

Dow Jones **News**wires**INTERVIEW: Colombian Banks Out Of Woods - Fogafin Chief**

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1,392 words

15 February 2000

11:14 AM

Dow Jones International News

DJI

English

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BOGOTA -(Dow Jones)- Colombia's wobbling financial sector has stepped back from the brink of collapse but needs much more money and restructuring to put it on a firm footing, said Jorge Castellanos, director of banking lifeboat fund Fogafin.

In an interview with Dow Jones News wires, Castellanos said that while the weakest institutions have been closed or undergone shock treatment at the hands of Fogafin, other large private banks haven't done enough to stem the losses.

"To us, or to the owners of the banks, what remains is to finish this process of putting in order the large private banks that haven't been cleaned up," said Castellanos, who heads government efforts to rescue financial firms.

"But now that we have the rest of the system controlled, these are no longer a systemic risk for us," he added.

He said the crisis until now has been concentrated in the first-tier state-owned banks, which deal directly with the public.

"But that sector has already been stabilized, and we've got a clear strategy to follow, which is to sell the banks," said Castellanos, adding that the government would absorb the cost of cleaning up the public banks.

Fogafin's current cost estimate of 7.5 trillion pesos (\$1=COP1953) could rise to COP8 trillion to COP9 trillion, or up to 6% of gross domestic product, according to the official. The cost, spread over 1999 and 2000, doesn't include money recovered, such as from over-provisioning.

Financial firms' woes came to a head with soaring 1998 interest rates, as the central bank fought to defend the embattled peso, and a subsequent deep recession. Preliminary official estimates put last year's economic contraction at 5%. Loan default rates jumped and non-performing assets mushroomed.

But economists say the sector was already vulnerable, due to bad management, poor credit analysis, inadequate supervision and corruption - mainly in bloated state firms - which nurtured an ill-supported early-1990's credit boom.

Colombia's financial institutions posted a net loss of COP2.41 trillion for 1999, up from COP1.78 trillion for 1998. The public sector's first-tier banks lost COP1.96 trillion, up from COP1.48 trillion the year before.

But Castellanos said the tide has turned, and that last year's results were so bad partly because they reflect heavy year-end write-offs that are central to Fogafin's solution.

"A mechanism was designed for the clean-up, as much for the private banks as for the public ones," he said. "It sought to strike out non-performing assets, which gave entities very negative net assets, and afterwards, reconstitute the capital, injecting funds from Fogafin."

Public Sector Banks Propped Up, Prepared For Sale

Fogafin took care of its own first. It's now the reluctant largest owner of Colombian credit institutions, with around 21% to 22% of the sector by total assets, Castellanos said. Grupo Aval comes second with roughly 20%.

Since 1998, Fogafin has taken over Banco Uconal, savings and loan Granahorrar and commercial financing firm FES, to add to the other losers in state hands: rural bank Caja Agraria, mortgage lender Banco Central Hipotecario and Banco del Estado. The official National Federation of Coffee Growers surrendered coffee bank Bancafe to Fogafin in 1999.

Worst off was the Caja Agraria. It was shut down last year to be reborn as the smaller, leaner Banco Agrario, at a total cost of around COP2.7 trillion, Castellanos said.

Banco Uconal was merged into Banco del Estado and COP1.3 trillion of those assets written off, while the better half of BCH's 3.5 trillion assets moved to Granahorrar.

"Last year, we injected COP2.8 trillion into the public sector first-tier banks, excluding the Caja Agraria," Castellanos said. "We will inject another COP2 trillion in this half of the year, with which we will finish putting the public sector first tier financially in order."

Planned injections include COP600 billion for Bancafe and COP500 billion for the newly-expanded Granahorrar.

The next step is to cut payrolls and operating costs, to slim down the oversized banks and help sell them off by end 2001, as agreed with the International Monetary Fund.

Sale plans focus on Granahorrar and Bancafe, with Banco Agrario staying in state hands to promote rural lending.

"The most likely to go first is Granahorrar, with Bancafe second - by our timetable, it's the second half of the year for one and the end of this year or the start of next for the other," Castellanos said. "The most probable buyers are international banking groups that already have a network in Colombia or in South America."

Fogafin will be left with FES and the remnants of BCH and Banco del Estado.

"Either we'll sell them afterwards - but I don't see much international demand for those banks, because they're much smaller - or we'll do more operations of dismemberment and eventual liquidation," the official said.

#### Private Sector Improving, But Needs More Work

Fogafin's approach to private firms is uncompromising.

"Those that were very weak were intervened in and eliminated from the system by the good discipline of the market," Castellanos said. "For private banks that don't comply with certain rules the government won't do bailouts."

Eleven private financial firms were closed in 1999.

To the troubled but potentially viable, Fogafin last year extended a credit line to help capitalize but demanded strict guarantees. Banks had to gut their balance sheets with wholesale asset write-offs, before rebuilding them with borrowed Fogafin bonds and shareholders' resources.

Some COP600 billion, including shareholders' input, was injected into nine companies, including bank Colpatría.

Castellanos said it was "possible, not probable" that the credit line will be reopened as he didn't expect demand.

"Fogafin's access conditions are tough, they're drastic," he said. "The rules are designed so that those who can (capitalize) on their own account do so."

As a result, the four large banking groups - Aval, Sindicato Antioqueno, Bolívar and Grupo Social - are going it alone.

"They're not so weak but they still haven't made the capitalizations needed," he said. "And it's going slowly."

Castellanos said that while Antioqueno's Bancolombia and some other firms were engaged in major fund injections, Grupo Aval had done less. Its recent share offer didn't sell as well as hoped, so he predicted it would have to "resort to other mechanisms."

Fogafin doesn't expect, but is prepared for, disasters.

"The contributions of the multilateral entities are our back-up fund, our support cushion," Castellanos said. "We're talking about \$500 million that's the reserve we have if we come to see a crisis in the private banking sector, or if the public sector crisis is worse than expected."

Fogafin will end up with around \$300 million from the World Bank and Inter-American Development Bank combined, and \$200 million from the Andean Development Corporation or CAF.

He added that while more loans come to Colombia nominally for bank rescues, most don't have spending restrictions and will go towards normal state outlays.

Castellanos said half of the \$500 million has already been disbursed and the rest will come this year, but none has been spent.

"Almost all the strengthening of the public sector banks is done with Fogafin bonds, although it's the government who pays to service the debt," he said.

He added that this smoothes the fiscal effects evenly over 10 years, as the bonds pay market interest rates and mostly have maturities of between two and 10 years.

The benefits of the measures should be felt long before then, according to Castellanos. He said results were already improving among banks Fogafin has helped purge and rebuild, a trend that should consolidate with February's figures.

Credit growth, needed for economic recovery, should reappear "when the banks, not for the whole year, but for the month going by start to show profits," he said.

"I expect this to be in the second half of this year, when all these processes of strengthening, ours and those that entities like Bancolombia are doing, start to be seen," he added.

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