in risk management for Micro-Agri loans. Likewise, it will provide training to Finagro, the development bank for the agricultural sector.

5.3.1.3. ADVANCES IN ACCESS TO CREDIT

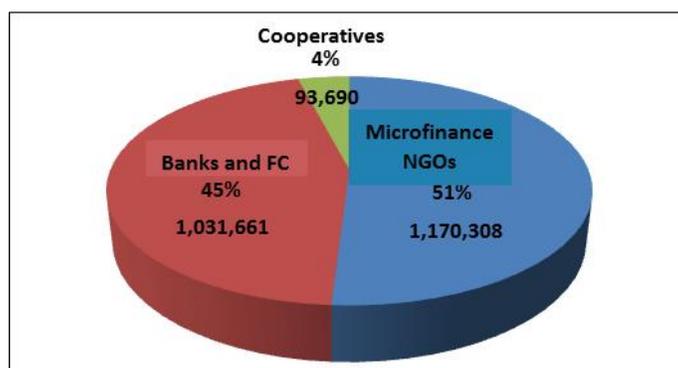
Access to credit increased significantly as a result of these combined interventions - regulation, *Microfinance Program* and policy instruments –. Indeed, the number of micro-enterprises with access to credit grew from 612,509 in 2006 to 1,724,809 in 2012 (Table 9, Graphic 22). Further, 3,820,088 micro-enterprises obtained access to formal credit for the first time during the 2006 – 2012 period (Graphic 23); and, 51 per cent of these loans were disbursed by microfinance NGOs (Graphic 21).

Table 9. Indicators for Microcredit in 2006 vs. Microcredit in 2012 ⁵⁷

MICROCREDIT INDICATORS	2006	2012	Variation
# Microentrepreneurs with loans	612.509	1.724.809	282%
# Microentrepreneurs with first time loans	191.299	653.964	342%
# Microloans Disbursements	533.415	2.295.659	430%
Amount of microloans disbursed (in millions of USD)	\$857	\$3.610	421%

Source: BdO

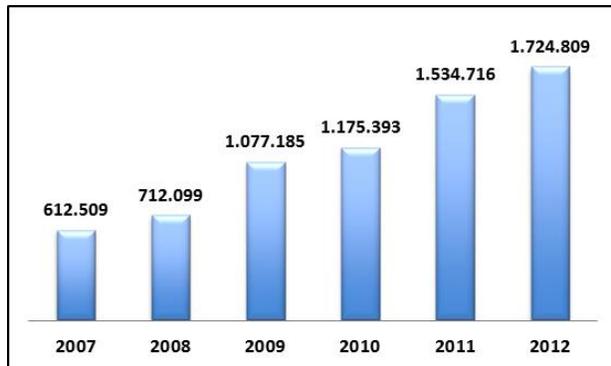
Graphic 21 Disbursements by Type of FI 2012



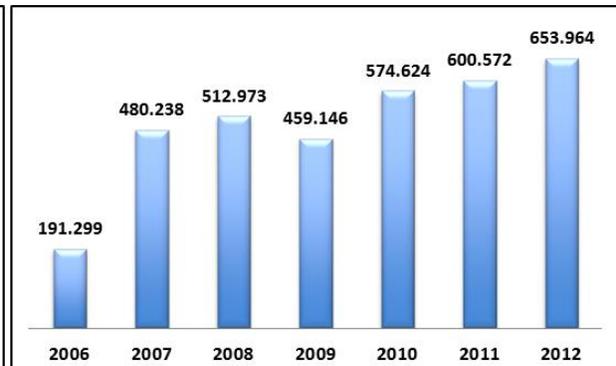
Source: BdO

⁵⁷ It does not include loans disbursed by the BAC with subsidized rates. During the period, three Microfinance NGOs were converted into banks.

Graphic 22 Growth of Micro-entrepreneurs with Credit **Graphic 23** Growth of Micro-entrepreneurs with First Time Credit



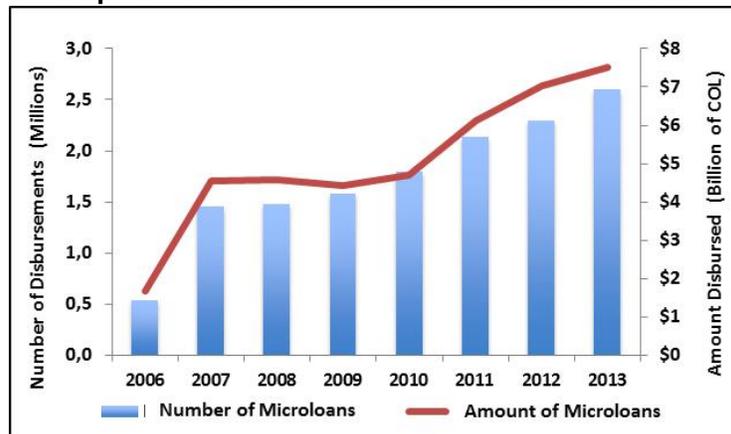
Source: BdO



Source: BdO

Disbursements of microloans rose from 533 thousand in 2006 to 2.3 million in 2012 and the amount disbursed rose from US \$857 million to US \$3.6 billion (Table 7, Graphic 24).

Graphic 24: Volume and Amounts of Microloans Disbursed

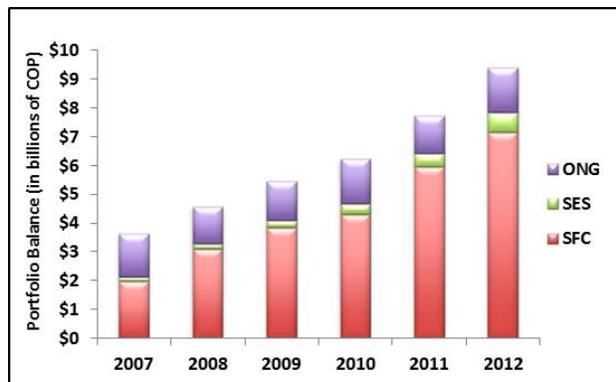


Source: BdO.

The microcredit portfolio rose from \$3.5 billion in 2007 (US \$1.8 billion) to more than \$9 billion in 2012 (US \$4.6 billions) (Graphic 25) and increased its share of the total financial system portfolio from 3 per cent in 2008 to 4 per cent in 2012 (Graphic 26). Regarding the microcredit portfolio 76 per cent corresponds to banks and finance companies (supervised by the SFC), 7 per cent to financial cooperatives (supervised by the SES), and 17 per cent to Microfinance NGOs (Graphic 26). The large increase in the participation of banks and finance companies is primarily due to the conversion of the 3 largest Microfinance NGOs into banks⁵⁸.

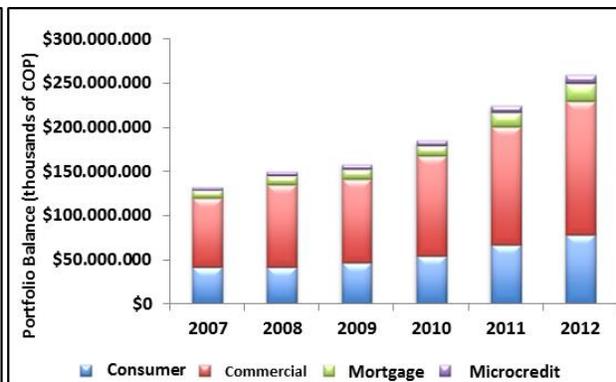
⁵⁸ *Corporación Mundial de la Mujer Medellín* and *Corporación Mundial de la Mujer Colombia* merged and partnered with BBVA to create *Bancamía* in 2008 and WWB was converted into a Bank in 2011.

Graphic 25 Distribution of Balances in the Microcredit Portfolio 2007 – 2012



Source: BdO

Graphic 26 Distribution of Total Portfolio 2007 - 2012



5.3.2. SAVING

USAID advised BdO regarding the design and implementation of policy instruments to promote saving through Savings and Credit Groups (SCG) (*Grupos de Ahorro y Crédito Local (GACL)*) and micro savings, in order to complement advances in the regulation of small balance savings accounts. It also supported the implementation of programs to promote saving and financial education among the populations benefitting from the GoC subsidies.

5.3.2.1. POLICY INSTRUMENTS

Savings and Credit Groups (SCG)

USAID advised BdO regarding the structuring of a TA program to permit implementation of the SCG methodology to promote saving among populations in far remote zones and in extreme poverty situations. The SCG was implemented in two phases: pilot program (2008 – 2010), in which the methodology was implemented for the first time in Colombia, and expansion program (beginning in 2012).

At October 2013 the SCG methodology had been transferred to 19 organizations and 3,107 SCG with more than 44,000 participants had been created. The participants had saved on average \$180,000 (US\$92) for a total of mobilized savings of \$7,920 million (US \$4 million). Details of the results are set forth in Annex 8.3

The implementation of the SCG has been very successful in building a savings culture. In 2012, 65 SCGs had more than \$5,000,000 (US \$2,564) in their respective savings “lockboxes”; 30 had more than \$15,000,000 (US \$7,692) and 2 had more than \$40,000,000 (US \$20,513). Because they are elevated amounts, USAID advised BdO in 2013 regarding the structuring of an advisory Project to structure mechanisms to bring these savings into the financial system. The advisory project is currently being executed.



“When I put on my savings and credit group t-shirt “Las Mercedes,” it is not like putting on any other t-shirt because when I wear the group t-shirt I feel happy. I want to keep saving because I want my son to be someone in life, I want him to attend university and I know that by saving I will be able to send him to a university” Helena, Tablón de Gómez, Nariño.

“Before, if I got five thousand pesos (USD \$2.5), I spent five thousand in that same day, and if I got twenty thousand pesos (USD \$10), I spent them all too. Not anymore because now I know how to save. Plus, before we had to go to the loan sharks and that was a nightmare because the day I didn’t have the daily loan payment of \$2000 (US \$1), they showed no mercy and I had to borrow money from somebody else to pay them. Now, when I need money the CSG I belong to lends it to me” Milena Clemencia, Bolívar.

Photographs of SCG in La Boquilla (Bolívar), in Yuto (Chocó) and SCG for children in Maria la Baja (Bolívar). Photographs Courtesy of BdO.

Micro savings

USAID advised BdO regarding the structuring of a TA program for FI to implement micro savings products. Although the regulatory advances had already opened the door to savings accounts without minimum balances or initial deposits in the field and through the cellular telephone, the goal of making micro savings a profitable product for the FI still needed to be achieved.

As a result, in May 2012, BdO engaged a TAP⁵⁹ to provide TA to six FI regarding the structuring and implementation of microsavings products. TA is currently being implemented in four banks (Banco de Bogota, AV Villas, Bancamía and BAC) and two finance companies (Giros y Finanzas and Opportunity International). Pilot programs were carried out in 2013 in 18 municipalities to launch the products in the course of 2014. In the pilot, 1,362 savings accounts with an average balance of \$200,000 (US \$103) were opened, of which 50 per cent correspond to new clients in the financial system.

⁵⁹ Consorcio DAI – Economía Urbana.

5.3.2.2. PROMOTING SAVING

USAID supported the implementation of finance education programs and savings promotions with municipal governments and with populations that are beneficiaries of the GoC programs, primarily *Más Familias en Acción* and victims of the armed conflict. These programs have served to inform the GoC about ways it could improve finance education strategy, primarily among vulnerable populations and populations living in extreme poverty. Detail regarding these programs can be found in Annex 8.4.



Testimonials of Beneficiaries of the Financial Education Program

"I learned about entrepreneurship and how to start my own business. I am also learning that saving is the best way to meet my goals, life plans and overall improve my quality of life".

"I am making a saving plan to finish my house"

"Now it is very clear to me how important saving is after this training session"

"In our training sessions they have taught us that we can be saving for our futures"

"We learned how to save and to feel secure about insuring a future for our family"

Financial Education Program in Timaná (Huila) with beneficiaries of the *Más Familias en Acción* Program, 2011. Photograph Courtesy of BDO.



Finance Fair with Victims from the Mampuján Massacre,⁶⁰ 2012. Photograph courtesy of PPP.

⁶⁰ The forced displacement and murders occurred in 2000 and were committed by paramilitaries belonging to the Héroes de Montes de María Block of the United Self-Defense Forces of Colombia.



Finance Education Workshop with child victims of the Vencedores de Arauca Massacre⁶¹, 2012.
Photograph courtesy of PPP.

5.3.3. INSURANCE PRODUCTS

USAID supported the implementation of microinsurance through the Microfinance Program and its support to BdO for the design of policy instruments.

5.3.3.1. MICROFINANCE PROGRAM

In 2009 USAID advised BAC regarding the implementation of micro- life insurance products for its micro-entrepreneur clients.

Box 5 Micro-Life Insurance from Banco Agrario de Colombia⁶²

- To insure the micro-entrepreneur's life and protect his or her family.
- Premiums begin at \$666/per month (USD \$0,37).
- No medical exams required, and no pre-existing conditions restrictions or other exclusions.
- Easy to acquire and present claims.
- Broad Coverage: death, total and permanent disability, monthly income and funeral assistance.
- The pilot program commenced in May 2009.
- In 2010, more than 5,000 micro-enterprises already have their microinsurance and in 2011 more than 38,000 policies had been sold.



⁶¹ The Vencedores de Arauca Block of the United Self-Defense Forces of Colombia committed rapes, murders, and forced displacement, between 1998 and 2005 in rural areas of the Department of Arauca.

⁶² <http://www.bancagrario.gov.co/Noticias/Paginas/MicroseguroBACCasoExitoso.aspx>

USAID also advised Bancoldex, the second tier development bank that provides credit to the FI, regarding the structuring of a micro-enterprise insurance product “Futurex” that could be offered through financial cooperatives and Microfinance NGOs in association with Seguros Mapfre. Thanks to this new product, Seguros Mapfre started insuring micro-enterprises without regard to the material with which those businesses were constructed, or if they were located in rural zones.

5.3.3.2. POLICY INSTRUMENTS

In 2009 and 2010 USAID advised BdO regarding the design and implementation of a policy instrument to promote the supply of micro-life insurance for populations in extreme poverty, which are beneficiaries of the Red Unidos Program.⁶³ The objective was to promote a culture of insurance among the poorest population and generate lessons learned about the product’s structuring and distribution channels.

As a result, Seguros la Positiva underwrote insured 39,200 families that were beneficiaries of the Red Unidos Program in 20 municipalities with a micro- life insurance policy covering death for any reasons with an insured amount of \$3 million (US \$1,538) and a supplement covering funeral costs of \$1 million (US \$513). During that year 61 events occurred and allowed the Insurer to understand the mortality rate for that population which was one of the greatest sources of uncertainty.

Red Unidos Program

The *Red Unidos* Program is the National Government’s strategy to overcome extreme poverty. Its goal during the 2010-2014 period is to achieve that 350 thousand families overcome extreme poverty. It is a network that brings together 26 State entities involved in the provision of basic social services to populations in extreme poverty.

The *Red Unidos* Program is the responsibility of the *Agencia Nacional de Lucha contra la Pobreza Extrema - ANSPE*.

Box 6 Microinsurance: A Product very Appreciated by the Poor



“We had a life insurance policy and when she passed away (Rosa – spouse), we only had to present the death certificate from the attorney general’s office and they took care of everything. That money was very useful to me (insurance payout). First, I paid for several masses for Doña Rosita. Then, with the remainder I paid off our debts and then invested the rest. If it were not for that money we would have been in a very bad state, a different situation”. Poliduro Hernández, 68 years old, Soacha (Cundinamarca).

“The Red Unidos counselor let me know that my mother belonged to the Red Unidos Program and that she had received a micro life insurance policy although the fact that she was already sick. Despite the sadness that our mother’s death causes us the insurance helped us a lot. I can’t imagine what it would have been like without it. It was very big help. I paid the past due school fees for my daughter’s school and invested in a catalogue sales business. My sister bought a computer for her children. The insurance policy improved our lives because there was a little left over for everyone and we are using it to help us improve in life.” My mother was help in everything ... economically, with advice, and she was very loving. Sandra Yanuri Botina, 32 years old, 3 children: Jenny Patricia Botina, 35 years old, 4 children, Natali Botina, 1 child, Alicia Rivera, Catherine Bellota – Pasto (Nariño).

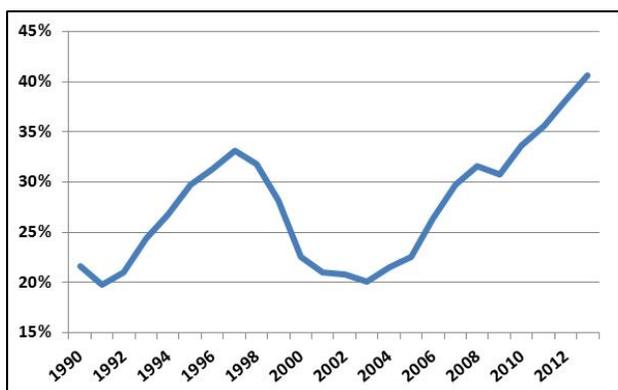
Beneficiaries of microinsurance policies en Cúcuta, Norte de Santander. Photograph courtesy of BdO.

⁶³ The instrument consists of the subsidy of the cost of the microinsurance policy premium during the first year, in exchange for the renewal of the microinsurance policy by the insurance company in the second year.

6. PENDING AGENDA

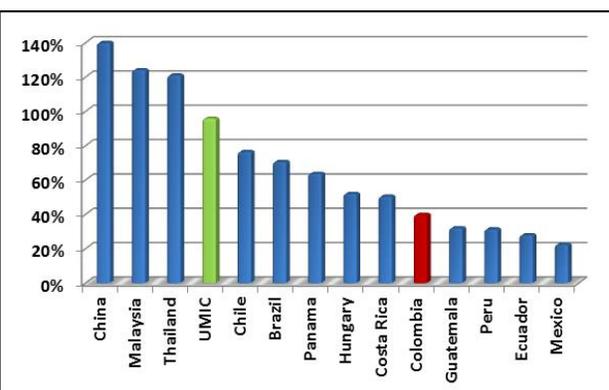
The GoC has achieved important advances in financial development in Colombia over the past decade. However, significant challenges still persist. Indeed, despite the fact that the domestic credit to the private sector by banks duplicated between 2004 and 2013, growing from 21.5 per cent to 40,7per cent (Graphic 27), Colombia continues to be one of the UMIC with the lowest level of domestic credit to the financial sector, much below the average of other UMIC (Graphic 28).

Graphic 27 Growth of Domestic Credit to the Private Sector by Banks (% GDP) in Colombia 1990-2013



Source: Banco de la República

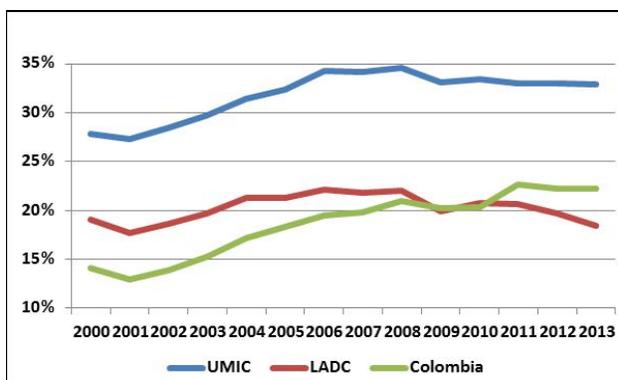
Graphic 28 Domestic Credit to Private Sector by Banks (% GDP) 2013 UMIC



Source: World Bank

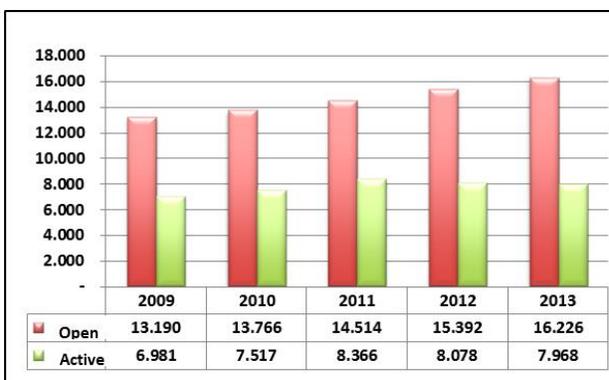
Further, levels of savings in the Colombian economy continue to remain low (22.3 per cent of GDP in 2013), very far below the other UMIC countries' combined average of 32.9 per cent (Graphic 29) and despite important advances in the development of savings accounts for the low income market, supply for these products is limited. Moreover, the percentage of inactive accounts remains high (51 per cent in 2013) (Graphic 30).

Graphic 29 Gross Domestic Savings (as % of GDP) Colombia 2000 – 2013



Source: World Bank, WDI

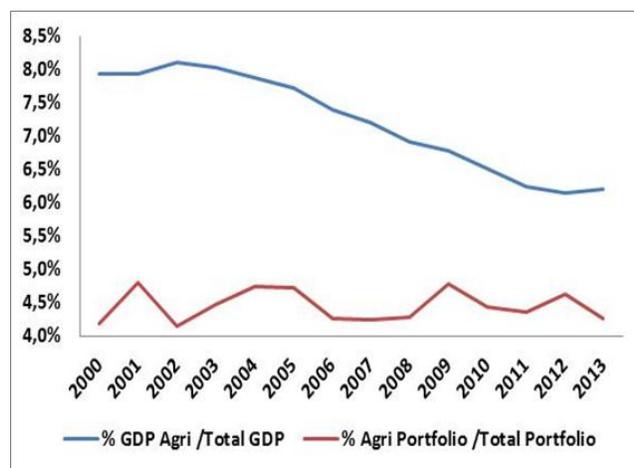
Graphic 30 Open Savings Accounts Vs. Active Savings Accounts, Colombia 2009 - 2013



Source: SFC and BdO (2014).

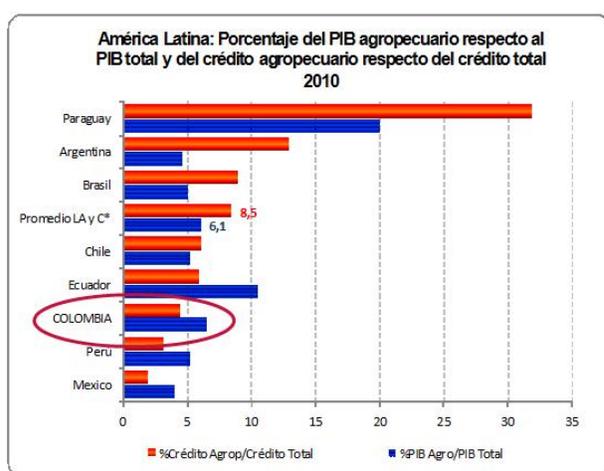
Although advances made towards financial inclusion have been significant during the past years and have allowed micro-enterprises and members of the low-income populations in urban areas to gain greater access to financial services, much still needs to be done for the rural sector. The agricultural portfolio accounted for only 4.2 per cent of the total portfolio in 2013 (Graphic 31) and Colombia is one of the countries with the lowest amount of credit available to the agricultural sector, compared to other LA countries (Graphic 32).

Graphic 31 Agricultural GDP/Total GDP & Agricultural Portfolio /Total Portfolio Colombia 2000 – 2013



Source: Finagro.

Graphic 32 Agricultural GDP/Total GDP & Agricultural Portfolio /Total Portfolio Latin America 2010



Source: Colombian Farmer's Society (SAC).

In 2012, 567,700 loans were extended to small producers that represent only 16 per cent of small producers in Colombia (3,510,546), thus 84 per cent of the remaining small producers did not have access to formal credit.⁶⁴

Given the foregoing it is considered important that the GoC continue making advances in regulation and institutionality, in the expansion of infrastructure and in product supply during the coming years.

6.1. REGULATION AND INSTITUTIONALITY

Significant regulatory and institutional bottlenecks still exist that hinder expansion of access to financial services, primarily:

Capital Markets: the capital markets should continue to strengthen, primarily for the agricultural sector, because the goal is to improve non-debt financing available to this sector. Particularly, PEFs should be developed for the agricultural sector and the institutionality of the Colombian Mercantile Exchange should be strengthened (BMC) (Box 8).

Infrastructure: the costs and risks inherent in cash management are one of the principal bottlenecks for expanding coverage. This hinders the expansion of the BA networks in small municipalities and rural

⁶⁴ Leivobich (2013).

zones, as well as the expansion of mobile banking, given that the BA are the cash-in and cash-out points for mobile banking products (savings accounts and electronic wallets). An option could be the implementation of a cash clearinghouse among banks, which would enormously facilitate cash management for the FI (Box 7).

Box 7 Reduce the costs and risks of cash management: key to continuing to expand infrastructure⁶⁵

Colombia has achieved infrastructure expansion thanks to the implementation of the BAs. However, regions still exist with limited financial coverage, particularly in rural zones. This hinders economic progress and creates a large volume of cash transactions that do not pass through the financial system and continue to create high indexes of informality in the local economies. When the number of BAs in Colombia is compared to the number in countries such as Brazil and Kenya, it is clear that this channel has the potential for greater development. One of the reasons that explain the lesser BA expansion is the costs and risks of managing cash.

In 2008 USAID supported the GoC in the development of a study on the management of cash in Colombia and in 2011 carried out a field study in four municipalities with low financial presence in order to identify alternative solutions to the management of cash that could increase the number of BA, the number and type of transactions that can be made, reduce transaction informality and facilitate the development of mobile banking. These studies recommended alternatives, such as:

- ❖ The implementation of a cash clearinghouse among banks that would permit a bank to receive the excess of cash of the BA of another bank, exempting these transactions from the GMF.
- ❖ The implementation of alternatives that have been successfully used in other countries and in Colombia, such as inter-banking agreements to receive deposits from BAs, through “banking tickets”, with payment of a service charge (Brazil); or the BAC as a public bank carrying out the task of consolidating and settling all cash deposits in the financial system (Brazil); or the use of prepaid installments for the BAs network (Kenya); or that surpluses and deficits be administered through a settlement clearinghouse (Grupo AVAL banks in Colombia).
- ❖ Boost the execution of cash exit transactions in the BA, such as loan disbursements and withdrawals.
- ❖ Achieve the commitment of the municipality administrations to use the BAs for payroll payments and thereby benefiting the economic dynamic for the municipality.

Transactions and Savings Products: The greatest barrier continues to be the existence of the FTT, which, due to the expenses it creates, substantially increases the preference for cash within the economy, and as a result, informal transactions. Further, the compulsory investments that the FI continue to have to make for agricultural sector financing (Box 1) increases the costs of offering these products to low-income sectors.

Credit: Although the limit on the microcredit interest rate has recently increased considerably and currently is 52.22 per cent EAR, this limit will continue to be a restriction for the extension of loans of lesser amounts (US \$500 or less). Further, despite the fact that the certification of interest rates for consumer/commercial loans has been separated from rates for microloans, it is necessary to also separate the certification of interest rates for consumer credit from commercial credit so that the FI can offer consumer credit to the low-income segment with appropriate products (Box 8).

⁶⁵ Sierra (2008) and Martínez (2011).

Box 8 The interest rate ceiling: a limitation for access to credit for the neediest.⁶⁶

In Colombia two interest rate Reference Rates are certified (CRR): one for consumer/commercial credit and one for microcredit. The ceiling rate is certified every three months for the former and every year for the latter. The CRR ceiling is calculated on the average of interest rates for all transactions executed by the FI during the respective period. In 2012 USAID supported the GoC in the development of a study of the effects of the calculation system for interest rates because interest rate ceilings hinder the FI ability to make small amount loans. The principal recommendations from this study carried out by Fedesarrollo, are the following:

- ❖ Only certify two usury rates: one for microcredit and one for consumer credit.
- ❖ Calculate the maximum interest rates as a simple average of the loans for the smallest principal amounts only in order to eliminate the distortion that including the rates for large principal amount loans with lower interest rates creates.
- ❖ In the medium term, apply maximum interest rates only to FI not supervised by the SFC.
- ❖ In the long term, remove the limitation that delay interests not exceed a percentage of the CRR.

Agricultural Financing: it is of fundamental importance to modify the Agricultural Financing System (*Sistema de Financiamiento Agropecuario*) (AFS), which has limited the supply of financing for the agricultural sector primarily to the BAC. To achieve this it is necessary to introduce regulatory reforms, modify institutionality, and modify the policy instruments currently used by the sector. (Box 9).

Box 9: Proposed Reforms to the Agricultural Financing System⁶⁷

The Agricultural Financing System (AFS) is based on policy instruments that create distortions and limit the supply of financing available to the agricultural sector, principally affecting small-scale farmers:

- ❖ Funding for agricultural financing comes from compulsory investments in TDA (Box 1).
- ❖ Loans are granted at subsidized interest rates that do not cover costs or risks for low principal amount loans.
- ❖ Subsidies to the sector are linked to the loan, marginalizing small-scale farmers without access to credit.
- ❖ State Credit Guarantee (AGF) promotes a non-payment culture, incentivizes adverse selection and discourages adequate evaluation of risks by the BAC, its principal user, due to its high coverage percentage.
- ❖ Distortions in the credit market have hindered the development of capital markets to serve the agricultural sector.
- ❖ Policy is centered on agricultural loans, excluding other financial services and non-agricultural rural activities.
- ❖ Inadequate institutionality in the National Agricultural Credit System, Finagro and the BAC.

During 2012 and 2013 USAID supported the GoC in the development of proposals to reform the AFS in order to offer installment financing sufficient for the needs of farmers and the rural population. The proposals cover the financial system, the capital markets, risk management and the institutionality of agricultural financing. The implementation of these proposals should be carried out comprehensively and gradually:

⁶⁶ Fedesarrollo (2012).

⁶⁷ Proposed reforms to the AFS can be found in 13 documents developed under the USAID PPP during 2012 and 2013 by consultants Antonio Hernández, José Leibovich, Marulanda Consultores and Carlos Sandoval. Some of these recommendations have already been implemented by the GoC.

Box 9: Proposed Reforms to the Agricultural Financing System (Cont.)

1. Financial System

Rediscount, interest rates and subsidies:

- ❖ Focus Finagro's resources (rediscount resources) on financing long term investments and gestation crops, small-scale farmers and the rural population. Progressively reduce interest rate subsidies.
- ❖ No linkage of loans with other subsidies granted to the sector.
- ❖ Permit microfinance NGOs to access Finagro resources.
- ❖ Provide FI TA relating to best practices in agricultural risk analysis and risk management.

Additionally:

- ❖ Review the current classification of farmers.
- ❖ Promote supply of financial services for non-agricultural rural activities.

2. Capital Markets

- ❖ Promote direct access to capital markets for agri corporates and Finagro.
- ❖ Promote private investment in the agricultural sector through PEF
- ❖ Strengthen the BMC's role as financing and hedging product provider.

3. Risk Management

Security

- ❖ Focus the AGF on small-scale farmers.
- ❖ Limit the AGF coverage to a maximum of 50 per cent.
- ❖ Make AGF available for all agricultural loans (not only those who meet Finagro conditions).
- ❖ Extend AGF guarantees based on loan portfolio, not by client.
- ❖ Introduce a risk evaluation per FI.
- ❖ Structure AGF premiums according to each FI's risk.
- ❖ Implement security over movable assets for the agricultural and rural sectors.

Insurance

- ❖ Implement insurance for natural disasters.
- ❖ Promote the supply of crop insurance and microinsurance products, providing incentives to the insurance companies, mainly TA.

Hedging

- ❖ Move from minimum price support policy instruments to price hedging.
- ❖ Broaden exchange rate and interest rate hedging products.

4. Institutionalility of the AFS

- ❖ Transform Finagro into a development agency for the agricultural and rural sectors.
- ❖ Strengthen the AGF so that it can adequately manage risk.
- ❖ Strengthen the BAC's intermediation capacity and strengthen its available supply of financial services, primarily savings.
- ❖ Eliminate the National Commission for Agricultural Credit and strengthen Finagro's board of directors.

Risk Management: Instruments to mitigate risk are fundamental to increase sources of financing as much in the capital markets as in the banking system. However, despite the advances made in recent years, much still needs to be done in this respect, mainly in the agriculture sector. In 2013, only 2 per cent of land dedicated to agriculture was insured⁶⁸ and the offer of crop insurance has been limited to one insurance company until very recently (Seguros Mapfre), despite the subsidy offered by the GoC (From 50 per cent to 80 per cent of the premium costs).

It is very important to develop the derivatives market available to the agricultural sector (commodities); as well as the insurance market, primarily natural disaster insurance and crop insurance.⁶⁹ Insurance against natural disasters would not only permit the reduction of the vulnerability of the population when faced with natural phenomena, such as the floods that occurred during the 2010 and 2011 extended rainy seasons, it would also save significant resources from the GoC's national budget. Due to the lack of such insurance products, the GoC had to spend significant resources when those disasters occurred.⁷⁰

Additionally, it is necessary to build capacity within the insurance companies to offer crop insurance which would significantly reduce the risk of extending Agri-loans and Micro- Agri loans and, as a result, boost their supply.

On the other hand, it is necessary to restructure the manner in which AGF operates. This credit guarantee should cover up to 50 per cent in the case of non-payment such that the risk will be shared equally with the FI. Likewise, the concept of loan guarantees should change to loan portfolio guarantees. This will reduce adverse risk selection and the risk of default⁷¹ (Box 8).

The development of these instruments requires information that allows the agents to adequately evaluate risks. Therefore, it is important to produce broad and detailed information about the agricultural sector.

Additionally, the SFC must implement risk based supervision for microcredit keeping in mind that during recent years important Microfinance NGOs have converted into banks and that microcredit is already present in the portfolios of banks and finance companies supervised by the SFC. It is also important to develop the SES' abilities to supervise microcredit for financial cooperatives.

Expanding Supply: the GoC's decisive move to provide reparations to victims and reintegrate former members of illegal armed groups into society is often fraught with limitations that create obstacles for reparation and reintegration efforts. In the case of victims, modifications to the BEP should be made (Section 5.1.2.3) to allow victims, especially those that have reached retirement age, or are about to reach retirement age, to contribute the one-time payment indemnification amounts that they receive to this mechanism to enable them to take advantage of the additional 20 per cent granted by the GoC for

⁶⁸ La República, http://www.larepublica.co/tierras-aseguradas-no-superan-2-del-per_centC3per_centA1re- sembrada_186086.

⁶⁹ Between 2007 and 2009, USAID contracted for the preparation of studies with proposals to promote the development of the derivatives market and crop insurance.

⁷⁰ The heavy rainy seasons of 2011 and 2012 affected 1 million hectares of land and more than 2 million people suffered losses that cost the MADR more than US \$500 million.

⁷¹ Marulanda Consultores (2013).

retirement⁷². In the case of demobilized persons, barriers, such as the difficulty of opening an account in a FI, due to a judicial record arise. For this reason, looking forward to a post-conflict process, it is imperative to create mechanisms to allow demobilized persons to access the financial system. This will facilitate the start-up of productive activities and income generation and thus, reintegration efforts.

6.2. INFRASTRUCTURE

The expansion of BAs and of Mobile Banking, as well as the development of payment ecosystems should continue to be encouraged.

Banking Agents: The great majority of transactions made with BA are transfers and payments that have the effect of increasing available cash in the BA. As a result it is important to implement cash exit transactions, such as loan disbursements in order to improve operations and profitability. This will also facilitate cash management.

Mobile Banking: It is important to help the FI to mass distribute their mobile banking products because, despite the fact that three FI already offer them, it is not easy for them to penetrate the low-income and rural markets for which these accounts were structured. It is further necessary to increase supply of these products by new FI and stimulate their expansion into rural zones.

Payment Ecosystems: The expansion of BA and mobile banking should go hand in hand with the development of payment Ecosystems that allow for resolution of the “chicken and egg” dilemma.⁷³ The GoC and the companies with broad distribution networks play an important role in the process of facilitating the implementation of payments G2P, P2G, P2B, B2P y B2B.⁷⁴

6.3. PRODUCTS

It is necessary to continue promoting product supply for the low-income population, primarily in rural zones and for vulnerable populations (extreme poverty, victims, demobilized combatants).

⁷² Current BEP regulations require that the person make periodic savings deposits. In this case, it means accepting the indemnification payment as a one time contribution.

⁷³ In multi-sided markets, specifically in payments, the term “chicken-or-egg” is commonly used to describe a situation in which it is very hard to reach a certain desired outcome (e.g. that consumers employ a new payment method) because a necessary precondition is not met (too few merchants are accepting the new payment method). <http://blog.4-ventures.com/nfc-wallets-are-dead-the-chicken-egg-and-rooster-dilemma/>

⁷⁴ These acronyms in English are used to refer to payments made through electronic media. Examples of G2P “Government to People” are the transfers and subsidies, such as those already being made for certain GoC payments, such as those made under the *Más Familias en Acción* Program or pension payments; P2G “People to Government” are payments made by contributors, for example, taxes; P2B “People to Business” are payments made by persons to businesses for the purchase of goods and services; B2P “Business to People” are the payments that businesses make to persons, such as salary payments; B2B “Business to Business” are payments between businesses, for example, payments by stores to the companies that distribute the products they sell (soft drinks, dairy products, etc.).

Technology: In order to expand supply of financial services in rural areas, it is of utmost importance that the FI implement technologies that allow for the reduction of the high transaction costs that serving populations in these remote zones implies.⁷⁵ This also requires that communications and connectivity allow for the use of such technologies.

Credit: It is necessary to build FI capacity to evaluate the risks inherent in the agricultural sector, to promote an increase in the participation by financial cooperatives with respect to the provision of financial services in rural zones and to boost the development of other credit products such as micro leasing.

The new Secured Financing Law⁷⁶ presents an important opportunity to expand access to credit for MSME, but its implementation first requires building capacities in FI to evaluate the risk of granting loans secured by movable assets (both tangible and intangible).

Saving: It is necessary to continue promoting FI supply of small balance savings accounts to achieve mass distribution and thereby motivate savings.

Insurance: In Colombia, the insurance market's penetration is very shallow, only 2.7per cent (premiums to GDP)⁷⁷, lower than Chile (4.0per cent) and Brazil (3.7per cent)⁷⁸. It is necessary to develop an adequate network that facilitates the distribution and collection of policies, the generation of economies of scale and the promotion of an insurance culture among the population.

Financial Education: Gaining an understanding of the importance of saving to reach goals, to protect wealth against accidents, natural disasters and family calamities; to pay loans on a timely basis and to avoid excess debt are all as important as having access to financial products.. This way, the population's access and use of financial products will improve. Also, financial services will become the population's ally in the quest for progress. Therefore, it is very important to continue the implementation of financial education programs. Although the GoC and the private sector are implementing significant advances in institutionalization and financial education programs, ⁷⁹ it is still imperative to create adequate mechanisms to bring it in an effective way to the population en masse.

7. CONCLUSIONS

USAID cooperation effectively contributed to financial development in Colombia during the 2004 – 2013 period. Colombia made significant advances and today has an improved regulatory framework and a more solidified institutionality with effective policies regarding the promotion of access to financial

⁷⁵ For example, mobile devices such as cellular telephones and tablets with access online to FI software facilitate transactions in rural areas and reduce the need to go to a PoS.

⁷⁶ Law 1676, August 2013, regulations issued in February 2014.

⁷⁷ BN Americas, <http://www.bnamericas.com/news/segueros/mayor-poder-adquisitivo-impulsa-penetracion-de-segueros-en-colombia>, June 30, 2014.

⁷⁸ LaRepública, http://www.larepublica.co/finanzas/colombia-todayper_centC3per_centADa-sigue-quedada-en-la-penetraciper_centC3per_centB3n-de-segueros_41557, June 27, 2013

⁷⁹ The FI have an obligation to provide financial education programs. Recently, the Ministry of Education included financial education as part of the scholastic core curriculum.

services. This is reflected in the strengthening of the capital markets, infrastructure expansion and greater and improved financial product supply for the MSME sector and the low-income population.

Among the greatest achievements, the following are highlighted:

- ❖ The strengthening of institutional capacity in the capital markets with the creation of the Colombian Superintendence of Finance (SFC) and the Securities Self Regulatory Organization (AMV).
- ❖ Reforms to the financial system that increased financing sources through the capital markets.
- ❖ The institutionalization of policies to promote financial inclusion and the creation of the *Banca de las Oportunidades* as the executive program for policy.
- ❖ The strengthening of BdO's institutional capacity is based on public private alliances. Through BdO the GoC offers co-financing, subsidies or TA in areas that are key to expanding financial inclusion in exchange for FI implementation commitment and the achievement of previously established goals. As a result, during the 2007 – 2013 period BdO successfully awarded 28 competitive bids: 12 to co-finance infrastructure expansion (Branches, BA and Mobile Banking); 14 to facilitate adequate product supply for the FI by financing TA and providing subsidies (SCG, Village Banking, microcredit, Micro-Agri loans, micro savings and life microinsurance); and 2 competitive bids to strengthen institutional capacity of the financial cooperatives and Microfinance NGOs. This framework has brought the BdO international recognition given the effectiveness of its performance.
- ❖ The expansion of financial coverage from 72 per cent of Colombian municipalities in 2006 to 99.7 per cent in 2013.
- ❖ The payment of CCT to approximately 748,000 beneficiary families of the Más Familias en Acción Program through cellular telephones.
- ❖ The increase in the supply of microloans by regulated FI and the access that almost 3.8 million micro-entrepreneurs had to first time formal credit formal between 2007 and March 2013.
- ❖ The development of regulation for small balance savings products that has allowed for the creation of savings accounts and electronic wallets that can be managed via cellular telephones.
- ❖ The implementation of financial products such as SCG and Village Banking for vulnerable populations and populations living in extreme poverty.

Despite the achievements, looking forward important challenges remain to be resolved and the agenda of pending issues is long. The domestic credit to the private sector by banks and the economy's savings levels continue to be shallow, despite positive trends during the past decade. In the rural sector, despite the fact that 4+ million farmers exist in Colombia and 88 per cent are small-scale farmers (3.5 million), only 16 per cent of small-scale farmers have access to credit (less than 600 thousand).⁸⁰ This means that almost 3 million small-scale farmers are still outside of the financial system.

At the regulatory and institutional level, the most important goal is AFS reform, followed by the elimination of FTT and the ceilings on interest rates. However, these reforms are complex and long term. It is also necessary to reduce the costs and risks of cash management to facilitate the expansion of mobile banking and the BA as cash-in and cash-out points.

Risk management is another chapter where much remains to be done to facilitate financing by the capital markets and the financial system. The broadening of risk coverage instruments such as derivatives and insurance are critical to finance agricultural activities.

⁸⁰ Leibovich (2013).

Regarding infrastructure, the BA must continue to be strengthened and Mobile Banking further developed. To achieve this it is important to help the FI implement and mass distribute products and promote the creation of payment ecosystems.

Finally, it is important for the BdO to continue to promote the supply of adequate products focused on the rural sector in alliance with entities such as Finagro.

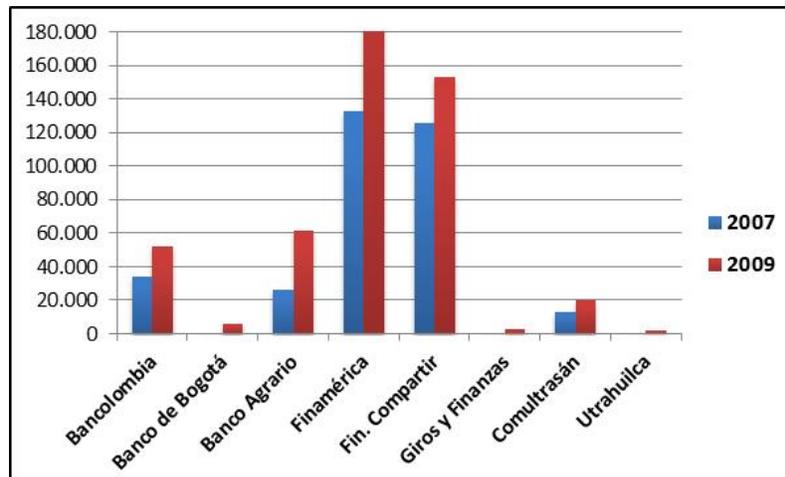
Box 10 Success Factors for USAID's Cooperation

- ❖ *Commitments of the GoC and FI to financial development in Colombia:* converted access to financial services into long-term State policy in order to improve competitiveness and promote economic and social development in Colombia.
- ❖ *GoC Institutional and technical capabilities:* The institutional and technical capabilities of the entities involved with regulation and politics related to financial development is solid and has the benefit of professionals with high technical levels and understanding who are committed to the implementation of these changes. This facilitated the cooperation provided by USAID towards the achievement of the objectives projected by the Colombian authorities.
- ❖ *Continuity of Public Policy and of Support for USAID Cooperation:* this allowed for a continuous process of moving forward over a 10 year period without regard for changes within the GoC and the USAID support programs. The GoC has a long-term vision and every USAID program built on the achievements of the preceding program. Certain consultants participated in several programs, thus facilitating the application of lessons learned and advances in implementation.
- ❖ *Coordinated Implementation of Policy among all Interested Participants:* regulatory authorities, responsible for the execution of the policies and the finance sector.
- ❖ *Strategic alliances with the Financial Sector:* as a mechanism to achieve greater and better results and to leverage resources.
- ❖ *Comprehensive Intervention:* TA from USAID was focused on supporting the GoC at all levels; at the macro level, in regulation and institutional and technical capabilities; at the meso level in the structuring and implementation of policy instruments; and at the micro level, providing TA to FI and to GoC entities that work with populations of interest (populations in extreme poverty, victims, among others). As a result, policy instruments and TA complemented regulatory developments and together facilitated the expansion of infrastructure and product supply.
- ❖ *Pilot Programs:* The realization of pilot programs made it easier for the GoC to make better and more accurate informed decisions by applying the lessons learned from the pilot programs. In the case of FI, it made it easier to test the viability of new products before incorporating them into their portfolio.
- ❖ *Focus on Creating Value Added:* Cooperation was focused on complementing the GoC's work, providing the GoC with information and knowledge by hiring experts, carrying out studies and providing TA.
- ❖ *Focus on sustainability:* institutional strengthening and adopting strategies to expand financial inclusion by public entities and FI to ensure that these entities continue improving regulation, institutional and technical capabilities, policy and products above and beyond the support received from USAID cooperation.
- ❖ *Creation of Synergies among BdO and other Government Programs:* such as *Más Familias en Acción*, *Víctimas*, *Red Unidos* and the Consolidation Unit that have facilitated coordination between BdO and other GoC entities and financial inclusion for poor and vulnerable populations and population in conflict zones.

8. ANNEXES

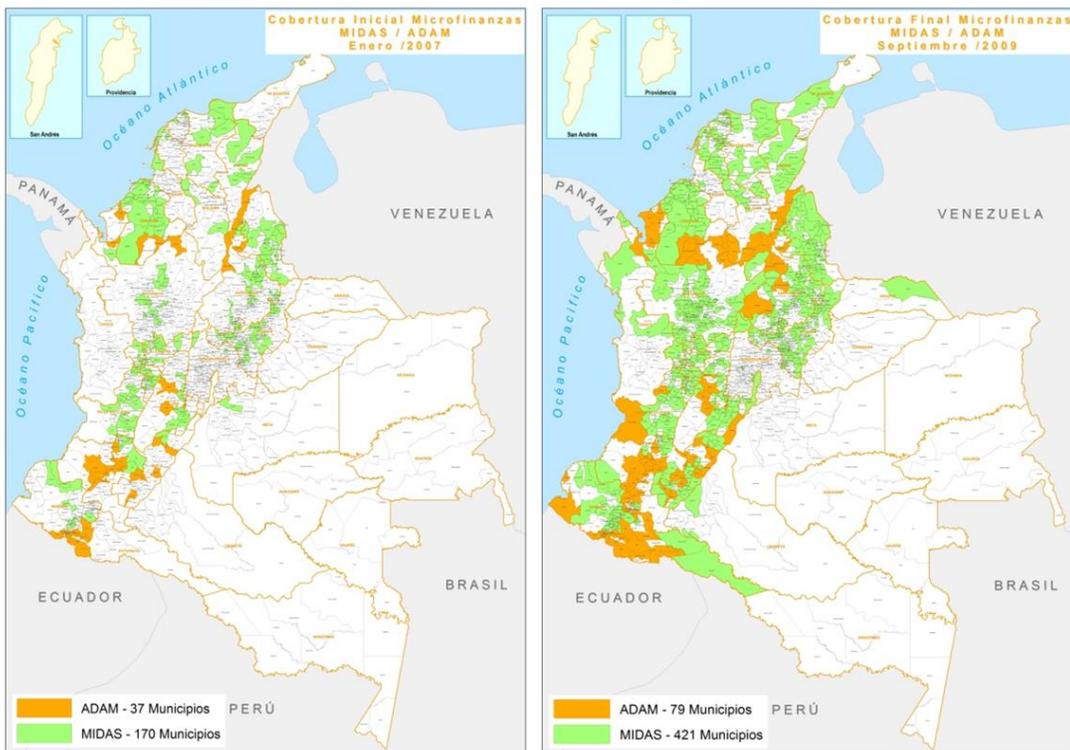
8.1. MICROFINANCE PROGRAM

Graphic 33 Current Portfolio for Regulated FI, 2007 vs. 2009



Source: Aecom (2009).

Graphic 34 Geographic Expansion of Microcredit 2007 vs. 2009



Source: AECOM (2009).

Strategic Alliances

Bavaria/Sab Miller – Financiera Comultrasán Alliance: The Microfinance Program advised Bavaria regarding the implementation of a program called Microcredit for Store Owners (*Microcrédito Social para Tenderos*) that began as a pilot program in 2009. Through this alliance Financiera Comultrasán offers microloans to store owners that sell Bavaria products. In this way, Bavaria promotes the progress of the storeowners' businesses and Comultrasán can access clients referred by Bavaria. Due to the pilot program's success, Bavaria expanded the Program and entered into agreements with two other FI (Bancolombia and Banco Agrario). To date, more than 6,000 storeowners have received loans thanks to this alliance, mostly for the first time.

Alliance Financiera Compartir – Asociación Occicafé – USAID ADAM Program: Under this alliance in 2007 Financiera Compartir extended Micro-Agri loans to specialized coffee producers from Huila that belong to the *Asociación Occicafé* and that receive TA from the USAID ADAM Program. Occicafé buys the coffee from its partners, discounts the value of the loan installment and makes the payment to the FI. Thanks to this alliance, small producers can carry out the drying process for the coffee and sell it at a better price (US\$220 vs. US\$120). The loans commenced with average disbursements of \$1,300,000 (US \$650) for 5-month terms that are rolled over successively. Given this pilot program's positive results, Financiera Compartir expanded Micro-Agri loans to other municipalities.

8.2. VILLAGE BANKING

Box II Village Banking Methodology to Reach the Poorest Micro-entrepreneurs

This methodology allows the FI to extend loans to members of populations living in extreme poverty that have no collateral to offer and no stable productive activities; that for reasons of income and risk could not be served on an individual basis. The Village Banking methodology consists of forming village banks, which are groups of 12 to 20 persons, primarily women and members of vulnerable populations that band together to obtain credit and to save. Using this methodology the FI transfers risk to the village bank with a joint guarantee; meaning that the members of the village bank commit to paying the installment of the other member if that member does not pay.

The loan per member varies between US \$50 and \$250. The sum of all member loans is the value of the village bank loan and the members as a group determine that amount. The average term is 4 months and the payment schedule is weekly. To renew a loan, the village bank members must repay the loan in its entirety.

Under this methodology the members also accumulate individual and group savings for common causes that strengthen community ties.

Source: AECOM (2009).

Table 10 Results of BdO Technical assistance in the implementation of Village Banking

Resultados AT Banca Comunal 2010 – 2012	
FI that received TA	1 bank: BAC. 1 Financial Cooperative: Financiera Comultrasan. 5 Microfinance NGOs: Fundación de la Mujer, Opportunity International, Fundación Mundo Mujer, Corfimujer-Casa de la Mujer and Contactar.
Coverage	18 Departments 103 Municipalities
Village Banks	2,145
Clients	40,921 63% women
Disbursements	USD \$9 million
Average Loan	USD \$218
Total Amount Saved	USD \$706,000.

Source: BdO

8.3. SAVINGS AND CREDIT GROUPS

Box 12 Savings and Credit Groups

The Savings and Credit Groups (SCG) are savings mechanisms for populations living in remote zones and in extreme poverty. They are comprised of groups that are voluntarily organized and meet bi-weekly to save money by buying shares. The SCG methodology is implemented by civic organizations, primarily NGOs (not by FI, in contrast with village banks). The SCG place saved cash in a locked box and not through a FI. The members create a fond with their savings through which they can access loans in times of need, for food, domestic crisis, household expenses or productive activities.

The SCG's most valuable contribution is the creation of a saving culture among the population that, given its poverty level, would not think of saving. The members mitigate their risks and vulnerability and develop capacities to self manage financial resources through the SCG.

This methodology was developed by CARE in Nigeria in 1991, and then implemented by CRS, World Vision, AKF, Oxfam América and Plan International, among others.

Source: Marulanda Consultores (2013).

Table 10 Results of BdO Technical assistance in the implementation of Savings and Credit Groups

	Piloto 2008 - 2010	Expansión 2012 - 2015	Red Unidos 2011- 2013	Alcaldía Bogotá 2012 - 2014
Resources Invested				
BdO	USD \$845,000	USD \$1.2 million		
Other Public Entities			USD \$1.3 millions	USD \$1.1 millions
Organizations trained in SCG methodology	1	1		
Operating Entities in the SCG Methodology	4	15		
Coverage	7 Departments 30 Municipalities	12 Departments 66 Municipalities	8 Departments 31 Municipalities	1 Municipality
SCG Participants	434 7,378	1,111 15,710	705 8,968	857 11,968
Average saving per participant		\$92 USD		
Average saving per SCG		\$1,026 USD		
Average Loan per participant		\$73 USD		
Share Price		Among \$25 cents of USD and \$5 USD		
Average Contribution to the Solidarity Fund		\$25 cents of USD.		
Average Solidary Fund Value per SCG		\$62 USD		
Average of resources lent by SCG		52%		

Source: BdO

8.4. PROMOTING A SAVINGS CULTURE

Financial Education Program

Between 2008 and 2009 USAID implemented a financial education program in alliance with SENA.⁸¹ USAID established the methodology and carried out a pilot program in two departments (Cesar and La Guajira). The pilot program allowed for the identification of the population's financial knowledge, its preference in respect of the content of the financial education, the forms and frequencies with which the populations wanted to learn and receive training. Further, USAID trained 11 public and private institutions, networks and training services providers. This pilot program provided lessons learned to the local governments and to the SENA regarding how to expand the financial education program.

Promotion of Savings with Beneficiaries of the Más Familias en Acción Program

In 2008 USAID advised the BdO and the DPS regarding the structuring and implementation of a competitive bid to pay the CCT into savings accounts in lieu of cash. The competitive bid was awarded to the BAC that opened 2.6 million ESAs between 2008 and 2010.

In order to promote saving by the Program's beneficiaries, USAID also supported the development of a pilot program to promote a culture of saving in such accounts. The pilot program was carried out in 12

⁸¹ SENA is a Colombian public entity that is dedicated to providing technical education.

municipalities with 48,439 mothers who were beneficiaries of the *Más Familias en Acción* Program during the 3-year period 2010 – 2013. Three types of assistance were targeted: i) financial education in 3 municipalities; ii) monetary incentives, based on the amount saved, in 3 municipalities; and iii) financial education and monetary incentives in 3 municipalities. The other three municipalities were control groups. This pilot program permitted the realization of an impact evaluation aiming to identify which instrument was the most effective individually, or on a combined basis.

Promoting Savings Among Victims of the Armed Conflict

USAID supported the GoC's UARIV in the structuring and implementation of a strategy to promote access to financial services for victims of the armed conflict, primarily savings products aiming to promote the adequate use of indemnification payments made by the GoC and to strengthen the GoC's assistance program for victims.

The majority of the victims come from rural areas and has not had access to the financial system. Neither do they have an understanding of finance that would allow them to make appropriate financial decisions. For the great majority, the indemnification payments are the largest amount of funds that they have ever received and therefore it is very important to ensure that they are appropriately utilized.

For this reason, USAID supported the implementation of a financial education program and finance fairs with the FI offering deposit products, primarily savings accounts CDs. The principal results were the following:

- ❖ 31 financial education workshops with 3,070 victims in 11 municipalities.
- ❖ 10 finance fairs in 6 municipalities with 4 FI (Davivienda, Bancamía, BAC and Fondo Nacional del Ahorro).
- ❖ Victims saved more than \$2,000 million (US \$1 million) in savings accounts and CDs, and also acquired life insurance products.
- ❖ Execution of an agreement between the UARIV and BdO to expand financial education workshops and finance fairs.
- ❖ UARIV adopted financial inclusion as one of its strategies within the Assistance Plan for victims.

Victims of the Armed Conflict

In Colombia there are 6.5 million victims of the armed conflict. Therefore, one of the GoC's priorities is to integrally serve and provide reparations to the victims. In order to achieve this, the GoC provides humanitarian assistance and complete reparations. Humanitarian assistance consists of monetary sums so that displaced victims can absorb the initial costs of temporary housing and subsistence. Reparations are structured so that the victim can take on productive activities; rebuild their lives and those of their family members. It includes an ongoing assistance plan and an indemnification payment to economically recompense the victims. The GoC pays approximately \$1 billion (US \$500 million) to approximately 100,000 victims per year. Each victim receives an average of \$6 million (US \$3,000), although some have received higher amounts.

The Unit for Comprehensive Victims' Assistance and Reparations *Unidad para la Atención y Reparación Integral a las Víctimas* (UARIV) is in charge of the Victims' Assistance and Reparations Program (*Programa de Atención y Reparación a las víctimas*).

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