



**A Guide to Selected Emerging Markets for
Microfinance Issuers and International
Investors:**

Colombia



Stichting to Promote Women's World Banking (WWB) gratefully acknowledges the contributions of Cleary Gottlieb Steen & Hamilton LLC, Shearman & Sterling LLC, Mosquera Abogados and Columbia University. These institutions generously supported the preparation of this document by making available the time and resources of their talented employees and students.

This guide was produced through the joint effort of Women's World Banking, Barclays Capital and local legal counsel in Brazil. A special thank you to the Women's Initiative Network at Barclays and to the team of São Paulo reviewers for their support throughout the project.

Information within this paper is not and should not be regarded as legal advice. It has been prepared with the understanding that prospective investors will seek local counsel before making an investment decision. No part of this publication may be published without the prior written consent of Women's World Banking.

COLOMBIA



CAPITAL MARKETS ACCESSIBILITY CHART	DIFFICULTY LEVEL
Investment Considerations for Foreign Investors	
Investment Regulatory Requirements:	
Foreign Direct Investment (FDI)	Medium
Portfolio Investments (PI)	Medium
Foreign Credit	Medium
FX Convertibility	Medium
Repatriation	High (requires approval and may be taxed)
Taxes on Gains	High for FDI; Low for PI
Taxes on Income (dividends)	Medium to Low
Issuance Considerations for MFIs	
Publicly Registered Securitis	Medium
Private Placements	Medium

CONTENTS

Overview of the Capital Markets and Microfinance Markets	—5
Microfinance Market Overview:	5
Capital Markets Overview:	5
Key Foreign Investor Considerations:	5
Key Local Microfinance Issuer Considerations:	5
Microfinance Market Overview	—6
Capital Markets Overview	—8
General Size and Activity	8
Securities Exchanges	11
Banking Sector	11
Foreign Investor Considerations	—13
Summary Chart: Key Steps for Investments and Repatriation in Colombia Capital Markets by U.S. Investors	13
Overview	14
Restrictions on Foreign Holdings	14
Expatriation and Repatriation of Capital	15
Tax Considerations	—16
Other Legal Restrictions on Capital Transfers	17
Types of Accessible Capital Markets	18
Local Microfinance Issuer Considerations ²¹	—20
Summary Chart: Keys Steps for Microfinance Issuers to Issue in Colombian Markets	20
Overview	21
Securities Available for Issuance	23
Key Contacts for Additional Information	25
Appendix I: Encaje	—26
Deposit Requirement for Portfolio Investments	26
A Note on Deposit Requirement for Foreign Credit Activities	26

OVERVIEW OF THE CAPITAL MARKETS AND MICROFINANCE MARKETS

Microfinance Market Overview:

- There is no standard regulatory framework for the microfinance industry.
- The potential for growth in the Colombian microfinance market remains substantial, as market penetration is currently estimated at 14%.
- Many of the largest microfinance institutions (MFIs) remain nongovernmental organizations (NGO), although a recent merger between two MFIs established the first microfinance bank in the country.
- Despite lack of a regulatory framework, in 2005 WWB Colombia, an NGO operating as an MFI in Latin America and the Caribbean, successfully issued two public bonds on the Colombian capital markets. There have been no further MFI issuances.

Capital Markets Overview:

- The Colombian capital markets are dominated by fixed income securities, with equity instruments making up a small fraction of trading activity.
- The principal equities and fixed income exchange in Colombia is the Bolsa de Valores de Colombia (BVC), which is the largest fixed income market in the region and the fourth largest equities market by profitability.
- Ratings are a mandatory requirement prior to any capital issues in the corporate debt market. The key rating agencies are Duff & Phelps de Colombia, S.A., Sociedad Colombiificadora de Valores (Duff & Phelps) and BRC Investor Services, S.A., Sociedad Colombiificadora de Valores (BRC).
- The Colombian peso is convertible and transferable for foreign investors as long as they register with the Colombian Central Bank (Banco de la República).

Key Foreign Investor Considerations:

- The Colombian government and the Central Bank exercise significant influence over the foreign investment process, which is divided into foreign direct investments and portfolio investments. Each is regulated separately.
- There is no income tax treaty currently in effect between Colombia and the United States. Capital gains taxes for foreign direct investments are 33%, but there are no taxes for portfolio investments.
- All foreign investments, regardless of their type, must be registered with the Central Bank of Colombia in order to exercise foreign exchange rights conferred by law. This should be done within three months of the investment date. Portfolio investors must make investments through a special investment vehicle, with an established local administrator and obtain the approval of the Colombian Superintendence of Finance (Superintendencia Financiera) (CSF).
- Foreign investors who wish to lend directly in Colombia can only do so if the Central Bank approves their business model as an accredited financial entity offshore. The foreign investor must register with the Central Bank to be added as an accredited external financial institution.
- No individual or corporation may hold more than 10% of a Colombian financial institution's capital stock without prior governmental authorization.

Key Local Microfinance Issuer Considerations:

- Colombian securities, both debt and equity, can be offered to foreign investors by means of a public offering or a private placement.
- Public offerings require: (i) obtaining the authorization of the CSF, (ii) registering the Colombian Issuer and the relevant securities in the Colombian National Securities Registry (Registro Nacional de Valores y Emisores), and (iii) complying with requirements applicable to the terms of the relevant securities.
- Private offerings must be approved by the CSF through either a general or specific authorization scheme.

MICROFINANCE MARKET OVERVIEW

History and growth

The potential for growth in the Colombian microfinance market remains substantial, as market penetration is currently estimated at 14 percent¹. In addition, of all microenterprises in Colombia, only 7.2 percent are currently MFI borrowers, indicating that there is potential to reach many more individual entrepreneurs².

Two of the key barriers to sector growth historically have been interest rate caps and the lack of a standard regulatory framework for the microfinance industry. Colombia has a de facto interest rate ceiling that stems from a “usury rate” defined in two different sets of legislation: criminal and commercial. This ceiling has always been seen as an obstacle to the development of Colombia’s financial sector, including microfinance, but given Colombia’s social and economic context, it has been difficult for the government to tackle the problem.

In 1999, the government changed key definitions in the two laws, presenting new challenges for the microfinance industry in the process³. A practical implication of the changes to usury rates was that the maximum lending rates fell from more than 40 percent to less than 20 percent. This drop had a negative impact on the incomes of financial institutions, as microfinance institutions (MFIs) were no longer able to cover basic operational costs⁴.

As a result, in part, of significant lobbying by those in the microfinance industry, Law 509, MIPYME (Micro Pequeña Y Mediana Empresa) was enacted by the Colombian government in 2000. The law defined microbusiness and microlending, and allowed MFIs to charge fees and commissions in excess of the interest cap, making it possible for them to cover transaction costs and fund growth. The law also established a microbusiness council⁵. The law generally is intended to foster and protect the development of medium and small enterprises, but it is not intended to regulate microbusinesses or the microlending institutions which may finance them.

As the sector experienced renewed momentum after the enactment of Law 509, local banks signed an agreement with the Colombian government whereby they committed to placing US\$ 130 million per year in microcredit between 2002 and 2006. One result was an increase in competition in the microfinance market, particularly in the main cities, and clients previously served only by NGOs have become more attractive to mainstream financial entities⁶.

A clearer regulatory framework could significantly boost the expansion potential of MFIs themselves, and would also encourage a more rapid downscaling by traditional financial institutions into the industry⁷.

Governing Regulations

Non-profit MFIs are not regulated by the CSE, but are required to comply with some of the same regulations that apply to supervised institutions. These include regional minimum

capital requirements and interest rate ceilings. In addition, they cannot issue public equity securities. Because they are not controlled by CSF, their access to Colombian public markets is restricted in general, which typically results in higher financing costs. However, most institutions operate within the framework set forth by the CSF.

The Colombian Commercial Code, known as the TIBCO, (Tasa de Interés Bancario Corriente) defines the usury rate as 1.5 times the weighted average interest rate on commercial short term loans (short term loans are defined as terms of one year or less). The Colombian Criminal Code, known as the TICOLA, (Tasa de Libre Asignación de los Bancos) establishes the crime of usury as charging an interest rate higher than 1.5 times the weighted average interest rates on commercial short term loans and credit cards. The government changes to the TIBCO in the late 1990s meant that it effectively fell from 42.4 percent at the end of 1998 to 17.45 percent at the beginning of 2000. Similarly, the TICOLA dropped from 50 percent to 18 percent in the same period.

Law 509, which was designed with the specific goal of promoting microfinance in Colombia, exempts certain financial institutions from the interest rate ceilings set out in the TIBCO and TICOLA, by allowing them to attach additional fees and commissions to their loans. With Law 509's enactment, new actors (commercial banks, co-operatives, etc.) became increasingly attracted to the sector.

In addition, Law 795, passed in 2003, complements Law 509 in that it establishes a clear difference between microcredit and consumer credit.

Largest Players

The three largest players in Colombia by gross loan portfolio outstanding are Banco Caja Social Colombia (BCSC), WWB Colombia, and FMM Popayan⁸.

THE 10 LARGEST MFIS IN COLOMBIA BY GROSS LOAN PORTFOLIO OUTSTANDING	
NAME	GROSS LOAN PORTFOLIO IN US DOLLARS
Banco Caja Social Colombia	2,332,925,383
WWB Colombia	214,067,337
FMM Popayán	149,789,617
FMM Bucaramanga	113,216,782
Finamerica	70,256,548
CMM Medellín ¹	68,196,530
CMM Bogotá	58,925,363
Interactuar ²	31,849,639
Microempresas de Antioquia	15,741,436
Contactar	9,341,434

(1) CMM Medellín and CMM Bogotá merged and became Bancamia as of October 2008

(2) Previously: ACTUAR Famiempresas Antioquia

(3) Data is as of 12/31/2008

BCSC is registered as a bank while WWB Colombia and FMM Popayan remain non-profit organizations. FMM Bucaramanga and Finamerica, both with non-profit status are also significant players. A new player to the microfinance arena is Bancamía, the first regulated microfinance bank in Colombia, which was created through the merger of the NGOs Corporación Mundial de la Mujer Bogota and Corporación Mundial de la Mujer Medellín. The merged entity was acquired by the BBVA Microfinance Foundation, which is the controlling shareholder with 51 percent ownership, while the two NGOs have a combined 49 percent ownership in the newly created entity.

Notable Recent MFI Capital Market Transactions

WWB Colombia issued two tranches of unsecured bonds on the BVC in February and November of 2005. The bond structure included a fiduciary trust authority that would monitor liquidity and solvency indicators, such as portfolio quality and operational efficiency, to substitute for the lack of CSF oversight. As a result of the trust authority, as well as its solid financial performance and development of corporate governance standards, WWB Colombia received an AA+ local rating from Duff & Phelps, giving it access to the institutional investor base on an unsecured basis. WWB Colombia also developed accounting practices in accordance with the guidelines issued by the CSF. WWB Colombia is not authorized to offer the bonds on the public debt markets. Establishing a relationship with the CSF as a bond issuer was a goal of the WWB Colombia bond offering.

The total value of the two WWB Colombia bond offerings were just over US\$ 50 million. The offerings were a combination of floating and fixed rate bonds. Both issuances were placed successfully with various types of investors: brokers, financial entities, individual investors, pension funds, trust funds, corporate and others. These issuances significantly lowered WWB Colombia's cost of capital.

CAPITAL MARKETS OVERVIEW

General Size and Activity

The Colombian capital markets are dominated by fixed income securities, with equity instruments making up only a small fraction of all trading activity. Total tradable debt outstanding in 2007 stood at US\$ 545 billion, of which just over 16 percent (US\$ 88 billion) was corporate debt. This reflects year-on-year (YoY) growth rates of -27.9 percent and 25.6 percent, respectively⁹.

Total equity market cap was US\$ 102 billion in 2007, an 81 percent year on year growth rate¹⁰.

Figure 1: Bolsa de Valores de Colombia Performance Indicators, 2006-2007

FIXED INCOME		(USD BN)	EQUITY		(USD BN)
Market Cap: 2007		545.1	Market Cap: 2007		102
Market Cap: 2006		755.9	Market Cap: 2006		56.2
YoY % Change		-27.9%	YoY % Change		81.5%
Volume: 2007		530.2	Volume: 2007		16.8
Volume: 2006		718.6	Volume: 2006		14.8
YoY % Change		-26.2%	YoY % Change		13.5%
New Issues: # 2007		5	New Issues: # 2007		7
Value of Capital Raised		0.6	Value of Capital Raised		4.6
			Avg Daily Turnover 2007		68.8
			Avg Daily Turnover 2006		61.3
			YoY % Change		12.2%
# bond issuers 2007		263	# of listed co 2007		90
# bond issuers 2006		256	# of listed co 2006		94

Source: WWB

Figure 2: Bolsa de Valores de Colombia Fixed Income Breakdown, 2006-2007

FIXED INCOME	PRIVATE SECTOR		PUBLIC SECTOR	
	(USD BN)		(USD BN)	
Market Cap: 2007		87.9	Market Cap: 2007	456.6
Market Cap: 2006		70.0	Market Cap: 2006	683.1
YoY % Change		25.6%	YoY % Change	-33.2%
Volume: 2006		84.1	Volume: 2007	445.6
Volume: 2006		70.5	Volume: 2006	646.2
YoY % Change		19.3%	YoY % Change	-31.0%
# bond issuers 2007		224	# of listed cos 2007	32
# bond issuers 2006		219	# of listed cos 2006	31
New Issues: # 2007		5	New Issues: # 2007	0
New Issues: # 2006		24	New Issues: # 2006	2

Source: WWB

Despite most traded debt being public (government issued), private sector issuances are growing rapidly (84 percent over the past four years). In 2006 alone, there were 26 new corporate bond issues with a total value of US\$ 2.2 billion¹¹.

Local issuances are not limited to sovereign rating ceilings, which in Colombia are Ba1, BBB- and BB+, respectively by Moody's Investor's Services, Inc., Standard & Poor's and Fitch Ratings Ltd¹². By far the highest demand for Colombia's corporate debt is for AAA local currency rated corporate bonds. Though lower rated bonds have been successfully marketed, those with ratings below AA struggle to raise funds in the local market.

Key Players

Apart from the Colombian government, the main issuers of debt are financial institutions, corporations and multilaterals such as the World Bank and the International Financing Corporation, historically concentrated among a few issuers that dominate the market. On the investment side, 30 percent of the total investment volume within the Colombian fixed income market comes from both foreign and local banks. Other major local investors are pension funds, generally that are administrated by Asofondos (private pensions) and Instituto de Seguros Sociales (public pensions).

Regulatory Framework and Bodies

The main financial regulators in Colombia are the national government and the CSF, the latter the authority responsible for exercising direct surveillance over financial institutions as well as the equity and debt markets. However, neither body universally regulates nor exercises surveillance over unregulated MFIs.

Local Currency and Convertibility

The Colombian peso is partly convertible for domestic investors in that it can only be sold subject to certain regulations from the Central Bank, which is designed to ensure exchanges occur in formal channels. Foreign investors can purchase freely convertible currency with Colombian pesos (COP), and transfer such funds abroad, if: (i) they present an auditor's certificate verifying the net proceeds of their investment¹³, and (ii) at the time the funds entered Colombia, they were duly registered with the Central Bank as foreign investment.

Prevalent Accounting Standards

Issuers of publicly traded securities must file annual and quarterly reports with the CSF. These statements must comply with Decree 2649, which sets forth generally accepted accounting principles in Colombia.

Foreign Participation

Foreign participation in the Colombian market remains relatively small (apart from foreign banks), making up only about 1.7 percent of the volume of the most active investors in the Colombian fixed income market in 2006. In 2007 there was no foreign investor participation, due in large part to onerous restrictions on foreign capital inflows, which have since been lifted. (See Appendix). It should also be noted that overall bond issuance declined from \$1.6 billion in 2006 to \$593.1 million in 2007.

Securities Exchanges

Overview of Debt and Equity Exchanges

The principal equities and fixed income exchange in Colombia is the Bolsa de Valores de Colombia (BVC), which was created in 2001 by the merger of the three existing stock exchanges: Bolsa de Bogotá, Bolsa de Medellín and the Bolsa de Occidente. The BVC is the biggest fixed income market in the region and the fourth biggest equities market in the region by profitability¹⁴.

There are currently approximately 100 companies listed on the exchange of which about 27 trade actively¹⁵. As mentioned, the bulk of this debt volume stems from public debt. The average volume of debt traded on the BVC secondary market has been rising since 2003. By year-end 2007, average daily volume of debt traded in the BVC was COP 8.2 billion per day, (approximately US\$ 4 million)¹⁶. The BVC has been growing rapidly, with trading volumes up more than 50 percent between 2005 and 2006.

Rating Requirements

According to existing financial regulations, ratings are a mandatory requirement prior to any capital issue in the Colombian corporate debt market. Traditionally, 72 percent of issuances have been AAA rated. Recent experience has shown that an AA+ rating can be enough to ensure a successful issuance. Key rating agencies include Duff & Phelps, and BRC.

Notable Recent Transactions

Recent major transactions in the Colombian market include, in the summer of 2007, the initial public offering of up to 10 percent of the state-owned oil company, Ecopetrol.

Banking Sector

Relevant Regulations and Regulators

The main regulators in Colombia for the banking sector are the national government, the CSF and the Central Bank. The CSF regulates the banking sector and also exercises direct surveillance over those financial institutions that require such surveillance. The Central Bank is authorized to request mandatory deposits from banks in its role as primary regulator of inflation.

The main regulatory framework is established by Governmental Decree 663 of 1993, as amended, known as the Organic Statute of the Financial System (Estatuto Orgánico del Sistema Financiero). The statute, together with the Basic Legal Circular (Circular Básica Jurídica C.E. 007 de 1996), as amended, covers, among others, aspects such as categorization of financial entities, permitted activities, capital requirements, administrative and operational requirements, as well as topics surrounding sanctioning proceedings.

In addition to this general framework, financial institutions are also subject to: (i) Regulation 100 of 1995 (Circular Básica Financiera y Contable 100), which includes several specific valuation procedures and reporting requirements and (ii) Decree 2649 of 1993, known as the Plan Único de Cuentas, which provides a set of defined standards for reporting of financial

information to the local authorities. Although financial institutions are not barred from using global accounting and reporting standards in the domestic market, the required standard is that established in Decree 2649 of 1993.

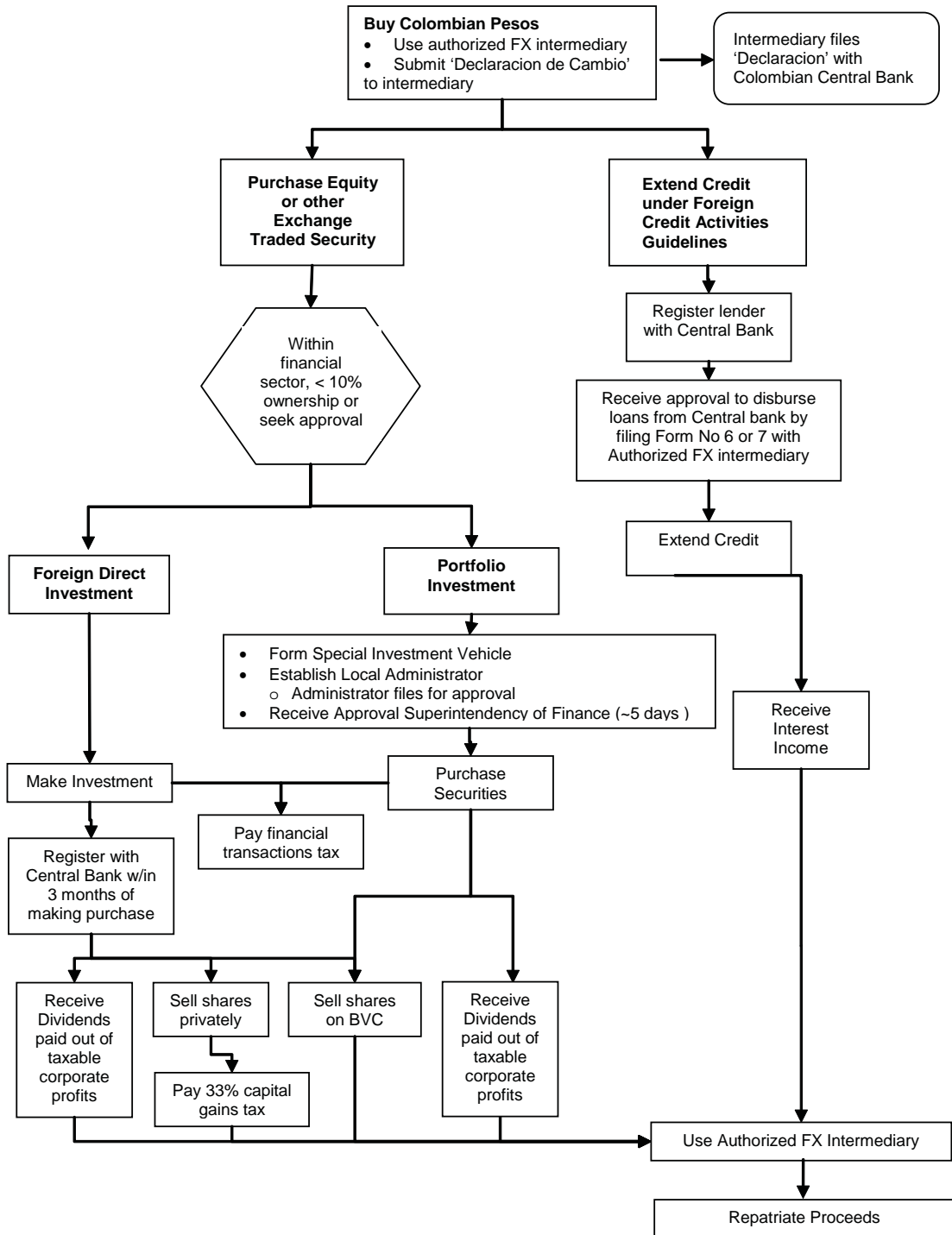
Key Players

Three local players currently dominate the banking market in Colombia, owning 60 percent of banking assets among the three entities. These three key players in the banking sector are Bancolombia, with a market cap of US\$ 6.2 billion, followed by Grupo Aval Acciones y Valores Aval (Grupo Aval Acciones y Valores) and Davivienda.

Foreign banks currently control only 21 percent of the country's banking assets. Of these, Banco Bilbao Vizcaya Argentaria's (Banco Bilbao Vizcaya Argentaria) (BBVA) is the largest¹⁷.

FOREIGN INVESTOR CONSIDERATIONS ¹⁸

Summary Chart: Key Steps for Investments and Repatriation in Colombia Capital Markets by U.S. Investors



Overview

The Colombian government and the Central Bank have historically exercised substantial influence over the Colombian economy and occasionally make significant changes in monetary, fiscal and regulatory policy. The Central Bank has several restrictions that govern foreign investment in Colombia: Colombia's Decree 2080 of 2000 (Decreto 2080 de 2000) and Decree 1844 of 2003 (Decreto 1844 de 2003) regulate the way in which foreign entities and individuals can invest in Colombia. The decrees make an important distinction between direct and portfolio investments.

In addition, External Resolution 8 of 2000 (Resolución Externa No. 8 de 2000) and External Circular DCIN 83 of December 2004 (Circular Reglamentaria Externa DCIN 83 de diciembre 2004) provide detailed procedures for the registration of foreign investments with the Central Bank, including foreign exchange transactions.

Key Regulations Governing Foreign Direct Investments

Broadly speaking, pursuant to Decree 2080, foreign direct investment refers to investments made by a foreigner (individual or company) for the purpose of running and managing a Colombian company or corporation, for example, by a private equity purchase and not through the BVC. Foreign direct investment covers only equity instruments. Generally, the securities will not be registered on the National Registry of Securities and Issuers (NRSI), however, ultimately the definitive criterion for determining whether an investment is direct or portfolio is the intention of the foreign investor, as determined according to the Central Bank's policies.

Key Regulations Governing Foreign Portfolio Investments (Market Investments—Debt & Equity)

On the other hand, portfolio investment, pursuant to Decree 2080, refers to investments made by a foreigner without the aim of obtaining control. These typically would be made by acquiring stocks, stock convertible bonds, corporate bonds and other securities that are registered in the public securities market, the NRSI. Portfolio investments must be made by specially set up investment vehicles.

Direct Lending—Foreign Credit Activities, A Further Distinction

Decree 2080 of 2000 expressly states that credits from foreign financial entities to Colombian residents (individuals or companies) are not considered foreign investment. Under current applicable legislation, foreign investment activities are different to those of credit activities. Credit activities are transactions that imply indebtedness with foreign funds by a Colombian resident (individuals or companies).

Before deciding on an investment in Colombia, foreign investors are urged to consult with Colombian legal counsel regarding these and other applicable regulations of foreign investments in Colombia.

Restrictions on Foreign Holdings

Pursuant to Colombian banking regulations, no individual or corporation may hold

more than 10 percent of a Colombian financial institution's capital stock without prior governmental authorization. Therefore, any transaction resulting in an individual or a corporation holding 10 percent or more of the capital stock of any Colombian financial institution requires prior authorization from the CSF. Approval by the CSF typically takes anywhere from 20 to 60 days. Transactions entered into without the prior approval of this authority are deemed null and void.

Investors should consult with Colombian legal counsel with respect to any applicable limitations on foreign ownership related to equity of Colombian entities.

Expatriation and Repatriation of Capital

Currency Convertibility, Transferability and Controls

In 1990, the Government of Colombia initiated a policy of gradual currency liberalization. Foreign exchange holdings abroad were permitted and, in a series of decrees, control of the exchange rate was shifted from the Central Bank to the commercial exchange market, known as *mercado cambiario*. The commercial exchange market is the main Colombian foreign exchange market for mandated trade and financial transactions. All remaining operations not restricted to this market are carried out on free market, known as *mercado libre*.

External Resolution 8 tightly controls foreign capital entering Colombia for purpose of financial transactions; most of the currency exchange pursuant to financial transactions in Colombia occurs in the commercial exchange market. Under Colombian law, foreign currency transactions associated with any foreign investments into or out of Colombia, including into Colombian capital markets, must be channeled through authorized intermediaries (e.g., banks or financial institutions). Other transactions, such as transactions for services, are not required to be made through the commercial foreign exchange market and can occur through the free market.

External Resolution 8 regulates foreign investments in Colombian securities as well as dividends, interest or principal payments made on those securities. Generally, under Article 1 of External Resolution 8, a foreign person would have to present a specified declaration (*declaración de cambio*) to the Central Bank or to an authorized foreign exchange market intermediary (e.g., Colombian banks and financial institutions) in order to exchange foreign currency for Colombian pesos, to purchase the Colombian Issuer's securities or to convert Colombian peso dividends, interest or principal payments to foreign currency for purposes of withdrawing the funds from Colombia.

Typically, investors must submit Form No. 4: Exchange Form for Foreign Investments to the applicable intermediary simultaneously with the foreign exchange transaction. The intermediary institution would then complete the filing with the Central Bank.

Failure of a foreign investor to report foreign exchange transactions relating to investments in Colombia with the Central Bank in a timely manner may result in a fine of up to 200

percent of the amount of the exchange infraction among other possible consequences. The imposition of such fines is made by the National Direction of Taxes and Customs to whom the Central Bank reports violations of this foreign investment regime.

Colombian law provides that the Central Bank may intervene in the commercial foreign exchange market if the value of the Colombian peso experiences significant volatility. Under Decree 2080, the Central Bank may also limit, on a temporary basis, the remittance of dividends and/or investments of foreign currency received by Colombian residents whenever the international reserves fall below an amount equal to three months of imports. Since the creation of the current foreign exchange regime in 1991, such action has not been taken.

From January 1994 to September 1999, the Central Bank maintained a limit within which the exchange rate was permitted to fluctuate. On September 25, 1999, the Central Bank decided to abandon this system and adopted a free floating exchange rate system. The transition to the new free floating foreign exchange regime did not result in a significant deterioration of the exchange rate.

The Colombian peso appreciated in a virtually continuous manner against the U.S. dollar throughout 2007 and early 2008. While the Central Bank intervened in the foreign exchange markets to control currency appreciation, the global credit crisis also contributed to a fall of the Colombian peso back to its weakest levels since 2006.

TAX CONSIDERATIONS ¹⁹

Capital Gains Taxes

Apart from the tax on financial transactions, the most relevant taxes for a foreign investor purchasing local securities are the capital gains tax and the income tax. The application of each tax depends again on whether the underlying investment is categorized as a foreign direct investment or a portfolio investment.

Capital gains based on a foreign direct investment are considered Colombian source income. The foreign investor selling the securities is required to file a tax return within a month of the sale for a tax of 33 percent of the gain on sale. However, if the capital gains arising from the sale of securities trading on the BVC and the securities sold (directly or indirectly through affiliates) amount to less than 10 percent of the listed securities, then the gain is not subject to taxation in Colombia.

Capital gains based on a portfolio investment are not subject to taxation in Colombia. A foreign investor engaging in portfolio investments is not subject to income taxes as long as all of its Colombian source income is obtained through its fund of portfolio investments.

Dividends or International Tax Income

A foreign investor engaging in foreign direct investments is subject to income taxes on dividends to the extent that any taxable dividends that it received from its investments are

subject to withholding tax at the point of sale.

Dividends resulting from tax-exempted profits are subject to a withholding tax rate of 33 percent of the distribution.

Other Withholdings

Any financial transaction made from Colombian bank accounts is taxed at a rate of 0.4 percent of the amount of the transaction. Payments relating to the sale or purchase of securities, if conducted through a local bank account, are subject to this tax. An exemption is available for transactions relating to the clearing and settlement of deposits for dematerialized securities and the corresponding payments for the administration of such deposits.

Tax Treaties with the United States

As of the date of this publication, there is no income tax treaty and no inheritance or gift tax treaty in effect between Colombia and the United States. Potential U.S. investors should consult their own tax advisors regarding the tax consequences of owning and disposing of Colombian securities.

Other Legal Restrictions on Capital Transfers

Registration Requirements for Foreign Direct Investments and Portfolio Investments

In the case of foreign direct investments, Decree 2080 requires that any foreigner making such an investment register with the Central Bank as a foreign investor and comply with the documentary requirements of the Central Bank. Registration must be made within three months of the investment date. This filing deadline may be extended for an additional three months in certain circumstances. Registration must be updated annually with the Central Bank. Typically, filing of the required form results in automatic registration of the investment and no approval process is triggered. The transfer of shares from one foreign investor to another foreign investor requires the filing of a substitution request with the Central Bank.

In relation to portfolio investments, Decree 2080 requires that any foreigner making such an investment shall make it through a special investment vehicle (*fondo de inversión de capital extranjero*), with an established local administrator for such fund and obtain the approval of the CSF. Pursuant to Article 28 of Decree 2080 of 2000, the local administrator, among whose chief responsibilities are to ensure legal and regulatory compliance, must obtain a tax identification number and submit the application before the CSF along with information regarding the investor and the experience of the local administrator. Generally, registrations are approved within five days after filing.

In relation to foreign credit activities, revenues and expenditures in foreign currencies that are related to loans in foreign currencies need to be channeled through the foreign exchange market. Investors who wish to provide loans directly to Colombian institutions need to be authorized as a foreign financial institution by the CSF. All external loans must be channeled through the foreign exchange market and must be reported to the Central Bank of Colombia prior to their disbursement by filling out Form No.6 with a foreign exchange market

intermediary. The registration requirements are explained in Circular for External Regulation (Circular Reglamentaria Externa) DCIN-83.

According to the Colombian tax system, the payments of principal and interest, commissions and other fees related to public foreign credit operations and similar operations, are exempt from all types of taxes, fees, assessments and national levies, as long as they are paid to person who do not have a residence or domicile in the country²⁰.

As tax laws are subject to change, this document does not attempt to provide legal advice. Interested investors should seek tax advice from qualified sources prior to any investment.

Deposit Requirements for Portfolio Investments and Foreign Credit Activities

During 2007 and the beginning of 2008, the Ministry of Finance and Public Credit have taken measures to control the inflow of short-term portfolio investments by requiring a 40 percent non-interest bearing deposit to be made on the investment at the Central Bank for a period of six months—the encaje. The Central Bank also imposed deposit requirements with respect to foreign credit activities in an attempt to control the strengthening of the Colombian peso.

However, as of October 9, 2008, the Central Bank issued Bulletin No.45, in which, Article 83 of External Resolution 08 of 2000 was modified to reflect that the foreign investor requirement would be dropped to 0 percent. In other words the 40 percent requirement or encaje was lifted. Similarly, the Ministry of Finance and Public Credit through Decree 3913 of 2008, issued October 8, 2008, modified Decree 2080 of 2000, allowing investors to claim their deposits made with the Central Bank and lifting the deposit requirement.

The measures are described in detail in Appendix 1 because many Colombian banks and MFIs expect to see them re-imposed should Colombian markets strengthen again.

Types of Accessible Capital Markets

Public Exchanges

The BVC is the principal public stock exchange in Colombia. The BVC was created on July 3, 2001 by the union of three extant stock exchanges in Colombia: Bolsa de Bogotá, Bolsa de Medellín and the Bolsa de Occidente (Cali). The company maintains offices in Bogotá, Medellín and Cali.

Over the Counter

There is no formalized dealer mechanism in Colombia for over-the-counter security trading.

Private Placements

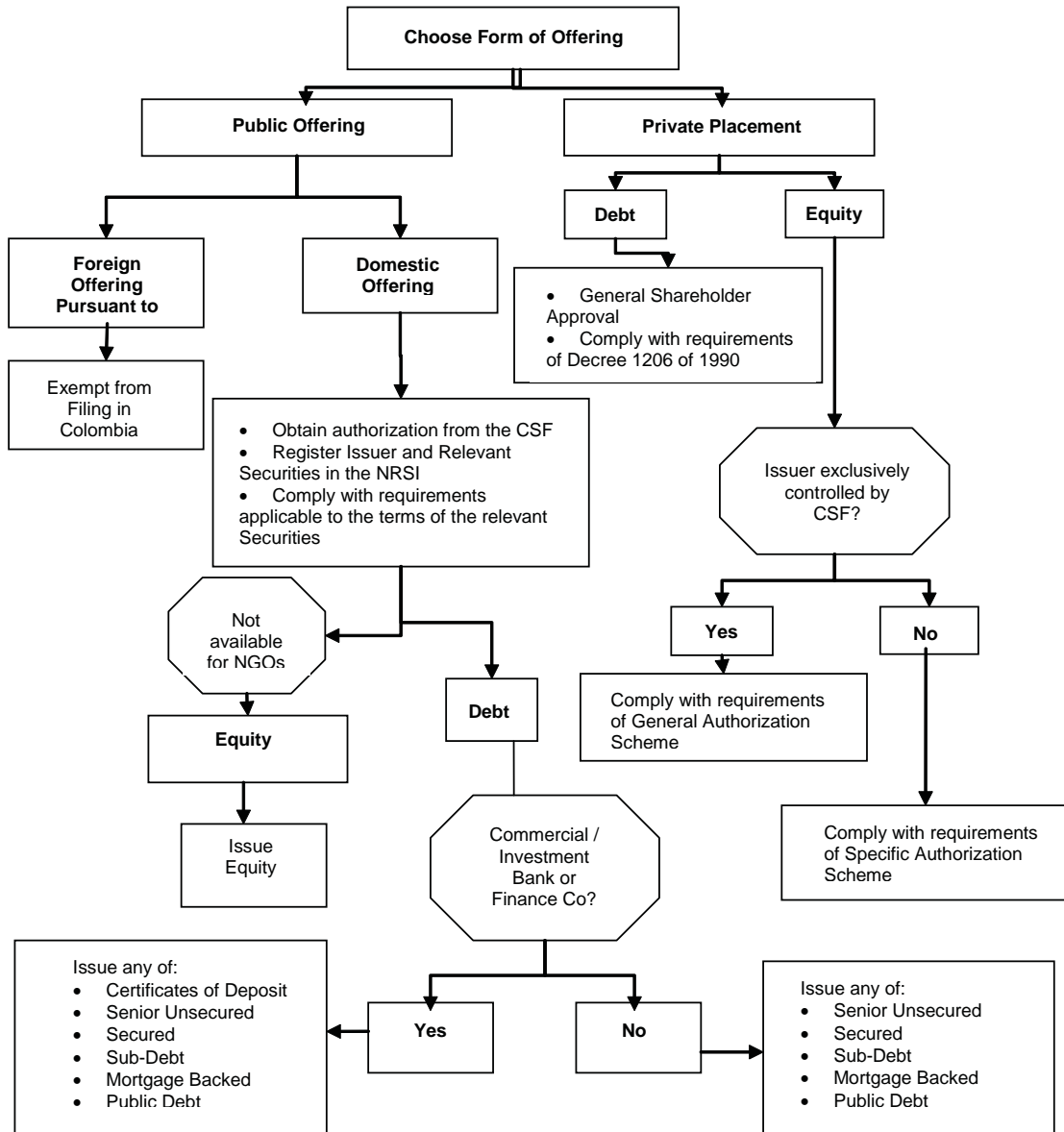
Foreign investors can purchase a variety of equity and debt instruments issued by Colombian issuers. Equity investments are, in many circumstances, subject to pre-emptive subscription rights maintaining that shares may only be sold to the public after existing shareholders have exercised or waived their rights to subscribe for shares of a new issuance in proportion to the number of shares already owned by the holder.

Debt instruments available for purchase include secured and unsecured bonds, subordinated debentures, put bonds and callable bonds, variable rate bonds, syndicate bonds and convertible bonds.

Colombian issuers may also issue notes (papeles comerciales), certificates of deposit of merchandise, securities resulting from securitizations, risk capital securities, banking acceptances, mortgage-backed securities (cédulas hipotecarias), bank certificates of deposit and public debt securities.

LOCAL MICROFINANCE ISSUER CONSIDERATIONS²¹

Summary Chart: Keys Steps for Microfinance Issuers to Issue in Colombian Markets



Overview

Laws and Regulations Governing Issuance

Both debt and equity securities of a Colombian issuer can be offered to foreign investors by means of a public offering or a private placement.

A public offering (*oferta pública*) is an offer made to indeterminate persons (through general advertising or general solicitation) or that is made to 100 or more identified persons²². A Colombian issuer engaging in a public offering is required to comply with the registration requirements of Resolution 400, which include: (i) obtaining the authorization of the CSF, (ii) registering the Colombian issuer and the relevant securities in the NRSI, and (iii) complying with requirements applicable to the terms of the relevant securities, the time and manner of the offering and the information to be provided to investors.

Resolution 400 applies to all domestic public offerings and, as mentioned above, to certain private placements. An exemption from Resolution 400 is available in the case of exclusively foreign offerings where a Colombian issuer offers and sells securities, whether in a public offering or a private placement, exclusively outside Colombia²³. Additionally, where an offering is conducted simultaneously within and outside Colombia, Resolution 400 makes available certain exemptions regarding the time and manner of an offering²⁴.

Decree 2177, enacted in 2007, amended Article 1.2.4.68 of Resolution 400 and relaxed the regulatory requirements further for securities offerings. Prior to the enactment of the decree, offshore offerings were subject to authorization by CSF and were limited to issuers with highly traded shares listed on the BVC. Colombian issuers engaging in offshore bond offerings were also required to demonstrate to the CSF that the offering would be deemed a public offering in the respective foreign jurisdiction. Colombian issuers engaging in simultaneous domestic and offshore offerings were required to have a rating that was not inferior to the sovereign debt rating of Colombia and, in addition, the Colombian issuer was required to reserve at least 20 percent of the securities for purchase by Colombian investors.

Decree 2177 allows Colombian issuers to offer their securities to foreign investors in an exclusively offshore offering without first obtaining the authorization of the CSF. Colombian issuers engaging in a simultaneous domestic and offshore offerings are now subject only to the restriction that the domestic portion be authorized by the CSF; all other restrictions were eliminated by the new rules.

A private placement is an offering that does not meet the criteria for a public offering. Private placements are subject to the Colombian Commerce Code (*Código de Comercio*) and to certain provisions of Resolution 400. In addition, private placements of debt securities may be subject to other specialized Colombian regulations²⁵.

Domestic Markets Overview

Public Exchanges

In order to issue securities on the public exchange an issuer must comply with the following guidelines:

Registration: Issuer must submit to the CSF:

- Certificate of incorporation
- Bylaws
- Certificate of good standing
- Global security or, in the case of a dematerialized issuance, an agreement with the Centralized Deposit of Securities (DECEVAL)
- Documents evidencing compliance with foreign exchange controls and international investment rules If securities are denominated in a foreign currency,
- An economic and financial feasibility study if the issuer is in preoperative stage or has been in operation for less than two years,
- Description of collateral structures of the issuance, if any
- If issue is collateralized by guaranty posted by foreign entities, guarantor's description of nature of guaranty, scope of guaranty, risks affecting the assets underlying the guaranty, applicable law of guaranty, and guarantor's rating issued by a recognized credit rating agency
- Prospectus containing the general characteristics of the securities and financial information of the issuer
- Identification of the internal auditors of the issuer

Launch of Public Offering: Issuer must submit, in addition to the documentation required for registration:

- Reasons for the pricing of the securities
- Draft offer notice, which shall include: (a) rules for placement of securities, (b) addressees of offer, (c) rating of securities by rating agency, (d) legend stating that the registration of shares with the NRSI and the authorization of the public offering do not imply qualification by the CSF of the registered individuals or legal entities, or the price, characteristics or negotiability of such securities, or the issuer's solvency
- Marketing materials to be used to promote securities
- Sample prospectus, which shall include: (a) general characteristics of securities and offering, (b) place and form of payment of capital and interest, (c) redemption rules, (d) use of proceeds, (e) commercial name and corporate purpose of controlling or subsidiary companies of issuer, (f) financial statements of issuer, (g) due diligence certificate of legal representative, audit firm and investment bank, (h) rating of securities with summary of analysis made by rating agency, and (i) for bond issuances: name, address, domicile, duties and obligations of bondholders' legal representative
- Underwriting agreement
- Collateral agreement; if guarantor is foreign, documents evidencing compliance

- with foreign exchange controls
- Copy of management agreement if offering is not managed by issuer,
- Agreement between issuer and bondholders' representative

Other Markets

In order to issue securities in a private placement, an issuer must comply with the following guidelines:

Private Placement of Bonds:

- Private placement must be pre-approved by shareholders at general meeting; or, if in a previous general meeting the shareholders have pre-approved the aggregate amount of the offering, the yield, the term, the convertibility, the underlying collateral (if any), and the purpose of the placement, then by approval of the Board of Directors
- The aggregate amount, in addition to the amount of outstanding debt securities of the issuer, should not exceed the paid capital, the reserves and the capital gains for the placement of shares. For convertible bonds, this percentage accrues to 40 percent of the capital gains of the issuer. For all other bonds, the amount should include 20 percent of the capital gains of the issuer obtained within 12 months prior to the filing of the request for authorization to engage in the private placement

Private Placement of Stocks:

General Authorization Scheme (Regimen de Autorizacion General)

- Available to issuers that are exclusively controlled by the CSF
- Issuer's legal representative and auditor must file with the CSF a: (a) certificate of incorporation, (b) good standing certificate for the issuer, (c) summary of the offering, and (d) list of 10 percent or more shareholders calculated after having given effect to the offering within 10 business days after the term of the offering,
- Number of shares to be placed must be equal to or less than 20 percent of the outstanding shares of the issuer
- Placement must be subject to pre-emptive rights to subscribe for shares
- Issuer's regulations for the placement must comply with the minimum requirements of the Colombian Code of Commerce (e.g., number of shares to be offered, proportion and form in which they can be subscribed for, term of the offering, price of shares, term for the payment of shares)
- Issuer must set forth all the rules needed to preserve the rights of convertible bond holders (if any)
- Specific Authorization Scheme (Regimen de Autorizacion Especifico)
- Applicable to issuers who cannot meet one or more of the requirements for the General Authorization Scheme
- Placement of shares must be authorized by CSF

Securities Available for Issuance

Issuances can take the form of a variety of equity and debt instruments. Restrictions on securities offered by Colombian issuers can be based on the characteristics of the securities being offered or the organizational form of the issuer itself.

Debt

Major Product Categories:

Debt instruments available for issuance include secured and unsecured bonds, subordinated debentures, put bonds and callable bonds, variable rate bonds, syndicate bonds and convertible bonds. Colombian issuers may also issue notes (papeles comerciales), certificates of deposit of merchandise, securities resulting from securitizations, risk capital securities, banking acceptances, mortgage-backed securities (cédulas hipotecarias), bank certificates of deposit and public debt securities

Restrictions on Issuance by Law:

In the case of bond issuances, there is a minimum, inflation-adjusted threshold for issuance size defined as: (a) the aggregate principal amount offered cannot be less than 2000 times the amount of state minimum monthly legal wages (amounting to a threshold of approximately COP 867.4 million or US\$ 433,000), (b) except in the case of convertible bonds, the maturity period of the bonds must be greater than one year, and (c) publicly offered bonds must be listed on the BVC.

In the case of note issuances: (a) the aggregate principal amount offered must not be less than 2000 times the amount of state minimum wages (amounting to a threshold of approximately COP 867.4 million or US\$433,000) and (b) unless the issuer is a financial institution (such as an MFI), proceeds from the sale of notes should not be used to engage in activities that amount to the extension of credit.

Restrictions on Issuance by Form of Issuer:

Securities offerings by Colombian issuers are further restricted by the organizational form of the issuer. Only commercial banks, investment banks and finance companies are authorized to issue certificates of deposit. Trusts cannot issue notes.

Equity

Major Product Categories:

Equity may be issued publicly over the BVC or in a private placement transaction.

Restrictions on Issuance by Law:

Equity instruments must include pre-emptive subscription rights that entitle each holder to subscribe for shares of a new issuance in proportion to the number of shares already owned by the holder. The remaining shares may be sold to the public only after existing shareholders have exercised or waived their rights. Pre-emptive rights may be waived by each shareholder or by the decision of 70 percent of the shareholders at a shareholder meeting. The offering of pre-emptive rights is limited to rights to subscribe for newly offered shares and not for

already issued shares. (The Colombian Code of Commerce provides that any corporate rule that limits the free trading of the securities of a listed company will have no effect for so long as the company is listed.) Accordingly, if a company's bylaws authorize the issuance of pre-emptive rights to subscribe for already issued shares, then those provisions are suspended while the company is listed²⁶.

Restrictions on Issuance by Form of Issuer:

Non-profit organizations and cooperatives, foreign governments, other foreign public entities and multilateral credit institutions cannot issue equity securities, as the participation in their capital is not represented by negotiable instruments such as shares.

Key Contacts for Additional Information

Colombian Central Bank

(Banco de la República)

Website: http://www.banrep.gov.co/index_eng.html

Financial Superintendence

(Superintendencia Financiera de Colombia)

Website: <http://www.superfinanciera.gov.co/>

Colombian Superintendency of Companies

(Superintendencia de Sociedades)

Website: <http://www.supersociedades.gov.co>

Colombia Stock Exchange

(Bolsa de Valores de Colombia)

Website: <http://www.bvc.com.co>

APPENDIX I: ENCAJE

Deposit Requirement for Portfolio Investments

On May 23, 2007, the Ministry of Finance and Public Credit announced an additional measure to control the inflow of short term portfolio investments. The measure, announced through Decree 1801, requires foreign investors to make a 40 percent deposit at the Central Bank for short term portfolio investments for six months with no interest payable. This deposit is also known as encaje.

There appear to be at least several exemptions to the deposit requirement. Investments in primary stock issuances, for example, are exempt, as are portfolio investments made pursuant to American Depositary Shares programs.

This requirement was lifted by Decree 3913 of 2008, issued October 8, 2008.

A Note on Deposit Requirement for Foreign Credit Activities

On May 6, 2007, through Resolution 02, the Central Bank introduced a new package of measures that are intended to tighten monetary policy and control the strengthening of the Colombian peso. The package included, among other measures, a deposit requirement with respect to the disbursement of debt obligations acquired by Colombian residents from non Colombian resident lenders. The newly created deposit requirement established that an amount in Colombian Pesos equal to 40.0 percent of the amount disbursed under foreign currency denominated debt facilities (both in the form of loans and debt instruments, including proceeds from packaged debt instruments such as collateralized debt obligations) to Colombian borrowers by non resident lenders be deposited by the borrower in a non interest bearing account maintained with the Central Bank. This non interest bearing deposit matures six months after the date of disbursement. The funds must be delivered by the intermediary in the exchange market to which the issuer transfers the funds to the Central Bank within the following 24 hours of the disbursement of the debt facility. Pursuant to Resolution 18, of November 26, 2007, and External Circular DFV-113, of November 30, 2007, both issued by the Central Bank, the funds may be withdrawn subject to the following discounts: (a) six months prior to maturity, 5.72 percent of the amount of the deposit, (b) five months prior to maturity, 4.79 percent of the amount of the deposit, (c) four months prior to maturity, 3.85 percent of the amount of the deposit, (d) three months prior to maturity, 2.90 percent of the amount of the deposit, (e) two months prior to maturity, 1.94 percent of the amount of the deposit, and (f) one month prior to maturity, 0.98 percent of the amount of the deposit. This new deposit requirement makes access to foreign currency debt more difficult and more costly for Colombian borrowers than it has been in the recent past. [chart]

On June 15, 2007, the Central Bank issued Resolution No. 6 of June 15, 2007, which among other things extends the scope of the deposit requirement imposed by the Central Bank to international corporate reorganization transactions, including mergers, acquisitions and spin offs, if as a result of the transaction the successor is a Colombian resident that becomes liable for

the payment of foreign debt operations that would have otherwise been subject to the deposit requirement of Resolution No. 2 of May 6, 2007.

On November 26, 2007, the Central Bank issued Resolution No. 18 which, together with External Circular DFV-113, dated as of November 30, 2007 and also issued by the Central Bank, allows Colombian residents subject to the deposit requirement imposed on May 6, 2007 to comply with such 40 percent deposit by paying the equivalent applicable discount of 5.72 percent on the same date as the deposit obligation is constituted.

On October 9, 2008, the Central Bank issued Bulletin No.45 in which Article 83 of External Resolution 08 of 2000 was modified to reflect that the foreign investor requirement would be dropped to 0 percent. In other words the 40 percent requirement or encaje was lifted.

End Notes

1. Credit Suisse. Equity Research “Compartamos.” 16 July 2007.
2. Economist Intelligence Unit (2007), “Microscope on the Microfinance Business Environment in Latin America,” Economist Intelligence Unit, Inter-American Development Bank and the Corporación Adina de Fomento, September 2007.
3. Abate-Frajul, Francisco Jose (2005), “Changing Government Policy: The Experience of the Colombian Affiliates of Women’s World Banking,” Microfinance Matters, Issue 10. http://www.uncdf.org/english/microfinance/pubs/newsletter/pages/2005_03/news_changing.php
4. Abate-Frajul, Francisco Jose (2005), “Changing Government Policy: The Experience of the Colombian Affiliates of Women’s World Banking,” Microfinance Matters, Issue 10. http://www.uncdf.org/english/microfinance/pubs/newsletter/pages/2005_03/news_changing.php
5. Credit Suisse. Compartamos Research Note. 16 July 2007.
6. Presentation “WWB Colombia Foundation Bond Issue” by Rocio Cavazos, Women’s World Banking at the Chicago Microfinance Conference, April 21, 2006
7. “Microscope on the Microfinance Business Environment in Latin America,” Economist Intelligence Unit, Inter-American Development Bank and the Corporación Adina de Fomento, September 2007.
8. <http://www.mixmarket.org>
9. The growth rates of 2007 incorporate the flight of capital from emerging markets at the end of the year and compares with unprecedented year-on-year growth rates the previous year of 1674 percent and 314 percent, respectively. In 2006, due to the attractive rates in Colombia, the Colombian government issued substantially all of its external financing on the local Colombian markets, increasing the market cap from \$38.5 billion to \$683 billion in one year.
10. World Federation of Exchanges (2006, 2007), “Annual Report and Statistics 2006” and “Annual Report and Statistics 2007.”
11. World Federation of Exchanges (2006, 2007), “Annual Report and Statistics 2006” and “Annual Report and Statistics 2007.”
12. Bloomberg Long Term Foreign Debt Ratings, April 20, 2009.
13. According to the International Trade Center
14. World Federation of Exchanges (2006, 2007), “Annual Report and Statistics 2006” and “Annual Report and Statistics 2007.”
15. World Federation of Exchanges (2006, 2007), “Annual Report and Statistics 2006” and “Annual Report and Statistics 2007.”
16. Bolsa de Valores de Colombia (BVC) Informe Anual de Gestión 2007
17. <http://www.iht.com/articles/2007/08/27/business/bankcol28.php>.
18. This section has been prepared by Glorimari Vargas and Shawn Doyle of Cleary Gottlieb Steen & Hamilton LLC (Cleary) in consultation with Colombian legal counsel. and Mosquera Abogados Cleary is not engaged in the practice of law in Colombia. This section is intended as a general discussion of the issues herein. It is not and should not be regarded as legal advice. This section has been prepared with the understanding that prospective investors will seek local counsel before making an investment decision to in Colombia.
19. This section concerning tax regulations has been prepared by Shearman & Sterling LLP and Brigard & Urrutia Abogados, Colombia, and is intended only as a general discussion of tax issues. This section is not, and should not, be regarded as legal advice.
20. Fiducoldex-Fideicomiso Proexport Colombia (2009), Doing Business and Investing in Colombia, Vol. 1 — No. 1, April 2009.
21. Shearman & Sterling LLP gratefully acknowledges the contributions of Brigard & Urrutia Abogados, Colombia. This section has been prepared by Shearman & Sterling LLP and Brigard & Urrutia Abogados and is intended only as a general discussion of these issues. This section is, not and should not, be regarded as legal advice.
22. Article 1.2.1.1. of Resolution 400.
23. Article 1.2.4.68. of Resolution 400. However, relevant Colombian tax, foreign exchange and foreign investment laws would continue to apply to the issuance.
24. Article 1.2.4.72 of Resolution 400. For example, underwriters may undertake a traditional book-building process prior to the pricing of a securities issuance, rather than the auction that is required under Resolution 400.
25. For example, Decree 1026 (Decreto 1026 de 1990).
26. CSF Opinion 20005-605 of May 10, 2000; Opinion 20058-408 of August 23, 2005.

