THE REFORM IN THE COLLECTIVE INVESTMENT INDUSTRY IN COLOMBIA

March 2003
Background of the collective investment industry in Colombia

• Structural problems

• Importance of the reform needed

• Proposal of change
THERE HAS BEEN GREAT GROWTH OF THE COLLECTIVE INVESTMENT SCHEMES (CIS) IN COLOMBIA IN THE LAST YEARS...

* Septiembre 2002

FUENTE: Sistema de Información Superintendencia de Valores y Superintendencia Bancaria.
INTERNATIONALLY A POSITIVE RELATION EXISTS BETWEEN IMPORTANCE ON CIS AND ECONOMIC DEVELOPMENT...

Net Assets Managed by CIS
As a % of GDP

* Septiembre 2002
FUENTE: Sistema de Información Superintendencia de Valores y Superintendencia Bancaria.

* Países Desarrollados
* Países en Desarrollo
* Total
THERE IS A VIRTUOUS CIRCLE BETWEEN GROWTH OF THE ECONOMY AND GROWTH OF THE CIS

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**INCREASE OF INSTITUTIONAL INVESTORS**

- Inflow of money from households to capital markets
- Channel demand to different sectors of the economy
- Trust of investors in system

**DEVELOPMENT OF CAPITAL MARKETS**

- More liquidity
- More issuers
- Wider variety of supply of issues
- Lower transaction costs
- Increases market efficiency

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Creation of Virtuous Circle
…BUT, HAS THIS VIRTUOUS CIRCLE APPEARED IN COLOMBIA?

Evolution of the capital markets (1950-2002)

Fixed Income 99.6%

Equity 0.4%

CAPITAL MARKET – FIXED INCOME NEGOTIATIONS BY TYPE OF ISSUES 1998 –2002

FUENTE: Sistema de Información Superintendencia de Valores.
### Composición de los portfolios de los fondos de pensión obligatorios en Colombia

<table>
<thead>
<tr>
<th>Año</th>
<th>Otros</th>
<th>Equidad y Securitizaciones</th>
<th>Ingresos, No-Financiero</th>
<th>Ingresos, Financiero</th>
<th>Tesoro</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>2.1</td>
<td>11</td>
<td>50</td>
<td>27</td>
<td>27</td>
</tr>
<tr>
<td>1999</td>
<td>2.9</td>
<td>11</td>
<td>14</td>
<td>33</td>
<td>40</td>
</tr>
<tr>
<td>2000</td>
<td>3.8</td>
<td>7</td>
<td>14</td>
<td>14</td>
<td>48</td>
</tr>
<tr>
<td>2001</td>
<td>4.9</td>
<td>6</td>
<td>14</td>
<td>14</td>
<td>50</td>
</tr>
<tr>
<td>2002</td>
<td>6.2</td>
<td>5</td>
<td>15</td>
<td>24</td>
<td>50</td>
</tr>
</tbody>
</table>

Fuente: Asofondos; Superbancaria
AT THE SAME TIME THERE ARE VERY FEW IPO´S...

At the same time there are very few IPO's...

Issuance of Fixed Income Securities, Financial Sector

* Issuance of Public Debt
  Bonds
Ordinary Bonds
Equity

1998 1999 2000 2001 2002

US$ millones 100%=
2,763 4,402 3,037 1,481 4,162

41% 23% 45% 32% 46%

20% 18% 29% 23% 20%

11% 2% 30% 7% 7%

Securitizations

* (1) Las ofertas con inscripción automática para el 2000, incluyen una oferta de Notas por US$ 115.000.000 y otra de Bonos Global por US$250.000.000. Para el 2002 se incluyen $478.901 millones de la inscripción automática de los TIPs.
Fuente: Supervalores
Although institutional investors have grown in the past years, they have NOT had the expected impact in the development of the Colombian securities market.

¿WHY?
AGENDA

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<table>
<thead>
<tr>
<th>Type of Fund</th>
<th>Fund Manager</th>
<th>Supervised by</th>
<th>Legal Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fondos de Valores</td>
<td>Brokerage Firms</td>
<td>SV</td>
<td>Res. 70/2001 y Res. 1200 Título 7</td>
</tr>
<tr>
<td>Fondos de Inversión</td>
<td>Management Firms</td>
<td>SV</td>
<td>Res. 70 2001 y Res. 1200 Título 7</td>
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<tr>
<td>Fondos Comunes Ordinarios y Especiales</td>
<td>Trusts</td>
<td>SB</td>
<td>Estatuto Orgánico del Sistema Financiero – Título V capítulo 1 y 3</td>
</tr>
<tr>
<td>Fondos de Pensiones Obligatorias, Voluntarios y de Cesantías</td>
<td>Pension Fund Managers</td>
<td>SB</td>
<td>Estatuto Orgánico del Sistema Financiero – Título V capítulo 5 y 6</td>
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<tr>
<td>Fondos Mutuos de Inversión (equivalente a los fondos de empleados pero con un 50% de inversión por la empresa)</td>
<td>Company</td>
<td>SV</td>
<td>Decreto 2968 de 1960 y sus modificaciones.</td>
</tr>
</tbody>
</table>
FUND MANAGERS PROVIDE ALL THE SERVICES…

Colombian Current System

**Fund Manager**
- Portfolio Management
- Custody of assets
- Promotes fund
- Sales shares
- Fund transactions and brokerage

**Regulator**

**CIS**

**Auditor**

**Weaknesses of the System:**

- High risks of conflict of interest.
- The system has no “checks and balances”.
- Weak defense of investors.
- All supervision in hands of supervisor.
... AND THERE ARE TWO SUPERVISORS WITH DIFFERENT FOCUS

<table>
<thead>
<tr>
<th>BANKING SUPERINTENDENCY</th>
<th>SECURITIES SUPERINTENDENCY</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Prudential regulation</td>
<td>✓ Investor protection</td>
</tr>
<tr>
<td>✓ Systemic Risk</td>
<td>✓ Market integrity</td>
</tr>
<tr>
<td>✓ Government insurance</td>
<td>✓ Transparency</td>
</tr>
<tr>
<td></td>
<td>✓ Market Development</td>
</tr>
</tbody>
</table>
THESE FACTORS GENERATE STRUCTURAL PROBLEMS TO THE FOLLOWING PLAYERS:

- Investors
- Regulators
- Industry
INVESTORS CONFUSED BECAUSE THERE ARE MANY PRODUCTS THAT ARE THE SAME BUT HAVE DIFFERENT PACKAGING…

- AFP’s
- Trusts
- Management Firms
- Brokerage Firms
- Companies

- FPO
- FPV
- F Cesantías
- FCO
- FCE
- FPV
- F Inversión
- F Valores
- F Mutuos de Inversión

Carry out same activity:
Manage Collective Investment Scheme
公共对信心是一个公共利益，是联合集体投资行业的基础。

只有整个行业对共同投资计划有信心，才能对其中的一个计划有信心。

任何使某人失去金钱的丑闻都会导致整个系统的信心丧失。它可能需要多年时间才能重建信心。

哥伦比亚的例子：公众对公共债务市场的信心丧失（2002年8月）

此外，缺乏监督和制衡减少了投资者对系统的信心……

- 公共信心是公共利益，是联合整个集体投资行业的基础。
- 只有整个行业对共同投资计划有信任，才能对其中一个计划有信心。
- 任何使某人失去金钱的丑闻都会导致整个系统对信心的损失。它可能需要多年时间才能重建它自己。

哥伦比亚的例子：公众对公共债务市场的信心丧失（2002年8月）
ON THE OTHER HAND, INDUSTRY IS AFFECTED BY THE LACK OF ECONOMIES OF SCALE …

Industry fragmentation:
- Lack of specialization and competition
- Lack of dedicated and specialized channels of distribution
- Low industry standards
- Dominance of banking sector
AND THE LACK OF RISK MANAGEMENT CULTURE...

- Paternalistic Regulation (minimal returns, fund rating, prospectus approvals).
- Lack of Risk Management from fund managers due to industry fragmentation.
- Non specialized channels of distribution that do not explain correctly that investor must share risks of investments, thus the investors are uninformed.
- Badly educated and misinformed investors reasserts paternalistic regulation.
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COLOMBIAN REQUIRES A COMPREHENSIVE REFORM THAT:

1. Increases investor confidence in the system
2. Optimizes fueling of savings to productive sectors of the economy
3. Strengthens the CIS industry so that it can stimulate the securities market
4. Assures the balance in the industry between the interests of the investors and the managers
5. Increases industry standards to include IOSCO principles
INSTITUTIONAL INVESTORS HAVE GRAT POTENTIAL OF GROWING IN COLOMBIA…

Relation between resources managed by CIS and GDP (Does not include Pension Funds)

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<tr>
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<tbody>
<tr>
<td>EEUU</td>
<td>57 %</td>
<td>67 %</td>
<td>78 %</td>
<td>73 %</td>
</tr>
<tr>
<td>FRANCIA</td>
<td>35 %</td>
<td>44 %</td>
<td>46 %</td>
<td>53 %</td>
</tr>
<tr>
<td>CANADA</td>
<td>33 %</td>
<td>37 %</td>
<td>44 %</td>
<td>42 %</td>
</tr>
<tr>
<td>ESPAÑA</td>
<td>32 %</td>
<td>43 %</td>
<td>37 %</td>
<td>31 %</td>
</tr>
<tr>
<td>BRASIL</td>
<td>13 %</td>
<td>15 %</td>
<td>15 %</td>
<td>26 %</td>
</tr>
</tbody>
</table>

Obligatory pension funds will represent 30% of GDP in 10 years

Fondos % PIB

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<tr>
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<tbody>
<tr>
<td>4,90</td>
<td>6,20</td>
<td>8,90</td>
<td>12,80</td>
<td>17,80</td>
<td>23,40</td>
<td>30,49</td>
</tr>
</tbody>
</table>

TACC+ = 18%
WE ANALYZED WHAT WERE THE COMMON CHARACTERISTICAS THAT EXPLAIN THE DEVELOPMENT OF CIS IN THE FOLLOWING COUNTRIES:

- United States
- Canada
- Great Britain
- Australia
- Spain
- Mexico
- Chile
- Brasil

FUENTE: Presentaciones Taller de Carteras Colectivas, Bogotá Febrero 6 de 2.003
... AND THE MAIN LESSONS FOUND WERE:

- Legal structure clearly defined
- Existence of qualified and independent custodian
- Manager can delegate activities but not responsibilities
- Operators require license. Supervisor reviews if person or company has minimal standards.
- Conflicts of interest clearly defined and controlled.
- Investors have rights clearly defined and have vote.
- Only one regulator with emphasis on investor protection and clear disclosure.

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CONCRETE PROPOSALS TO BE EXECUTED IN THE SHORT TERM:

✓ Harmonize regulation to preclude regulatory arbitrage.
✓ Promote risk management culture where fund managers can offer different types of risk and investors can construct their own asset allocation.
✓ Incentivate specialization of different players.
Fund managers must dedicate exclusively to this activity

Increase *checks and balances* of the system through:

- The need of independent custodial that must accomplish supervisory functions
- Compliance committee’s
- Compliance officer

Unify regulation and only one regulator

Create higher standards for portfolio managers, risk managers and sales force

License requirements for the different players
HOWEVER, SOME OF THE BIGGER CHANGES REQUIRE A LAW TO PASS:

- Changes expected to introduce through law:
  - Regulation based on activity and not entity
  - Only one supervisor for collective investment schemes.
  - Creation of a company dedicated exclusively to managing collective investment schemes
  - Independent custodian
ACTIONS THAT HAVE BEEN TAKEN:

✓ Meetings with World Bank members who approve of changes
✓ Signature of agreement between Banking and Securities superintendencies
✓ Workshop with industry where following consensus was reached
  • Harmonize and homogenize regulation.
  • Increase Standards.
  • Increase Checks & Balances
✓ Meetings with the committee (SB–SV)
✓ Agreement with government
✓ Must take place meetings with industry