



COSTA RICA: REVIEW OF THE FINANCIAL SYSTEM

December 2020

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REVIEW OF COSTA RICA BY THE COMMITTEE ON FINANCIAL MARKETS

This review of the financial system in Costa Rica was prepared by the OECD Committee on Financial Markets (CMF) as part of the process of Costa Rica's accession to the OECD.

The OECD Council decided to open accession discussions with Costa Rica on 9 April 2015. On 8 July 2015, the Council adopted a Roadmap for the Accession of Costa Rica to the OECD Convention [C(2015)93/FINAL] (hereafter "the Roadmap") setting out the terms, conditions and process for accession. The Accession Roadmap provides that in order to allow the Council to take an informed decision, Costa Rica underwent in-depth reviews by the relevant OECD committees, including the Committee on Financial Markets (CMF), which provided the Council with a formal opinion.

The CMF reviewed Costa Rica's financial system, including its market and regulatory structure, to assess whether it is market-oriented and sufficiently open, efficient and sound, based on high standards of transparency, confidence and integrity. This review presents the results of that assessment and highlights the significant reforms undertaken by Costa Rica to further align its practices with these standards.

This report was prepared by the Secretariat to support the examination of Costa Rica's position, and was finalised on the basis of information available as of July 2020. The Committee on Financial Markets has declassified this report on 27 November 2020.

Progress made by Costa Rica since the 2017 Review by the Committee on Financial Markets

Areas in which Costa Rica has made progress since its accession review by the Committee on Financial Markets in October 2017:

- Approved a legal reform to strengthen the independence of the Central Bank by eliminating the voting right of the Minister of Finance in the Board of Directors of the Central Bank and delinking the designation of the President of the Central Bank from the political cycle (Law No. 9670 which entered into force in March 2019).
- Approved a legal reform to allow banking services by branches of foreign banks, which has entered into force on 5 September (Law No. 9724).
- Abrogated the Law for Discouraging Foreign Capital Inflows (No. 9227).
- Reformed the lender of last resort function of the BCCR.
- Reformed the funding arrangements of the superintendencies by increasing the level of funding provided by supervised entities;

- Approved a bill of law that widens the supervisory perimeter of SUGEF and of the other superintendencies, to include consolidated supervision (No 9768).
- Reformed the legal protection framework for supervisors, ensuring that legal assistance is granted to supervisors and regulators by their institutions, and protecting former supervisors and regulators for activities undertaken while they held the position.
- Passed the necessary amendments to become a full signatory to the Multilateral Memorandum of Understanding (MMoU) of the International Organisation of Securities Commissions (IOSCO) in a law that reforms the Law Regulating the Securities Market that was approved by the Legislative Assembly in September 2019.
- Has taken action to strengthen corporate governance in state-owned banks, inter alia by implementing the Corporate Governance Regulation (Regulation No. 16-16) in all financial entities supervised by the financial superintendencies; approving Regulation on Suitability of Members of the Management Body and Senior Management of Financial Entities (Regulation No. 22-18) which establishes fitness and propriety requirements for senior management and boards of directors of all entities supervised by SUGEF; implementing the Action Plan on Corporate Governance for state-owned enterprises (SOEs) to address the recommendations of the OECD Working Party on State Ownership and Privatisation Practices (WPSOPP).¹
- Presented to the Legislative Assembly a draft bill of law on financial consumer protection to develop a framework for financial consumer protection, assisted by the World Bank; created an inter-institutional task force that comprises technical representatives with expertise on financial consumer protection from the Ministry of Economy, Industry and Trade, specifically the Office for Consumer Protection; the financial superintendencies, CONASSIF and the Central Bank that will be assessing the gaps in the legal framework and reforms necessary for Costa Rica to meet international standards and best practices in line with the G20/OECD High Level Principles on Financial Consumer Protection; prepared an Executive Decree that creates the National System for Consumer Protection, including a committee to discuss and coordinate the implementation of policy regarding financial consumer protection and education.
- Approved a bill of law that establishes a deposit guarantee fund and a bank resolution regime (Law 9816, voted on 6 February 2020 and which came into force on 12 February 2020).

¹ OECD (2020), Corporate Governance in Costa Rica (available at <http://www.oecd.org/publications/corporate-governance-in-costa-rica-b313ec37-en.htm>).

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I. Financial system: structure and operations

1. The Costa Rican financial sector is dominated by the *banks and other intermediaries sector (BFIS)*, with total assets of the BFIS sector standing at 91.25% of GDP as of 2019. Insurance sector assets were equal to 7.05% of 2019 GDP, securities sector assets 1.38% and pension fund manager assets 0.21% of 2019 GDP, respectively.

Table 0.1. Costa Rican financial system assets, 2013-19

Measured relative to GDP, in percentage

	2013	2014	2015	2016	2017	2018	2019
Banks and Financial intermediaries (BFIS)	83,10%	86,33%	89,39 %	93,01%	94,72%	93,97%	91,25%
Securities market	1,18%	1,15%	1,21%	1,17%	1,28%	1,35%	1,38%
National pension system (managers)	0,20%	0,18%	0,18%	0,18%	0,16%	0,17%	0,21%
Insurance market	6,60%	6,79%	6,65%	6,84%	6,86%	6,88%	7,05%
Total financial system assets	91,08%	94,45%	97,43%	101,19%	102,98%	102,36%	99,89%

Source: SUGEF, SUGEVAL, SUGESE, SUPEN.

A. Financial institutions and financial groups

2. BFIS comprises state-owned banks; banks created by special law (Banco Popular y de Desarrollo Comunal; Banco Hipotecario de la Vivienda); private banks; savings and loan cooperatives; savings and credit mutuals; non-bank financial companies; and other financial entities (such as Caja de Ahorro y Prestamo de la Ande – Savings and Loans Fund of the National Association of Educators).² Non-bank financial companies are allowed to take deposits and extend loans but they cannot offer current or savings accounts (Law 5044).

3. The BFIS is largely dominated by state-owned banks, which account for 35% of total BFIS assets as of March 2020, while the 11 private banks³ active in the country account for 33.1% of total BFIS assets and Banco Popular accounts for the remaining 14%. Among the private, Banco Bac San Jose is the largest bank by assets (11.1% of total BFIS assets), followed by Scotiabank de Costa Rica and Banco Davivienda (6.3% and 5.54% of total BFIS assets, respectively).

² A regulatory framework exists for the establishment of cooperative banks, but no such bank is currently operating in Costa Rica.

³ There were 12 private banks active in Costa Rica in 2016, Nova Scotia merged with Scotiabank in June 2018.

Table 0.2. Composition of the Banks and Other Financial Intermediaries (BFIS) sector in Costa Rica

	Number of participants		Composition of assets	
	2007	2020	2007	2020
State-own banks	3	2	44,9%	35,0%
Banks created by special laws	2	2	10,5%	11,8%
Private banks	12	11	29,8%	33,1%
National Housing System institutions	2	2	3,9%	3,6%
Savings and loan cooperatives	31	22	7,4%	10,7%
Non-bank financial companies	7	5	1,6%	1,2%
Other financial entities	1	1	1,8%	3%
Foreign-exchange houses	3	2	0,0%	0,0%
Total BFIS	61	47	100,0%	100,0%

Note: 2020 data as of 31 March.

Source: SUGEF.

4. The country experienced a credit boom during the period 2006-09, with credit growth of 30% p.a. driven by private consumption, housing and trade. In the early 2000s, the level of credit granted to the private sector increased from 21% to 45% of GDP. Credit growth slowed considerably in the period 2009-10 due to the national and international economic slowdown and has since recovered to more moderate growth rates of 12% p.a. on average in the period 2012-18, followed by a slowdown, recording a 0.4% growth rate as of 31 March 2020.

5. As of March 2020, state-owned banks accounted for 31% of the BFIS loan portfolio, while private banks generated about 35% of loans and the special-law bank Banco Popular y de Desarrollo Comunal (Banco Popular) 12% of total loans. Private banks are the main providers of foreign currency loans, with 71% of the total loan portfolio of private banks being extended in foreign currency (as of March 2020). The dollar-denominated deposits reached 65% of total deposits of private banks in the same month. Foreign currency lending by state-owned banks represented 30% of the total lending portfolio of state-owned banks and 32% of deposits in foreign currency, as of 2018.

6. Leasing services are provided by private banks (accounting balance of CRC 130.680,4 million as of March 2020) and specialised companies belonging to financial groups. State-owned commercial banks are also authorised to provide leasing services.

7. There are no restrictions on bank cross-sector investments in the financial sector for banks that are not part of a financial group or conglomerate, and Costa Rican banks are prohibited from engaging in non-financial activities.⁴ Banks belonging to a Costa Rican financial group (whether locally or foreign-owned) cannot participate in the capital of other financial or non-financial companies in Costa Rica (Article 146 of Law 7558, see Section II.D).

⁴ Article 73 of the Structural Law of the National Banking System. This prohibition does not apply to savings and credit cooperatives which may participate in the capital of non-financial companies up to a maximum 25% of their assets.

Table 1.3. Loan and deposit market shares in Costa Rica

	MARKET SHARE	
	LOANS	DEPOSITS
Banco de Costa Rica	12.8%	16.2%
Banco Nacional de Costa Rica	18.7%	23.5%
BANHVI	0.6%	0.0%
Banco Popular	11.6%	9.1%
Banco San Jose	12.4%	13.2%
Banco CMB	0.4%	1.7%
Banco General	1.1%	0.8%
Banco BCT	1.0%	1.2%
Banco Cathay	0.5%	0.6%
Banco Davivienda	5.7%	4.4%
Banco Improsa	1.1%	0.9%
Lafise	1.2%	1.6%
Prival Bank	0.4%	0.4%
Promerica	3.7%	3.6%
Scotiabank	7.2%	6.3%
Cooperatives	11.3%	9.8%
Other	10.4%	6.9%
TOTAL	100.0%	100.0%

Source: SUGEF, as of March 2020.

Dollarisation of the financial system

8. High dollarisation is one of the primary characteristics and risks of the Costa Rican financial system. As shown in Figure 1, about 50% of private deposits are denominated in foreign currency, mostly with private domestic and foreign banks. This has historically led to higher intermediation spreads, high market segmentation and weakened monetary policy transmission⁵. Similarly, about 40 percent of credit to the non-financial private sector in Costa Rica is denominated in foreign currency, and over 70 percent of such credit is extended to unhedged borrowers. This high dollarisation of credit in Costa Rica has amplified credit growth volatility due to the pass-through of exchange rate changes, and created a currency-induced credit risk in the financial system. As a result of a Central Bank shift toward greater exchange rate flexibility since the second half of 2018, credit has tilted toward local currency-denominated loans (1.0 year-on-year growth rate for local currency-denominated loans vs. 1% reduction for foreign currency-denominated loans, as of March 2020), reducing the high levels of bank loan dollarisation (see also paragraph 182 for measures taken to reduce dollarisation). High dollarisation generates systemic risks, solvency risks and liquidity risks in the banking system.⁶ Such risks stem from BCCR's limited capacity to be a lender of last resort in providing dollar liquidity, and with solvency risk linked to USD credits held by unhedged borrowers who are non-generators of dollars and who may be unable to reimburse their debt in case of a sudden depreciation of the colón. This would, in turn, significantly undermine the quality of the banking sector's credit portfolio.⁷

⁵ IMF (2016), Costa Rica: selected issues and analytical notes, 23 May.

⁶ IMF (2018), Costa Rica: Financial Sector Stability Review, IMF Country Report No. 18/80, April.

⁷ Idem.

Figure 1.1. Costa Rica: structure of the financial system as of March 2020

	#	Total Assets		Market Share Percent	Total Liabilities		Deposit	
		Billions of Colones	Percent of GDP		Billions of Colones	Percent of GDP	Percent of GDP	Domestic Currency (Percent of Total)
Banks	14	27,251	77	80	23,958	67	53	50
State owned banks	3	15,957	45	47	13,892	39	31	66
Domestic private banks	2	738	2	2	648	2	1	23
Foreign private banks	9	10,557	30	31	9,418	27	21	29
Non-Bank FI	33	6,762	19	20	4,942	14	11	92
Total	47	34,013	96	100	28,900	81	64	52

Source: BCCR.

9. High levels of dollarisation are attributed to the legacy of high inflation rates in the early 1980s, and still-high and predictable inflation during the crawling peg exchange rate regime (1983 to 2006). Over the last decade, deposit and credit dollarisation have decreased, given the improved monetary policy framework and greater exchange rate volatility (floating exchange rate regimes) in Costa Rica.

10. There has been an increase in foreign bank liabilities, particularly after the global financial crisis, due to the availability of cheaper foreign currency funding for banks, and the high liquidity in foreign markets. More recently, with the increase in uncertainty about the fiscal situation and a fall in the premium on local currency instruments, there has been a slight reallocation of savings into foreign-currency financial instruments.

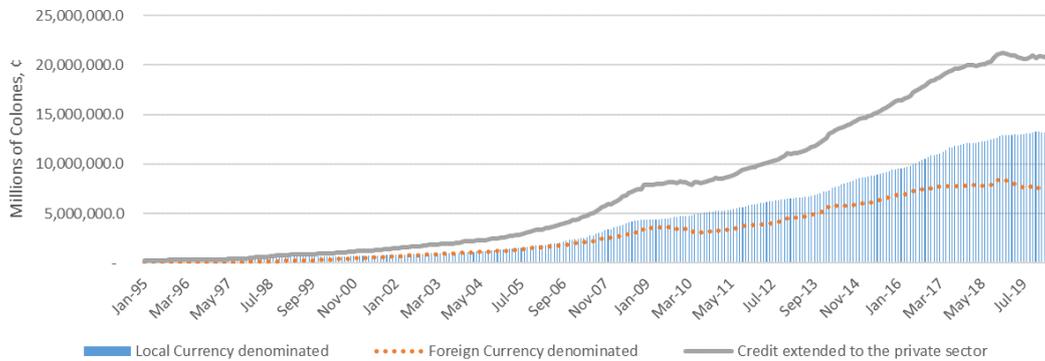
11. Notwithstanding the overall long FX position of the banking system, a large depreciation of the colón may affect asset quality, given the large segments of unhedged FX liabilities in the household and corporate sectors. Given low profitability and heavy dollarisation of the banking system, financial stability could be jeopardised by substantial currency depreciation and higher non-performing loans (NPLs). Costa Rican authorities have acknowledged that currency mismatches in the private sector pose a key risk to financial stability. Both the proportion of foreign currency credit over the total credit extended to the private sector and its growth rate are financial stability risks that BCCR is monitoring, both from the banks' perspective but also from the borrowers' perspective, as most borrowers do not have their main source of income in foreign currency (non-generators of dollars, as defined by SUGEF).

Figure 1.2. Evolution of private savings in foreign currency as a proportion of total savings (LHS) and year-on-year inflation (RHS) in Costa Rica, 1995-2020



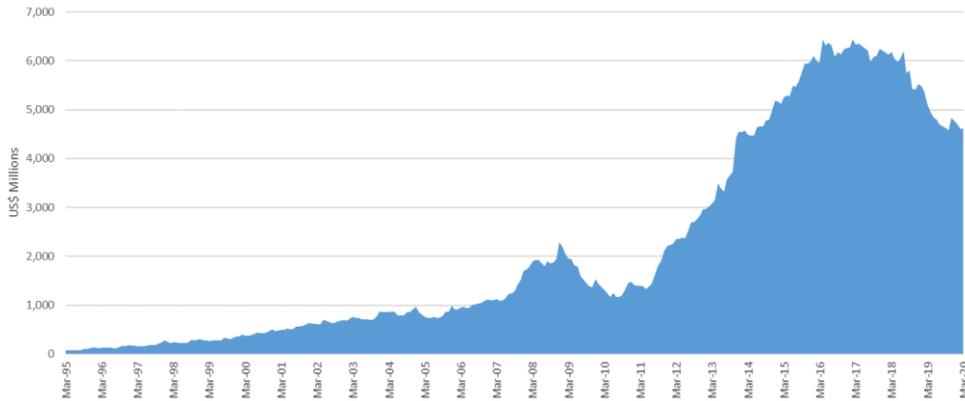
Source: BCCR.

Figure 1.3. Evolution of credit extended to the private sector in colon and foreign currency and total private sector credit evolution in Costa Rica, 1995-2020



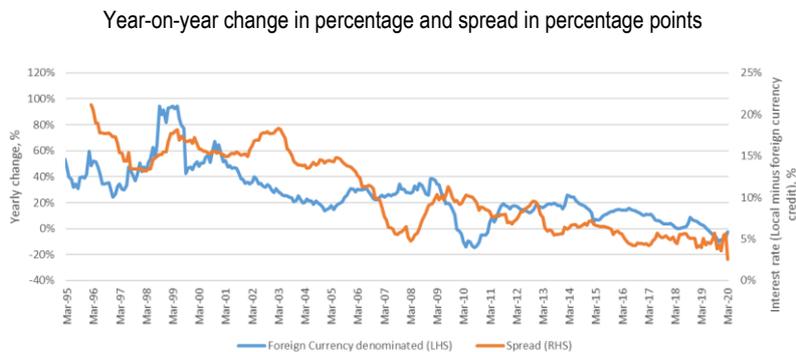
Source: BCCR.

Figure 1.4. External liabilities of commercial banks in foreign currency, 1995-2020 (in USD million)



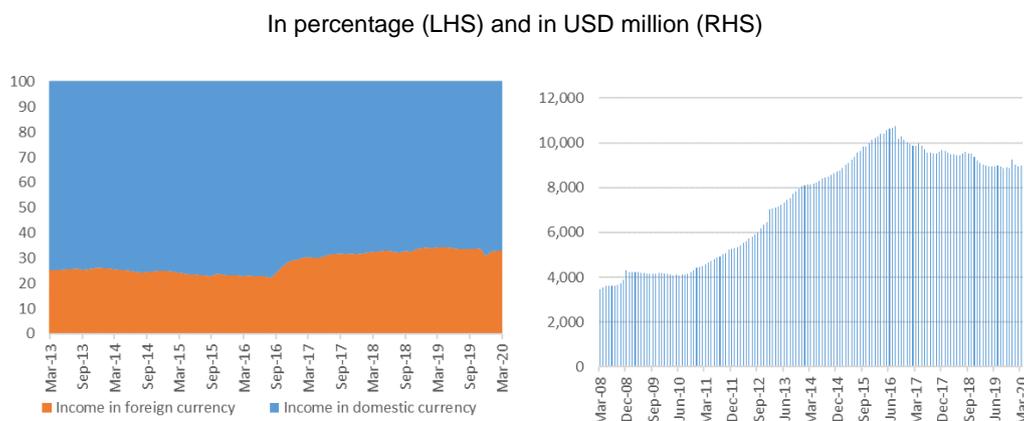
Source: BCCR.

Figure 1.5. Yearly change in foreign currency credit to the private sector (LHS) and spread between interest rate applied to local and foreign currency credit (RHS)



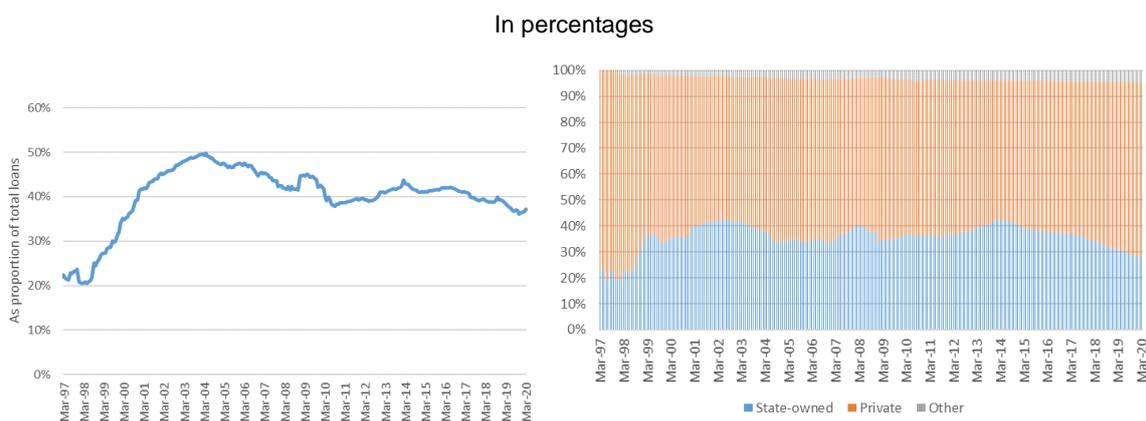
Source: BCCR.

Figure 1.6. Composition of foreign currency credit to the private sector by borrowers' source of income and level of unhedged FX borrowing



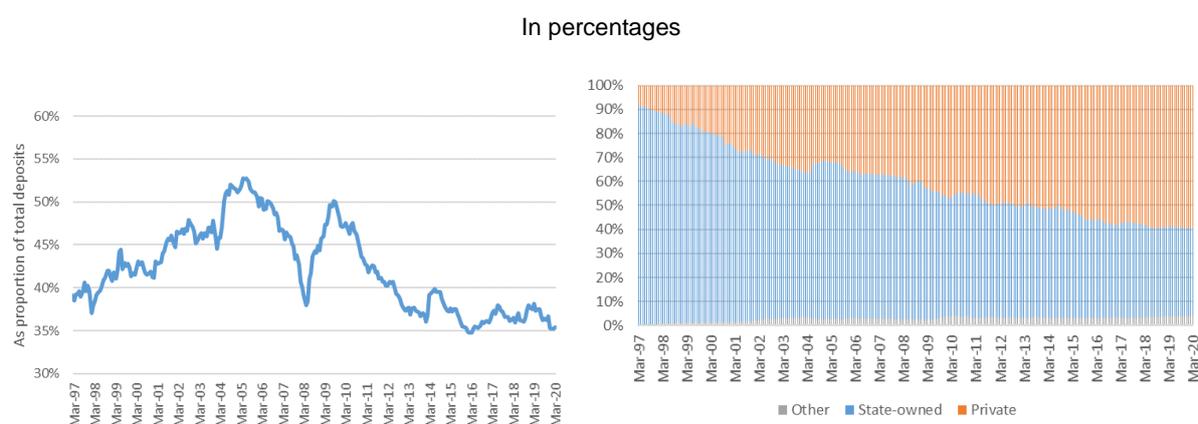
Source: BCCR.

Figure 1.7. Foreign currency-denominated loans in Costa Rica and breakdown by holder



Source: BCCR.

Figure 1.8. Foreign currency-denominated deposits in Costa Rica and breakdown by holder



Source: BCCR.

Figure 1.9. Foreign currency funding of the Costa Rican banking system

Foreign currency liabilities as a percentage of total [LHS] and financial system FX liabilities in USD million [RHS]



Source: BCCR.

12. High net foreign liabilities of banks, growing household leverage and sovereign exposures represent other vulnerabilities of the financial sector. After a period of large bank borrowing abroad to fund the rapid growth of FX credit to residents, Costa Rica is among the countries in the region with higher reliance on foreign bank funding, raising concerns about rollover risks. Indeed, IMF staff analysis⁸, based on network model simulations of spill-overs from asset quality and capital shocks in international banks, suggests that reduced foreign bank funding could lead to a significant reduction of credit in Costa Rica.

B. State-owned financial institutions and banks created by law

13. There are currently two state-owned banks operating in Costa Rica: Banco Nacional de Costa Rica and Banco de Costa Rica. Banco de Crédito Agrícola de Cartago or Bancrédito, representing three percent of total bank assets in 2015, is no longer active in retail banking following its failure in July 2017 (see Box 3, Section IV.C.).

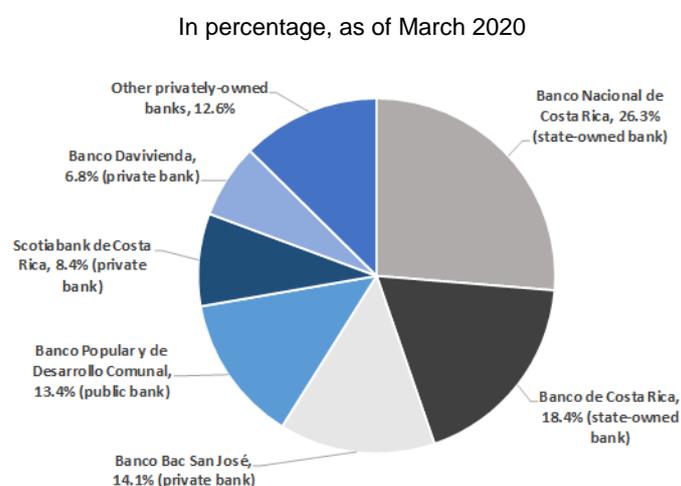
⁸ IMF (2016), Costa Rica: selected issues and analytical notes, 23 May.

14. In addition, there are two non-state public banks created by law: Banco Popular y de Desarrollo Comunal and Banco Hipotecario de la Vivienda (BANVHI):

- Banco Popular y de Desarrollo Comunal (Banco Popular) manages the funds of the mandatory contributions made by employers (0.5% of wages) and employees (1.0% of wages) pursuant to Law 4351 (*Ley Orgánica del Banco Popular y de Desarrollo Comunal*). All deposits made at Banco Popular are tax exempt (see Section IV.C).⁹
- BANVHI is the lead agency and governing body of the National Housing System created by Law 7052 and is allowed by law to operate only as a second-tier bank. BANVHI is covered by an unlimited and subsidiary state guarantee and provides a counter-guarantee to mutual savings and loan associations.

15. Private banks operating in Costa Rica must transfer funds to the state-owned commercial banks which manage the Credit Fund for Development (*Fondo de Crédito para el Desarrollo*), corresponding to a 17% of their 30-day or shorter-term deposits (in both CRC and foreign currency), if they have not opened agencies or branches in certain areas listed in the law, or have a mandatory credit portfolio equivalent to 10% of deposit of 30-day or less, in local or foreign currency, when having those agencies or branches. Such funds are lent to state-owned banks¹⁰, are remunerated at an interest rate equal to 50% of the basic deposit rate set by BCCR or the monthly LIBOR rate for foreign currency denominated deposits, and are used to fund programmes of the System of Banking for Development (SBD, see Box 2). According to Costa Rican authorities, this policy, set forth by article 59 of Law 1644, was created to ensure and strengthen the placement of credits to the small and medium-sized enterprises sector.

Figure 1.10. Breakdown of banking sector assets in Costa Rica



Source: SUGEF.

⁹ According to Law 9635, (Strengthening of Public Finances) Transitory XXII and for the effects of article 31 of Title II, capital gains generated by securities issued by the Banco Popular during the first year, will have a tax rate of 7%, which will increase one percentage point each year, until it reaches 15%.

¹⁰ Banco Nacional de Costa Rica and Banco de Costa Rica.

16. Those banks wishing to establish agencies or branches, instead of transferring the 17% levy, have to establish at least four agencies or branches providing basic banking services (lending and borrowing) in certain rural regions. In addition, they are required to maintain a minimum balance equivalent to 10% of their total 30-day or shorter-term deposits (in both CRC and foreign currency) in credits for programmes determined by the Governing Council of the SBD, placed at a rate no higher than the basic deposit rate set by BCCR or the monthly LIBOR rate. Currently, only BAC San Jose, BCT and Improsa have chosen to open agencies or branches instead of transferring reserves¹¹.

17. State institutions and state-owned enterprises can only make deposits and current account transactions and savings through state-owned commercial banks, thus enabling easy access to funding for the latter (Article 118 of Law 1644). According to Costa Rican authorities, the services provided by each state-owned commercial bank are defined according to each bank's own business strategy without state intervention.

18. Up until 2019, the fiduciary of the Fideicomiso Nacional para el Desarrollo (FINADE), one of the funds of the SBD, had to be a state-owned bank, selected through a public bid process open only to state-owned banks (Law 9274 Reforma Integral de la Ley Sistema de Banca para el Desarrollo). Law 9654 established that, from 2020 onwards, FINADE will become a 'Development Fund' and there will be no need for a public bid process for the selection of its fiduciary. Trust agreements of the Fondo Nacional de Telecomunicaciones (FONATEL) are only signed with state-owned banks (Law 8642 Ley General de Telecomunicaciones).

19. State-owned banks can be used for the achievement of policy objectives and their involvement may be explicitly required in infrastructure development and SME lending.¹² Some operations of state-owned banks fall under the National Development Plan (PND)¹³ which mandates they fulfil certain development objectives.

20. However, there have been cases where banks have contested the request of the state to direct lending to specific institutions or to finance infrastructure projects. For example, in late 2015 and early 2016 when the Ministry of Public Works invited a group of private and SOE banks to take part in a syndicated loan for the construction of a highway from San José, the capital, to San Ramón. The National Bank of Costa Rica did not participate in the syndicate, citing risks arising from insufficient clarity regarding the investment and insufficient technical and financial analysis.

21. The state gives an unlimited guarantee to state-owned banks' liabilities¹⁴. Article 4 of the Structural Law of the National Banking System establishes that *"the banks of the State will possess the guarantee and the most complete cooperation of the State and of all its dependences and institutions. The State guarantee established in this article shall not apply to subordinated financial instruments or subordinated loans issued*

¹¹ These requirements are known as "*peaje bancario*" or "banking toll".

¹² According to the Corporate Governance Accession Review of Costa Rica against the OECD Guidelines on Corporate Governance of State-Owned Enterprises [DAF/CA/CG/ACS(2016)9/REV3]: *"Despite the fact that SOE banks are generally seen to be able to act with autonomy, the social policy goals of the State are reflected in the cost of lending and the credit allocation process with lending channelled to different types of clients such as SMEs."*

¹³ Each new government develops its own 4-year PND which it uses to guide its development strategies and to assess outcomes. The overall direction is set by the President while line ministries (with other relevant sectoral institutions) set supporting goals.

¹⁴ No state guarantee is extended to cooperative and private banks or the Banco Popular.

or contracted by the state-owned commercial banks, nor to the obligations or rights emanating from them (...)". According to opinion C-024-2004 of 20 January 2004 of the Attorney General's Office, this state guarantee covers passive banking operations and its quantitative limit is set by the solvency of the State itself. According to the same opinion, such guarantee is covering crisis situations which prevent the normal operation of a state-owned bank and, by consequence, is not a guarantee against any type of default by the bank¹⁵.

22. State-owned banks are subject to a 30% income tax from their profits. Fifty percent of their after-tax profits are used to increase the banks' legal reserves and 10% is used to increase the capital of the National Institute of Cooperative Development (INFOCOOP). The remaining profits are used to increase the banks' capital.

23. State-owned banks are subject to the following *parafiscal* contributions to a number of other state funds, with such contributions being applied on net income and expensed in the income statement.¹⁶ These contributions go to, in addition to the National Institute of Cooperative Development (*Instituto Nacional de Fomento Cooperativo*) (10%), the National Commission for Education Loans (*Comisión Nacional de Préstamos para Educación*—CONAPE) (5%), the National Commission of Risk Prevention and Emergency Response (*Comisión Nacional de Prevención de Riesgos y Atención de Emergencias*—CNE) (3%) and The Regime for Disability, Old Age and Death (*El régimen de Invalidez, Vejez y Muerte*—IVM) (15%). These transfers go directly to the relevant institutions and do not pass through the state budget.

24. In addition, state-owned banks are required to hold a significant portion of their capital in bonds issued by the Ministry of Finance. These may be purchased either directly or through the market.

25. There is conflicting evidence on the efficiency of state versus private banks in Costa Rica, especially after the opening of the banking market to competition in the early 1990s. However, the Costa Rican banking sector as a whole is deemed less efficient when compared internationally, and that the dominance of SOE banks within the banking sector appears to be dampening competition overall (OECD, 2016).

26. In order to increase state-owned bank efficiency, the government issued a directive instructing state-owned banks to cut their administrative expenses so as to improve their efficiency indicator¹⁷ by 15% and their intermediation margin¹⁸ by at least one percentage point by 2018 (Directive 035-H of 27 October 2015), and increase the diversification of their credit portfolio to reduce their risk. State-owned banks have not been able to meet the goal of reducing their efficiency indicator by 3.75% or the financial intermediation margin by 0.33% per year; on the contrary, many of them have actually increased them according to Costa Rican Authorities. In April 2019, Directive N° 045-MH-MCEE established new provisions to improve banking efficiency and financial inclusion for natural persons and SMEs, by (i) improving the efficiency indicator over a period of four years until reaching progressively the 52% goal by the end of 2022, so that it converges to the standards of the most efficient private banks in the country. Currently, this indicator is 63.86% (BN) and 69.53% (BCR); (ii) gradually reducing by a percentage point the margin of intermediation

¹⁵ This conclusion has been ratified by opinion C-349-2008 dated 25 September 2008.

¹⁶ Banco Popular is not required to contribute to CONAPE and the National Emergency Fund at the same level as state-owned banks. BANCVHI contributes 3% of its profits to the National Emergency Fund. Private banks contribute 5% to CONAPE.

¹⁷ Efficiency ratio defined as the ratio of personnel expenses plus overheads over the gross operating result for the last 12 month period.

¹⁸ Financial intermediation margin defined as the difference between the ratio of loan income over the balance of loans over a 12-month period and the ratio of expenses for intermediation liabilities (loans) over the balance of such intermediation liabilities over a 12 month period.

of loans in CRC over the next four years, which implies an annual reduction of 0.25%; and (iii) eliminating the gap between the financial intermediation margin in dollars and the dollar margin of the most efficient private banks in the country. The Directive applies only to state-owned banks.

27. At present, board membership in state-owned enterprises is limited to individuals of Costa Rican nationality.

28. A new Corporate Governance Regulation (Regulation No. 16-16) was approved by CONASSIF in December 2016 covering the entire financial sector, including state-owned banks. This principle-based regulation establishes requirements that will increase the fit and proper requirements of the BoD and senior management of financial entities (skills, competences, knowledge, experience and integrity necessary to manage and supervise the businesses and activities under their responsibility), while it also addresses accountability mechanisms for the board and management of financial institutions. The new CONASSIF Governance Regulation, if effectively implemented, will bring Costa Rica largely in line with the G20/OECD Principles of Corporate Governance.¹⁹ The regulation is mandatory.

¹⁹ Recommendation of the Council on Principles of Corporate Governance [C(2015)84].

Box 1. The Development Banking System of Costa Rica (SBD)

The Development Banking System (SBD) of Costa Rica was created in May 2008 through the enactment of Law on the Development Banking System No 8634 and its reforms, aiming to benefit micro, small and medium-sized enterprises.

SBD is not a bank, but a mechanism of system-wide coordination, including financial intermediaries (state and private banks, credit and savings cooperative, mutual banks and loan providers), and microfinance entities. Its main function is to channel resources towards financial operations authorised by the Governing Council, with the objective of financing and promoting productive and viable development projects (e.g. SMEs, entrepreneurs, specific geographic regions, etc.). Credit allocation towards SBD beneficiaries is mandatory for state-owned banks through FOFIDE and for private commercial banks through FCD or CREDES.

The SBD has four funds governed by the provisions issued by the Governing Council of SBD: (i) FINADE (own fund managed through a fiduciary and divided into a fund for financing, a guarantees fund, a seed capital fund and a fund for non-financial services and business development); (ii) FOFIDE (owned and operated by the state-owned banks); (iii) FCD (owned by private banks and lent to state-owned banks as per requirement for operation); and (iv) CREDES (owned and managed by private banks).

In the case of the funds owned by private banks, FCD is capitalized through a special mandatory transfer of funds corresponding to 17% of deposits of 30-day or less, in CRC or foreign currency by all private banks which have not opened agencies or branches in certain areas listed in law 7558. These funds must be transferred to a state-owned bank in accordance with the dispositions set by the Governing Council. For CREDES, private banks with agencies or branch presence in such specified areas are required to constitute a credit portfolio equivalent to 10% of deposit of 30-day or less, in local or foreign currency, allocated to SBD beneficiaries.

SBD is governed by a five-member Governing Council, comprising two government ministers, two representatives of the industrial and agricultural sectors and an independent member. Execution, coordination and implementation of projects are supported by a Technical Secretariat which has its own legal personality and assets and is managed by an Executive Director. The Technical Secretariat has 40 staff members and is divided into four directorate-generals: (i) Operations and Finance; (ii) Commercial Division and Promotion of Development; (iii) Risk; and (iv) Digital Strategy.

The Governing Council and the Technical Secretariat have a Code of Corporate Governance and a strategic plan for the fulfilment of their mandates, and have the power to issue policies and guidelines of compliance by participating entities of the SBD and carry out interventions in specific cases (e.g. the disbursement of financing in special programs when national emergencies occur due to climatic events).

The Law on the SBD was reformed through Law 9274 and its Regulations, enacted in 2014/20. As part of the reform to the Law of the SBD, SUGEF issued in 2016 Regulation 15-16, laying down specific guidelines for the participation of supervised financial intermediaries in the SBD. According to this regulation, operations performed under the SBD by supervised entities are not exempt from CONASSIF requirements in the areas of corporate governance, risk management, countercyclical estimates, accounting and auditing standards, provisions on limits on active operations, regulation on disclosure of information and publicity of financial products and services, among others. It also includes provisions for the calculation of capital requirements for such operations.

In February 2019, a new legal reform for SBD was enacted, Law 9654. In this new law, one of the main changes for SBD is eliminating the FINADE with a public bank as fiduciary and converting it into a Fund managed by the Technical Secretariat of SBD (FONADE). FONADE will allocate resources towards financing, guarantees, seed and venture capital and other non-financial services and business development.

Source: Costa Rican authorities.

29. State-owned financial institutions dominate the non-bank financial intermediary and securities markets. State-owned investment fund management companies represent 56.2% of total net assets and 77.14% of total accounts in the market. Brokerage houses belonging to state-owned financial conglomerates conduct 55.2% of the buying and selling operations in the primary and secondary markets. Similarly, 82%

²⁰ Regulations to Law 9274, Regulation on Credit Management and Evaluation for the Development Banking System (SUGEF 15-16 Agreement), and the Operating Regulations on the first and second floor credit activity of banks participating in the SBD.

of securities held in custody are held by custodians (e.g. banks, brokers) belonging to a state-owned financial group.

Competition in the banking sector and foreign participation

30. Costa Rica's banking sector opened to competition in 1995, with the elimination of the state-owned banks' monopoly on current and savings accounts. State-owned banks and non-state public law banks still largely dominate the market, with the two state-owned banks and Banco Popular accounting for 58% of total banking system assets and 55% of total banking sector loans, as of March 2020. Foreign-owned banks account for the lion's share of private banking activity, representing more than 93% of privately-held assets and loans extended by private banks.

31. Costa Rican authorities have indicated that segmentation in the banking market exists between privately-held and state-owned banks, which could be reducing the incentive to compete. They claim that private banks operate mostly in deposits and credits in dollars, while SOE banks operate in colones.

32. There are no restrictions in the participation of foreign investors in banks incorporated in Costa Rica. According to Law 1644, non-residents who wish to conduct banking activities in Costa Rica must incorporate a subsidiary in the form of a sociedad anónima and obtain authorisation from SUGEF. Currently, branching by non-resident banks is not permitted in Costa Rica. Following the Accession Review of Costa Rica by this Committee and the Investment Committee, and its recommendation to Costa Rica to further relax restrictions for the establishment of bank branches by foreign banks, Costa Rica decided to allow the provision of banking services in Costa Rica by branches of foreign banks. Accordingly, a law modifying Law 1644 was adopted by the Legislative Assembly on 30 July 2019. In addition, the Costa Rican authorities prepared an action plan for the implementation of this reform (see Annex VI).

Table 1.4. Concentration in the Costa Rican banking sector

Bank	Source of Capital	Main Shareholders	Shareholder of main shareholder	Part of a conglomerate
Banco de Costa Rica	State-owned	State of Costa Rica (100%)		
Banco Nacional de Costa Rica	State-owned	State of Costa Rica (100%)		
Banco Hipotecario de la Vivienda	Non-state public law institution			
Banco Popular y de Desarrollo Comunal	Non-state public law institution			
Banco BAC San José S.A	Private capital, foreign	BAC International Bank Inc. (Panama)	Grupo Aval Acciones y Valores S.A. (Colombia)	Yes
Banco BCT S.A.	Private capital, local	Corporacion BCT S.A. (Costa Rica)	Privately held	Yes
Banco Cathay de Costa Rica S.A.	Private capital, foreign	Privately held	Privately held	No
Banco CMB (Costa Rica) S.A.	Private capital, foreign	Privately held	Privately held	No
Banco Davivienda (Costa Rica) S.A.	Private capital, foreign	Banco Davivienda (Colombia)	Grupo Bolivar S.A. (Colombia)	Yes
Prival Bank (Costa Rica) S.A.	Private capital, foreign	Prival Bank (Panama)	Privately held	Yes
Banco General (Costa Rica) S.A.	Private capital, foreign	Fideicomiso de Crédito Banco General Costa Rica	Privately held	No
Banco Improsa S.A.	Private capital, local	Grupo Financiero Improsa S.A. (Costa Rica)	Privately held	Yes
Banco Lafise S.A.	Private capital, foreign	Privately held	Privately held	Yes

Banco Promerica de Costa Rica S.A.	Private capital, foreign	Privately held	Privately held	Yes
Scotiabank de Costa Rica S.A.	Private capital, foreign	Bank of Nova Scotia (Canada)	Institutional investors (51%)	Yes

Note: (1) Former Citibank Costa Rica, acquired by Scotiabank Costa Rica on February 2016, renamed and integrated as a subsidiary of Grupo Financiero BNS de Costa Rica.

Source: Factset, Thomson Reuters Eikon. Information about shareholdings cannot be disclosed by SUGEF.

33. BCCR has mentioned in its Macroeconomic Programs as well as in research documents that the domestic banking sector shows reduced competition that has led to higher intermediation margins and lack of responsiveness to movements of the monetary policy rate, affecting the economic performance of the country negatively. The Central Bank has promoted the improvement in the levels of efficiency in the state-owned banks and better credit allocation. However, there is no specific Central Bank policy related to competition in the financial sector.

C. Savings and credit cooperatives and mutuals

34. There are 22 savings and credit cooperatives active in Costa Rica as of March 2020 and two mutuals (Alajuela La Vivienda Mutual Group of Savings and Loan and Cartago Mutual of Savings and Loan), with mutuals focusing on mortgages as part of the National Housing System. Although the number of cooperatives declined from 31 in 2007, the sector increased its share in total BFIS assets from 7.4% in 2007 to 10.7% in March 2020. Based on their credit portfolio, the cooperative sector represents 11.3% of the BFIS, as of March 2020.

35. Savings and credit cooperatives may carry out all lending and deposit operations for which they are authorised by the Law Regulating the Financial Intermediation by Cooperatives (N° 7391). Prior authorisation by SUGEF is required and is only granted upon compliance with all the requirements prescribed by the law. The difference between a cooperative and a mutual is that mutuals are part of the National Housing System for Housing Operations and primarily provide mortgages.

36. Savings and credit cooperatives can only carry out financial intermediation operations with their members, except those cases where the law expressly permits them to carry out transactions with non-member third parties.

37. Contagion stress tests performed by BCCR have shown that exposure of banks (assets side of the balance sheet) to the cooperative sector is significant for some small and medium private banks, which could have a negative bearing on their solvency ratio.

38. Law 7391 allows associates to withdraw their contributions whenever they want, creating concerns around capital and leverage in the credit union sector. Cooperatives can nevertheless establish limits in their statutes for the withdrawal of contributions by members.²¹

D. Financial groups

39. A holding company must be established for a financial group to be able to hold different financial entities in its structure (Law 7558)²². The holding company has to be a corporation whose sole purpose is to

²¹ According to Law of Cooperative Associations No. 4179, Savings and Credit Cooperatives may regulate the statutory exercise of the right of withdrawal, without prejudicing the right of associates to withdraw.

²² In the case of savings and credit cooperatives, the holding company can be an organisation with the same cooperative nature (article 141 of Law 7558).

acquire and manage shares issued by the companies of the group. Prior to the accession review process of Costa Rica, the holding company was required to own at least 25% of the subscribed capital of each entity in the group. This requirement was thereafter eliminated with the entry into force of Law 9768 (November 2019). State-owned banks are excluded from such restrictions and, as such, can control financial conglomerates without a holding company structure, as the state-owned bank itself acts as a holding company. Financial groups controlled by non-regulated companies are not allowed in Costa Rica.

Table 1.5. BFIS financial groups and conglomerates in Costa Rica

Financical group/ conglomerate	Ownership (private vs. state-owned and local vs. foreign ownership)	Assets (in CRC billion)	Market share (by assets)
Conglomerado Financiero Banco de Costa Rica y Subsidiarias	State-owned	4 896.8	15.9%
Conglomerado Financiero Banco Nacional de Costa Rica y Subsidiarias	State-owned	7 121.2	23.2%
Conglomerado Financiero Banco Popular y de Desarrollo Comunal y Subsidiarias	Non-state public law institution, local	3 536.4	11.5%
Conglomerado Financiero Caja de Ahorro y Préstamos de la ANDE	Private, local	1 422.1	4.6%
Conglomerado Financiero Group Mutual Alajuela – La Vivienda de Ahorro y Préstamo y Subsidiarias	Private, local	805.9	2.6%
Grupo Financiero Alianza	Private, local	545.6	1.8%
Grupo Financiero BAC Credomatic	Private, foreign	3 595.4	11.7%
Grupo Financiero BCT	Private, local	338.4	1.1%
Grupo Financiero BNS de Costa Rica	Private, foreign	2 093.8	6.8%
Grupo Financiero Cafsa	Private, local	85.1	0.3%
Grupo Financiero Cathay	Private, foreign	167.7	0.5%
Grupo Financiero Citibank	Private, foreign	393.7	1.3%
Grupo Financiero Coocique	Private, local	256.4	0.8%
Grupo Financiero Coopenae	Private, local	823.3	2.7%
Grupo Financiero Davivienda	Private, foreign	1 782.5	5.8%
Grupo Financiero Improsa	Private, local	368.7	1.2%
Grupo Financiero Lafise	Private, foreign	479.3	1.6%
CS Grupo Financiero	Private, local	691.4	2.3%
Grupo Financiero GMG Sociedad Anónima	Private, local	61.0	0.2%
Grupo Financiero Prival	Private, foreign	142.8	0.5%
Grupo Financiero Promérica	Private, foreign	1 112.9	3.6%
Total		30 720.4	100.0%

Source: Costa Rican authorities, as of March 2020.

40. According to SUGEF's Agreement 8-08, the banking superintendence (SUGEF) is the supervisor of financial groups or (industrial) conglomerates that include a financial intermediary (credit institution) domiciled in Costa Rica. Prior to the accession review process of Costa Rica, groups with no financial intermediary domiciled in Costa Rica were supervised by the superintendence supervising the financial entity with the highest volume of assets. Following the reform introduced through Law No. 9768 (which modified article 140bis of Law No. 7558), the responsible supervisor for the financial group shall be the supervisor who supervises the entity with the highest amount of total assets or the highest amount of net assets under its management, depending on the nature of their operations, except when a special law states the responsible supervisor. Regarding the entities supervised by other superintendencies in the country, the individual supervision of these entities will be carried out by the supervisor of the entity according to the respective special legal frameworks. Where supervisory actions or orders issued by the supervisor responsible for the group or conglomerate, concerns or affects entities individually supervised by other national or foreign superintendencies, the actions shall be carried out in a coordinated manner, through active participation in

Supervisors' Colleges of financial groups, the signing and execution of memorandums of understanding (MoUs) with authorities of other countries, and the gathering and exchange of information and coordination of supervisory actions through the Consolidated Supervisory Committee. In addition, there are also supervisory procedures which include coordination actions among the supervisors of the national financial system. For authorisations of financial groups supervised by different supervisors, the supervisor-in-charge coordinates with the other supervisors involved for documentation, information and approval required for the authorisation process.

41. Prior to the accession review of Costa Rica by the Committee on Financial Markets, there was no legislation in Costa Rica allowing for consolidated supervision of financial groups, with the exception of state-owned financial conglomerates whose holding company must be a state-owned bank and whose supervisor is therefore SUGEF, both in their capacity as individual institutions and as holding companies. A bill of law on Cross-border and Consolidated Supervision of Banking Group (Law No. 21355) was presented to the Legislative Assembly on 23 April 2019, was approved by the Special Commission of the Legislative Assembly on OECD matters²³ on 2 September 2019, voted by the Plenary on 16 October 2019 and entered into force on 4 November 2019 (see Section IV.B).

42. According to Article 141 of Law 7558, financial groups cannot include non-financial institutions in the group. As an exception, the financial group may have one or several corporations that own or manage the group's goods, chattels and real estate. In addition, according to Article 146 of Law 7558, entities that participate in a financial group cannot participate in the capital of other financial or non-financial companies.²⁴ Entities that are part of financial groups are also prohibited from carrying out transactions between them under conditions that are different from those applied in their normal operations with independent third parties (see Section IV.B).

43. Subsidiaries of Costa Rican Financial Groups abroad were not authorised to carry out any operations or payment services in colones (Law 7558, Article 147). The measure was created in 1995 for market transparency purposes and to counteract irregular operations performed in the past by subsidiaries abroad as part of Costa Rican financial groups, which are not subject to monetary control by Costa Rica's Central Bank or to supervision by national superintendencies. Following the Accession Review of Costa Rica by the Investment Committee, the Committee invited the Costa Rican authorities to consider modifying or eliminating this restriction. Costa Rica considered that thanks to modernisation efforts in improved supervision, the measure was no longer necessary from a prudential point of view and eliminated this restriction. The abrogation of the specific legal provision was included in the Bill of Law on Cross-border and Consolidated Supervision of Banking Groups, which was presented to the Legislative Assembly on 23 April 2019, was approved by the Special Commission on 2 September 2019 and is currently pending debate, voted by the Plenary on 16 October 2019 and entered into force on 4 November 2019.

44. Four financial groups are currently active in the securities sector of Costa Rica, and fall under the supervision of the securities superintendency (SUGEVAL).²⁵

²³ The Special Commission for OECD Affairs was established in September 2018 and became fully functional in the third quarter of 2018. The Commission operates like other parliamentary commissions and reviews OECD-related bills in order to help expedite their adoption.

²⁴ Investment companies are exempt from such provision pursuant to the law regulating the stock market. In the case of state-owned commercial banks, the activity of these banks must comply with the legal framework that regulates them (e.g. the administration of IMAS, the state entity that operates airport duty-free shops, was previously undertaken by Bancrédito, a state-owned bank, which has been merged with Banco de Costa Rica in 2018).

²⁵ The state-owned National Insurance Institute (INS) financial group, mainly active in insurance, has activities in investment funds and securities services.

Table 1.6. Financial groups in the securities market of Costa Rica

Financial group/ conglomerate	Ownership	Other companies in the group	Type of activities
Grupo Bursatil Aldesa S.A.	Private, local (unlisted)	Aldesa Sociedad de Fondos de Inversión S.A.	Investment fund management company
		Aldesa Fideicomisos S.A.	Trust services
Grupo Empresarial SAMA, S.A.	Private, local (unlisted)	Inversiones SAMA, Puesto de Bolsa S.A.	Brokerage firm
		SAMA Sociedad de Fondos de Inversión G S, S.A.	Investment fund management company
		SAMA Valores (G S) S A	Advisory, intermediation and other auxiliary financial services (credit reporting and analysis, investment advice, portfolio management, acquisitions and corporate restructuring)
		SAMA Internacional (G S) S A	
		SAMA Consultores Profesionales S.A.	
		Edificio Grupo SAMA S A	Real estate occupied by financial group entities
Grupo Financiero ACOBO	Private, local (unlisted)	ACOBO Puesto De Bolsa, S.A.	Brokerage firm
		VISTA Sociedad de Fondos de Inversión S.A.	Investment fund management company
		Servicios Fiduciarios ACOBO, S. A.	Trust services
		Inmobiliaria ACOBO, Sociedad Anónima	Real estate occupied by financial group entities
Grupo Financiero Mercado de Valores de Costa Rica S.A.	Private, local (unlisted)	Mercado de Valores de Costa Rica, Puesto de Bolsa S.A.	Brokerage firm
		Multifondos de Costa Rica Sociedad Anónima Sociedad de Fondos de Inversión	Investment fund management company
		Inmobiliaria Mercado de Valores de Costa Rica, S.A.	Real estate occupied by financial group entities

Source: SUGEVAL.

II. Financial infrastructure

A. Central Bank and monetary policy framework

45. The Central Bank of Costa Rica (Banco Central de Costa Rica, BCCR) is responsible for monetary and exchange rate policy, oversees the management of international monetary reserves²⁶ and operates the internal and external payment system. BCCR has the exclusive right to issue banknotes and coins in national currency (Costa Rican Colón or CRC). BCCR's structure, governance and operation are prescribed by the Organic Law of the BCCR (Law No 7558).

46. BCCR's main monetary policy instruments are the short-term monetary policy rate (target interest rate) and open market operations. The monetary policy rate is adjusted in response both to deviations of forecasted inflation to its target and from the output gap. It is used as a reference to maintain the cost of overnight transactions in the Integrated Liquidity Market²⁷ within the range determined by BCCR's Board of Directors (BoD), and also as a reference for the rate on other BCCR financial instruments, such as

²⁶ The BCCR has an indicative target balance of international reserves of between 11% and 15% of GDP, as per BCCR's strategic plan.

²⁷ The Integrated Liquidity Market BCCR's open market operations platform, also used by financial institutions to carry out short-term liquidity operations among themselves.

electronic deposits. Open market operations are undertaken either through the issuance of BCCR's own bonds or Monetary Stabilisation Bonds issued by BCCR in auctions (in CRC), or through transactions in the secondary securities market.

Inflation targeting regime

47. BCCR followed a crawling peg exchange rate regime from 1983 until 2006, and the average inflation rate for that period stood at 18.7%. In order to improve the control of inflation and monetary policy effectiveness, BCCR moved into greater exchange rate flexibility, and in 2005 approved a strategic project for the transition to an inflation-targeting regime (Inflation Targeting Regime for Costa Rica, Board session No 5229-2005).

Figure 1.11. Inflation target range, inflation and inflation expectations in Costa Rica



Source: BCCR.

48. As part of the process to transition to an inflation-targeting regime, the BCCR has implemented reforms in six key areas:

- i) **Macroeconomic modelling:** BCCR has developed semi-structural and statistical models, allowing for simulation and analysis of different monetary policy scenarios for inflation, as well as inflation forecasting;
- ii) **Financial capitalisation of the BCCR:** an inter-institutional commitment was agreed between the Ministry of Finance and BCCR for, the re-capitalisation of BCCR during the period 1999-2004 (see Box 1). Under the same legislative framework, the ability of BCCR to lend to the public sector was reduced; BCCR can only purchase Treasury Bills under exceptional circumstances, for a maximum of three months with the vote of five members of the Board of Directors and only up to 5% of the government's budget, increasing the degree of independence of BCCR decisions from fiscal considerations.
- iii) **Exchange rate flexibility:** in October 2006, BCCR moved from a crawling peg exchange rate regime to a moving band. BCCR adopted a more flexible managed floating exchange rate regime from February 2015. The BCCR has allowed for greater flexibility from the second half of 2018, prompting the IMF to classify the country's de facto exchange rate regime as "floating".
- iv) **Short-term interest rates as a monetary policy tool:** BCCR separated the debt management operations from the monetary control operations so as to improve its ability to promptly intervene and manage liquidity.

- v) More recently, the BCCR has strengthened its communication efforts, explaining its monetary policy decisions –whether the policy rate is adjusted or not—from a forward-looking perspective as a result of an assessment of upward and downward pressures and risks for inflation over the 24-month ahead inflation forecasting horizon. Publications such as the Inflation Report, the biannual Macroeconomic Program and the monthly Economic Report are also part of BCCR’s communication effort with regards to its monetary policy decisions.²⁸
- vi) Strengthening of the independence of the BCCR: In February 2019, following the Accession Review of Costa Rica by the Committee on Financial Markets and the relevant recommendation on strengthening the independence of the Central Bank, a new law (Law 9670) was enacted by the Legislative Assembly strengthening the autonomy of the BCCR. In particular, it: (i) requires that the removal of the BCCR President by the Council of Government be based on well-founded reasons (where before no reason was needed); (ii) introduces a one-year separation between the term of the BCCR President and that of the President of the Republic; and (iii) takes away the voting rights from the Minister of Finance in the BCCR Board.

49. Currently, BCCR has an explicit inflation target of 3% (where inflation is measured as the year-on-year change of the consumer price index, CPI, with a tolerance range of ± 1 pp for a two-year time horizon.

Credit operations

50. BCCR provides rediscounting and grants emergency loans to supervised financial entities, subject to conditions prescribed by Law 7558. In particular, in order to rediscount their securities, private banks need to maintain a permanent remunerated²⁹ minimum balance of 12% of their total loans in the state bank managed by the Credit Development Fund, created through the Law for the Development Banking System (see Box 2).

²⁸ BCCR also issues an annual Central Bank and Superintendencies Report, as well as the BCCR’s President Report to Congress. All publicly disclosed reports issued by the BCCR are available at <http://www.bccr.fi.cr/publicaciones/>.

²⁹ According to article 52 of Law 7558, the state-owned bank which manages the Credit Development Fund pays to private banks an interest rate equal 50% of the financial intermediaries’ weighted offered rate calculated by BCCR or the Libor rate at one month.

Box 2. BCCR's financial deficit and its negative capitalisation

BCCR has had a persistent financial deficit for more than four decades; the deficit emerged in the 1970s when BCCR financed public sector activities, considered of interest by the Government, with loans covered by exchange rate guarantees. These loans were never repaid as the underlying activities became insolvent.

During the same period, BCCR also financed large lending programmes through commercial banks, subsidising both the interest rate and the exchange rate. Losses resulting from the currency hedging of said subsidised lending programmes added to the Central Bank's financial imbalance, as such currency hedging was done internally due to limited access to the international hedging markets.³⁰

During the period 1970-80, BCCR's objectives included both the pursuit of macroeconomic stability and the stimulation of economic development and growth, with the latter being pursued at the cost of weakening the Central Bank's financial position.

By the early 1980s, BCCR's liabilities covered sevenfold its assets. With the CRC depreciating from 8.6 CRC/USD in September 1980 to 63 CRC/USD in June 1982, BCCR's debt surged from 20% of GDP in 1980 to 63% of GDP in 1983, and its net worth dropped from -2.1% of GDP to -41.4% of GDP in the same period.

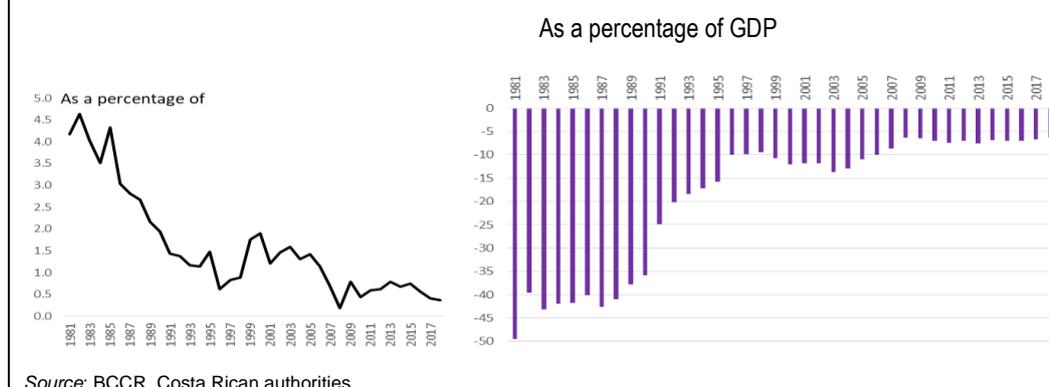
Since then, BCCR has taken several actions in order to address its financial deficit. At the end of the 1990s, BCCR restructured part of its external debt through its participation in the Brady Plan. An inter-institutional commitment to recapitalise BCCR was agreed between the Ministry of Finance and BCCR, as per Articles 175 and 175bis of the Organic Act of the BCCR (Law 7558, as of November 1995). The Ministry of Finance recapitalised BCCR twice, in 1999 and 2004, with amounts estimated at 3% and 1.4% of GDP, respectively. The recapitalisations were performed through the issuance of securities called Monetary Stabilisation Bonds in open market operations. Both recapitalizations allowed BCCR to pay its liabilities without affecting inflation and, along with the increment of the minimum reserve requirement, helped to improve the ratio of interest-earning assets to cost-generating liabilities (on average 1.5 during 2007-15).

BCCR's move from a crawling peg to a band exchange rate regime in 2006 has improved monetary control, releasing pressures on monetary expansion from exchange rate operations. Nevertheless, there is still a gap between the interest rates paid on BCCR's assets and the interest rates BCCR pays for its liabilities.

Although the structural imbalance of the Central Bank seems to have been resolved, BCCR still has a financial deficit 0.37% of GDP in 2018 (down from 0.6% in 2016) and a negative capitalisation of -6.3% of GDP (down from 7.2% in 2016) as of 2018. According to Costa Rican authorities, the current fiscal situation of the central government does not allow it to implement additional transfer programs to ease BCCR's deficit in the near future. As such, there are no plans for the completion of BCCR's recapitalisation agreed by the Ministry of Finance and BCCR in the period 1999-2004. It should be noted that Congress approval is required for any transfer of funds from the State to BCCR.

According to BCCR, the current capitalisation position does not affect the financing of superintendencies (c. 15% of the current deficit on a yearly basis) or the capacity of BCCR to act as lender of last resort. BCCR expects the current deficit to be gradually eliminated in 24 years without a recapitalisation.

Figure 0.12. BCCR's deficit (LHS) and net worth (RHS)



51. Besides its open market operations, BCCR can acquire, sell or maintain securities as an investment. This includes the purchase of treasury bills, provided that they are not purchased to pay other treasury bills in its possession and subject to the approval of its BoD and the notification of the Legislative Assembly.

Public debt management

52. BCCR participates in public debt management both through the issuance of public debt as well as through the servicing of public debt with funds drawn by the National Treasury. Both issuers (Ministry of Finance and BCCR) semi-annually announce to the market the allocation target for the following semester and the instruments intended to be issued, as well as past results and any deviations from previous announcements. BCCR does not run debt auctions on behalf of the Ministry of Finance.

53. Coordination between the Ministry of Finance and BCCR is ensured through the establishment of the Domestic Debt Auction Commission of the Government of Costa Rica (Executive Order 37008-H) and the formalisation of a coordination framework in June 2016. Participation of the Minister of Finance in the BoD of BCCR allows for an extra degree of coordination between debt management and monetary policy.

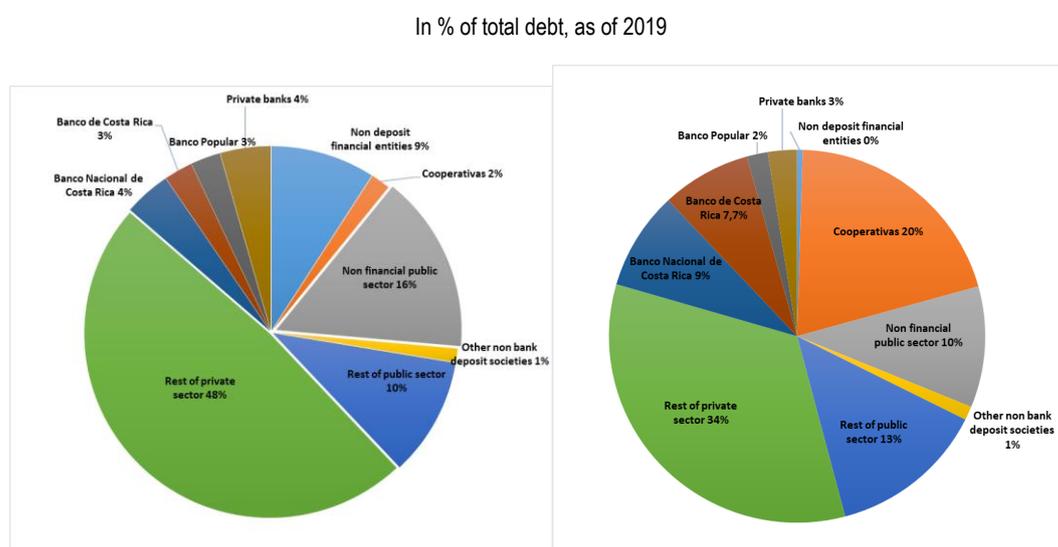
54. In order to manage its debt for the transmission of interest rates and to avoid competition with the Ministry of Finance, BCCR has been coordinating maturities and yields with the Ministry of Finance since 2016. BCCR has concentrated its bond placements in the short and medium term (up to three years) part of the curve, and the Ministry of Finance has been issuing bonds with three years or more maturity (although it still offers shorter-term bonds, too).

55. The Domestic Debt Auction Commission (DCP) proposes to the budgetary authority the Debt Indebtedness Policy, which requires final approval by the Executive Power of the Costa Rican Republic. DCP is also responsible for the recording of explicit government debt, as well as the identification of the implicit contingent liabilities. DCP is currently working on a new methodology for the calculation of implicit contingent liabilities; however, none of DCP's calculations include contingent liabilities derived from state-owned enterprises.

³⁰ This was due to limited resources and financial technology required to access the international hedging markets, and due to internal regulation that prohibited BCCR from buying financial derivatives used for hedging.

56. The total public debt to GDP ratio (including debt issued by state-owned institutions) stood at 76.6% at the end of 2019. Congressional approval is required to issue external debt bonds and the current limit authorised is zero.

Figure 1.13. Breakdown of central government debt (LHS) and BCCR bond holdings (RHS)



Source: BCCR.

B. Payment system

57. The National Electronic Payment System (SINPE) is BCCR's electronic payment system, owned and operated exclusively by the BCCR since 1997. The platform offers 32 electronic services and 11 other services in six business lines: funds clearing and settlement, securities clearing and settlement (book entry system), state's cashier-bank, cash handling and distributing, internal and external stability of the national currency.

58. SINPE has the capacity to process operations in real or deferred time, in gross or net form, of low (payment instruments available to citizens, such as electronic transfers, checks, credit cards and taxes) or high value (payments carried out between institutions with fund accounts in the BCCR). In 2019, SINPE settled 56 million transactions with a total value of USD 646 billion, which represents approximately 10 times the value of Costa Rica's GDP.

59. The platform's operational stability is safeguarded through an alternate platform, which operates simultaneously with the main platform, rated as Tier IV by the Uptime Institute.³¹ This alternate platform has equal capacity with SINPE, guaranteeing uninterrupted service in case SINPE fails. All infrastructure (including servers and database components), processes and teams are duplicated for this alternate site, while BCCR has policies in place to back up SINPE information, ensuring its recovery in case of a disaster.

³¹ <https://uptimeinstitute.com/tiers>.

60. Financial stability of SINPE's settlement services is ensured through the imposition of minimum guarantees³² as a requirement for participation in net settlement services provided through SINPE, as prescribed by the Payment System Rules and Regulations (defined by the BoD of BCCR). Additional guarantees are required for participants in the Integrated Liquidity Market (ILM), which is integrated in the SINPE platform with participation by the BCCR and all other banks active in Costa Rica. To comply with these requirements, entities must deposit standardised negotiable securities in a BCCR account which are valued on a daily basis, with a 10% discount applied on them. According to Article 68 of Law 7558, these reserves and funds are used as the basis of and guarantee for the payment system³³, and participating entities are authorised to use these resources to cover their obligations in the payment system.

Table 1.7. SINPE transaction volumes

In USD million

Table 7. SINPE: transaction volumes
In USD million

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
HIGH VALUE	55 824,9	64 099,6	82 306,6	87 410,1	89 281,1	88 812,3	84 626,8	87 576,1	92 583,2	85 562,0	67 965,8
Interbank transfers	55 824,9	64 099,6	82 306,6	87 410,1	89 281,1	88 812,3	84 626,8	87 576,1	92 583,2	85 562,0	67 965,8
LOW VALUE	75 955,2	90 391,9	101 029,8	114 617,8	129 128,9	142 498,7	159 508,4	184 621,3	193 634,3	194 722,2	211 563,6
Credit Transfers 1/	48 747,6	62 460,2	71 247,3	81 326,9	91 387,8	98 383,8	107 387,4	120 635,6	123 446,7	123 847,4	132 424,7
Debit direct 2/	4 330,4	5 496,6	7 551,5	11 392,5	19 011,9	27 473,8	35 805,5	48 949,6	56 511,8	58 572,9	66 278,9
Checks (CLC)	17 853,7	17 481,6	16 965,2	15 727,7	14 465,3	13 302,9	12 736,3	11 317,8	8 697,5	5 717,7	4 582,3
Others Securities	2 977,6	3 104,8	3 241,1	3 941,6	1 988,8	1 046,6	1 112,1	1 171,1	1 289,2	1 182,8	947,7
Settlement for external services 3/	856,3	1 097,1	1 162,2	1 211,9	1 151,8	1 123,6	1 179,0	1 137,9	2 211,9	3 801,8	3 879,6
Taxes (LI)	1 189,5	751,6	862,5	1 017,3	1 123,3	1 168,1	1 288,2	1 409,4	1 477,2	1 599,6	3 450,5
MARKETS	77 828,7	127 497,1	188 168,2	205 383,2	253 883,7	221 445,2	282 149,1	276 224,0	283 544,6	339 663,8	366 913,1
Money Market 4/	7 387,7	58 092,4	110 030,6	127 344,3	168 292,3	150 537,4	213 055,3	200 653,9	194 346,2	243 935,8	291 226,4
Securities Market 5/	11 707,3	17 434,3	22 266,8	22 879,9	31 307,3	24 508,0	23 321,6	20 403,9	32 591,0	39 368,3	30 317,7
Direct collocations securities market 6/	23 016,2	27 496,3	26 379,3	21 537,6	21 449,2	15 334,0	15 652,3	24 840,1	25 403,9	26 389,0	16 666,3
Cash Market 7/	14 151,5	18 163,8	21 959,6	24 404,1	24 675,9	23 296,2	22 699,3	23 795,1	22 915,9	22 776,7	20 548,1
Exchange Market 8/	5 024,8	6 049,8	7 531,9	9 217,1	8 158,9	7 769,7	7 420,6	6 531,0	8 287,6	7 194,1	8 154,6
Interbank Market 9/	16 541,2	260,6	0,0	0,0	0,0	0,0	0,0	-	-	-	-
TOTAL	209 608,8	281 988,6	371 504,7	407 411,2	472 293,8	452 756,3	526 284,3	548 421,4	569 762,1	619 948,1	646 442,6
Percentage of variation	-	34,5%	31,7%	9,7%	15,9%	-4,1%	16,2%	4,2%	3,9%	8,8%	4,3%
Daily average (millions)	838,4	1 138,3	1 497,0	1 641,5	1 900,7	1 822,2	2 124,0	2 209,4	2 273,8	2 461,6	-
Ratio SINPE/ GNP	6,8	7,5	8,7	8,7	9,4	8,8	9,5	9,5	9,7	10,3	10,4
Days necessary to move an amount equal GNP	36,8	33,4	28,7	28,8	26,6	28,3	26,3	26,4	25,7	24,4	24,0

Notes: (1) Includes the real time credits to third-party direct credits clearing and Sinpe mobile transfer. (2) Includes real time debit and direct debit clearing transactions. (3) Includes settlements for ATM and Pension Fund Operators transactions and since 2017 includes liquidity of VISA. (4) Includes Integrated Market of Liquidity operations. (5) Includes securities settlement and securities transfers services. (6) Includes SINPE securities settlement services for direct collocations of BCCR and Ministerio de Hacienda. (7) Includes Cash market like Auxiliary Cash Custody y Cash Market. (8) Includes Foreign Currency Market (MONEX). (9) System operated by BNV. (10) GNP, current prices/ Data are preliminary for 2017-2018. Forecast 2019-2020 used in the Macroeconomic Program 2019-2020, approved by the Board of Central Bank of Costa Rica according to article 6 of the minute of the extraordinary session 5861-2019 on January 25, 2019. (11) Purchase Banco Central Bank of Costa Rica reference exchange purchase rate was expressed as annual average. Source: BCCR.

61. BCCR launched in May 2015 mobile SINPE, a mobile payment system that allows users of the financial system to make electronic money transfers to accounts linked to a mobile telephone number from any electronic banking channel (internet banking, SMS/applications/other on-line banking or ATM networks). Fifteen supervised entities are currently offering this service to their clients.

62. Since 2016, the BCCR approved simplified accounts to expedite the opening of bank accounts (just the identification document is required). In addition, for control purposes, a single accounts register was created, allowing to have integrated data from all accounts (current, savings, and simplified accounts) that a customer may have in the entire financial system.

³² According to Article 261 of the Payment System Rules and Regulations, the minimum guarantee stands at 30 million CRC or its equivalent in USD, calculated at the reference exchange rate on the date of the transaction.

³³ If a financial intermediary does not settle its position, SINPE will automatically settle it and deduct the corresponding amount from the institution's reserve account at BCCR.

63. The IBAN (International Bank Account Number) was introduced in Costa Rica for all accounts in the country in 2019. This has contributed to the improvement of bank penetration levels in the country, reaching 81.5% of adults as of August 2020. In addition, the use of contactless technology in Costa Rica has increased: as of December 2019, 93% of payment cards (debit and credit) in circulation and 92% of POS had contactless technology, and approximately 50% of card payment transactions at merchants are contactless.

III. Securities markets: structure and operation

A. Recent developments

64. The Costa Rican secondary securities market is organised in three sections:

- i) Liquidity market: comprising the Integrated Liquidity Market (MIL) organised by BCCR, the Liquidity Market (MEDI) and the Repurchase Market (REPO). The first is linked to SINPE payment system for clearing and settlement. MEDI and REPO are organised by the National Stock Exchange (Bolsa Nacional de Valores) and linked to SINPE for clearing but settlement is organised by the National Stock Exchange, which represent 61% of total volume traded in the National Stock Exchange in 2019.
- ii) Debt market³⁴: public debt market comprising securities issued by the Ministry of Finance and BCCR (mainly zero coupon securities, fixed-rate securities, adjustable rate securities and inflation-indexed securities)³⁵; and private debt placements organized by the National Stock Exchange (deposit certificates, commercial paper and bonds); and
- iii) Equity market: a single regulated market (National Stock Exchange) and 10 equity issuers with listed stocks as of December 2019.

65. The equity market of Costa Rica is under-developed, given insufficient incentives for equity listings (including a double taxation on profits and dividends), and a majority of companies being family-owned and heavily reliant on bank credit. There have been 10 equity offerings of corporations, including common and preferred shares.

66. As of December 2019, there were 41 securities issuers listed on the National Register of Securities and Intermediaries. Six of them were government issuers, three of them were commercial state-owned banks and 32 private ones, while 21 of them were financial issuers and eleven non-financial. Ten issuers are issuers of common and/or preferred shares, 31 are issuers of corporate debt, out of which 13 are banks³⁶. In addition,

³⁴ Debt issuances by the Ministry of Finance and BCCR represent 84.88% of total debt issuances in Costa Rica as of 31 May 2019.

³⁵ Debt is placed through a competitive bidding mechanism (auctions) or through the “electronic shop” option. Allocation in auctions is done by yield or price offered, while in the case of the electronic shop participants, they subscribe based on a predefined debt placement size and unique price/yield announced by the issuer.

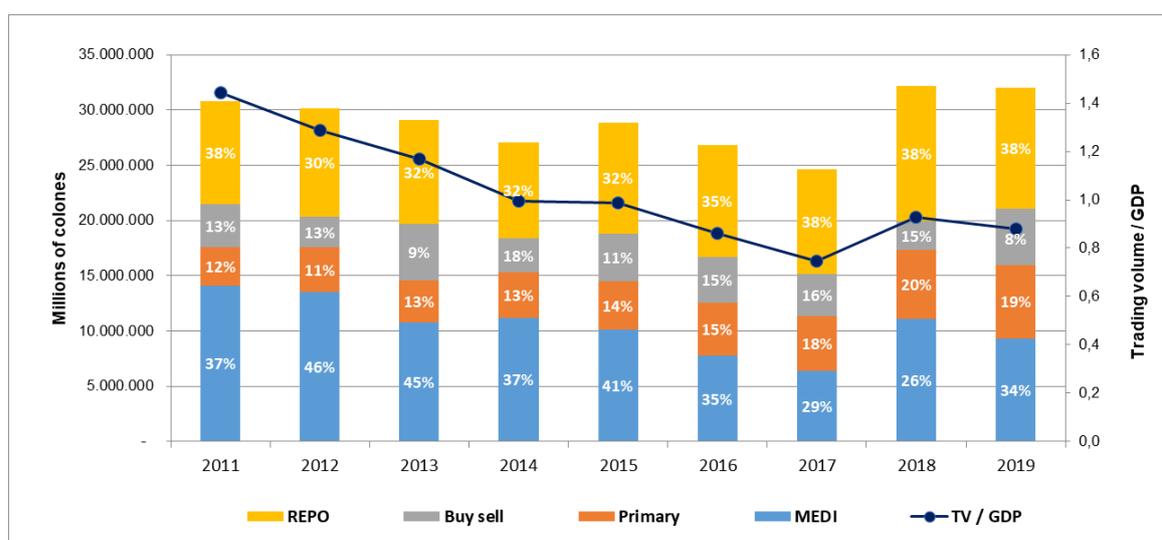
³⁶ State-owned banks and non-state banks created by law dominate the debt securities market, with debt securities issued by them representing 47% of the total outstanding debt securities in the market as of May 2019.

27 closed-end investment funds have listed their shares on the National Stock Exchange as of December 2019.³⁷

67. Thirty-two percent of all debt and equity issuances are denominated in USD and 3% in Development Units (DU)³⁸, a monetary account unit defined under law and whose value is used as an inflation-adjusted index to denominate debt transactions and encourage long-term credit.

Figure 1.14. Annual trading volume by type of securities market, 2011-19

In CRC million (LHS) and as a percentage of GDP (RHS)



Source: SUGEVAL.

68. The market capitalisation of the National Stock Exchange amounted to USD 2.23 billion as of December 2019. The book value of closed-end listed investment funds as of December 2019 stood at USD 3.0 billion.

B. Capital market intermediaries

69. The National Stock Exchange (Bolsa Nacional de Valores BNV) is the sole stock exchange operating in Costa Rica. All shares of BNV initially belonged to the Costa Rican Development Corporation (CODESA). CODESA's shares were sold to private investors in May 1993, following which BNV became a privately-held organisation. Today it is owned by brokerage houses (86.6%) and other individuals and companies (13.4%).

70. BNV is a self-regulated entity and its main functions are: (i) authorisation and suspension of the operation of brokerage houses and brokers; (ii) supervision and on-site visits of brokerage houses; (iii)

³⁷ Out of a total of 96 investment funds listed in the National Securities and Intermediaries Registry and in operation. Twenty seven of the ones listed on the National Stock Exchange, 20 are real estate funds and development of real state project funds, and the remaining seven invest in financial assets.

³⁸ Development Unit is an account unit defined under the Law on the Development of the Secondary Mortgage Market to increase accessibility of Costa Ricans to property ownership and strengthen credit indexed inflation (Law 8507 as of 28 April 2006).

establishment of procedures and systems to facilitate the purchase and sale of securities; (iv) safeguarding of transparency in price formation; and (v) provision of information on securities, issuers and trades. It has trading platforms for primary market, secondary market and repos and is the only market authorised to organise secondary markets.

71. There are two types of securities intermediaries active in Costa Rica: (i) brokerage houses, and (ii) investment funds management companies (or collective investment schemes). Brokerage houses are authorised by the stock exchange to engage in brokerage activities and their main functions include: sale and purchase of securities and trading on behalf of clients; private placements of clients' securities³⁹; securities advisory services to investors; and management of individual investment portfolios. Investment funds management companies have the sole responsibility of managing invested funds.

72. There are 16 brokerage houses (four state-owned and 12 private) active in Costa Rica, of which 14 provide services to third parties, as of December 2019. Four of the 16 brokerage houses are state-owned and represent 54% of the market by volume traded. Five of the remaining 12 are foreign-owned.

73. State-owned and privately-held brokerage houses operate under the same regulatory framework and rules. There is no obligation for state-owned entities to conduct operations on stock exchanges through state-owned brokers.

74. Over the period 2008-19, the number of brokers operating in the market and the size of their activity has decreased, due to merger activity in the sector and a decrease in the volume of primary market transactions. As of December 2019, total assets managed for third parties by brokerage houses amounted to CRC 4,159 billion (USD 7.3 billion), compared to CRC 3,408 billion (USD 6.1 billion) in 2008. Total assets of brokerage houses amounted to CRC 435.16 billion (USD 763 million) at the end of 2019, compared to CRC 178.6 billion (USD 318 million) in 2008.

Table 1.8. Brokerage firms operating in Costa Rica

Brokerage firm	Ownership (private vs. state-owned and local vs. foreign ownership)	Market share (percentage of trading volume)			Part of a financial group
		2017	2018	2019	
BN Valores CR	State-owned	9.2%	8.2%	9.1%	Yes
Popular Valores	State-owned	20.8%	19.2%	19.3%	Yes
BCR Valores	State-owned	17.3%	18.5%	18.1%	Yes
INS Valores	State-owned	9.8%	9.3%	7.5%	Yes
BAC San Jose	Privately held, foreign-owned	10.5%	13.4%	15.6%	Yes
BCT Valores	Privately held, local	4.5%	5.7%	4.1%	Yes
CITI Valores	Privately held, foreign-owned	2.0%	1.7%	1.8%	Yes
Davivienda Puesto de Bolsa	Privately held, foreign-owned	8.0%	4.0%	2.0%	Yes
IMPROSA Valores	Privately held, local	1.2%	1.0%	1.9%	Yes
LAFISE Valores	Privately held, foreign-owned	0.5%	0.4%	0.8%	Yes
PRIVAL Valores	Privately held, foreign-owned	4.3%	6.2%	6.8%	Yes

³⁹ Regulated by SUGEVAL's Regulation of Securities Trading and Complementary Activities.

ACOBO Puesto de Bolsa	Domestic privately-owned	1.3%	1.7%	1.8%	Yes
ALDESA Valores	Domestic privately-owned	1.3%	1.1%	0.3%	Yes
Inversiones SAMA	Domestic privately-owned	2.8%	2.6%	1.6%	Yes
Mutual Valores Puesto de Bolsa	Privately held local	3.6%	3.4%	5.8%	Yes
Costa Rica Puesto de Bolsa	Domestic privately-owned	2.9%	3.6%	3.4%	Yes

Source: SUGEVAL.

75. Investment funds management companies managed funds equal to 9.93% of GDP as of 2019. There are 14 investment funds management companies (four state-owned⁴⁰ and nine private) active in Costa Rica as of December 2019. Although the number of fund management companies decreased over the period 2007-19 due to merger activity, net assets of the funds industry almost doubled in the period, standing at CRC 3.2 trillion (USD 5.6 billion) as of 2019 (compared to CRC 1,038 billion or USD 1.9 billion in 2007). The number of investors using such fund management companies also doubled in the same period, standing at 123,094 in 2019 (compared to 34,844 in 2007).

76. State-owned investment fund management companies are subject to the same regulations applying to privately-held investment fund management companies. There is no obligation for state-owned investment fund management companies to invest in any of the instruments issued by the Costa Rican public sector. Securities issued by investment funds under management of state-owned investment fund management companies are not considered securities issued by a public entity and therefore are not covered by a state guarantee.⁴¹

Table 1.9. Investment fund management companies operating in Costa Rica (as of 30/12/2019)

Investment Fund Management Company	Ownership (private vs. state-owned and local vs. foreign ownership)	Net Assets (in USD million)	Number of active funds	Market share (by net assets)	Part of a financial group
Aldesa Sociedad de Fondos de Inversion S.A.	Private	194,67	3	3,5%	Yes
Bac San Jose Sociedad de Fondos de Inversion S. A.	Private	236,74	8	4,2%	Yes
BCR Sociedad Admin de Fondos de Inversion S. A.	State-owned	1.445,22	12	25,7%	Yes
BCT Sociedad de Fondos de Inversion S.A.	Private	85,65	5	1,5%	Yes
BN Sociedad Admin de Fondos de Inversion S.A.	State-owned	902,86	13	16,1%	Yes

⁴⁰ The state-owned investment fund management companies cover 56.2% of the market in terms of assets managed.

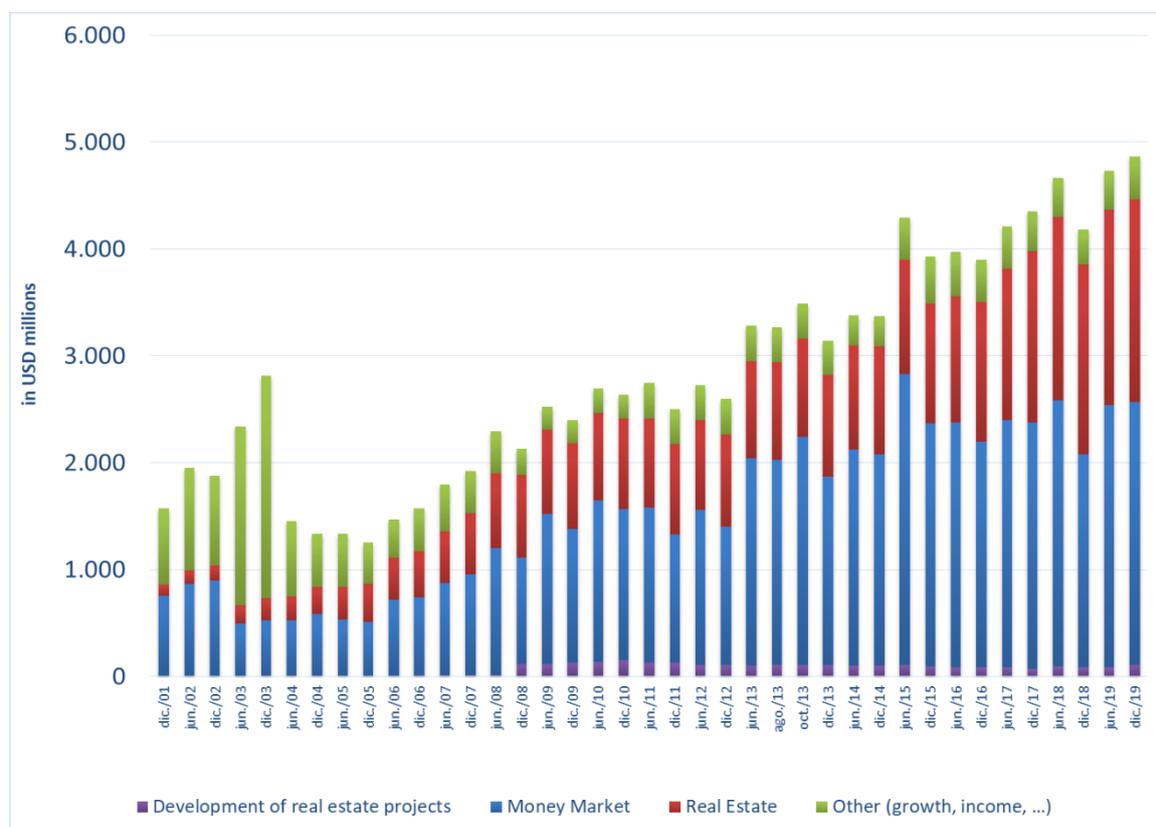
⁴¹ Even in the case of an investment fund management company invested 100% in sovereign debt, the securities issued by the company are not securities guaranteed by the state.

Improsa Sociedad Admin de Fondos de Inversion S.A.	Private	709,96	5	12,6%	Yes
INS – Inversiones Sociedad de Fondos de Inversion S.A.	State-owned	268,89	9	4,8%	Yes
Multifondos de CR, S.A. Sociedad de Fondos de Inversion	Private	601,44	9	10,7%	Yes
Mutual Sociedad de Fondos de Inversion S.A.	Private	26,00	5	0,5%	Yes
Popular Sociedad de Fondos de Inversion S.A.	State-owned	557,51	7	9,9%	Yes
Prival Sociedad de Fondos de Inversion S.A.	Private	175,71	4	3,1%	
Sama Sociedad de Fondos de Inversion S.A.	Private	56,53	2	1,0%	Yes
Scotia Sociedad de Fondos de Inversion S.A.	Private	74,10	7	1,3%	Yes
Vista Sociedad de Fondos de Inversion S.A.	Private	284,67	5	5,1%	Yes
Total state-owned		3.174,47	41	56,5%	n.m.
Total privately-owned		2.445,47	53	43,5%	n.m.
Total		5.619,94	94	100,0%	n.m.

Source: SUGEVAL.

77. Money market and real estate fund management companies registered the highest growth rates over the period 2007-19. These funds issue certificates of participation and 28 of them are listed on the stock exchange. The 90% growth of the money market funds in the period 2012-19 is mainly attributed to a drop in interest rates and a subsequent search for yield in liquid instruments. It should be noted that prior to the opening of the banking market (1996), state-owned banks managed pooled portfolios ‘disguised’ as trusts, preventing investment fund managers to develop.

Figure 1.15. Net assets managed by the investment fund management industry in Costa Rica, 2001-19



Source: SUGEVAL.

78. Although regulation covering investment funds allowed for the authorisation of funds for venture capital investing, there has been no venture capital fund operating in Costa Rica. SUGEVAL is in the process of reforming the General Regulations on Management Companies and Investment Funds to address the need for differentiated marketing of riskier and complex products; potential conflicts of interest between fund managers and related entities and information disclosure requirements around management fees; and requirements on experience and competencies of those responsible for the management of the venture capital fund.

79. On 21 June 2016, CONASSIF approved the Investment funds project development reform⁴², which aims to address the main challenges facing the investment fund management industry: (i) improve design of new types of funds that meet investor needs; (ii) strengthen understanding of retail investors through improvement in disclosure in prospectuses, websites and sales materials; and (iii) define more precisely the role and responsibilities of entities involved in the distribution of investment funds.

80. On 23 May 2019, the Legislative Assembly approved bill of law No. 20.863 to amend Article 85 of the Law Regulating the Stock Market (No. 7732). The amended legislation establishes that venture funds

⁴² CONASSIF session 1261-2016.

may invest their resources not only in private securities (i.e. securities not subject to public offering), but also in other financial instruments and assets.

Derivatives

81. According to Law 7558 (article 90), futures or term transactions and other similar transactions in foreign currency are controlled by BCCR and supervised by the entity specified by BCCR. The BoD of BCCR has approved two regulations on derivatives:

- i) *Regulation on the use of derivatives transactions in foreign currency*: regulates authorised foreign currency derivatives that financial intermediaries supervised by SUGEF can subscribe in order to hedge for interest rate fluctuations. It regulates the period covered, counterparties' qualifications and general information that may be required by the supervisor; and
- ii) *Regulation on transactions with foreign currency derivatives*: regulates transactions of foreign currency derivatives carried out by entities supervised by the SUGEF, SUGEVAL and SUPEN, and information on them should be provided to BCCR and the superintendencies.

82. There is no domestic market for derivatives and standardised derivatives are not traded in the stock market. Therefore, non-residents are not allowed to offer derivatives and structured products in the country (Central Bank regulation adopted in session 5404-2008). The Law Regulating the Stock Market (Law No 7732, LRMV) regulates transactions in the futures market⁴³ and prescribes that rules and requirements for standardised derivative transactions (margins, coverage, duration) and participants (requirements for brokers) should be established and supervised by the respective stock exchange. The Stock Exchange can issue a contract for difference by-law.

83. As of 29 July 2020, total derivative operations amounted at USD 116.2 million, concentrated in three private banks with regional presence (98.3%) and one savings and credit cooperative (1.7%). Only four institutions are currently authorised to issue derivatives (three privately-held and one state-owned bank). Most of them are used for exchange rate hedging.

84. Brokers can also negotiate Contracts of Difference on exchange rates and interest rates, which are regulated by the rules of the National Stock Exchange. There has been no trading in these derivatives in 2019.

85. Law No. 9746 that amends the Law Regulating the Securities Market was presented to the Legislative Assembly on 8 March 2019, was approved by the Special Commission on 5 August 2019, voted by the Plenary on 16 September 2019 and in force since 22 October 2019. The Law intends to encourage the growth of the securities markets and develop a local derivative market, and among other things, it introduces basic regulation of financial instruments such as derivatives.

C. Custody, clearing and settlement

86. In Costa Rica the buying, selling and repurchase of securities in public offerings is handled by the respective members of the stock exchanges. Currently, there is only one stock exchange, Bolsa Nacional de Valores (BNV).

⁴³ Authorised FX derivatives by BCCR include Foreign Exchange Forwards (Contratos a Plazo), Exchange Rate Difference or Exchange Swaps (Contratos de Diferencia), Currency Futures (Contratos de Futuros), Foreign Exchange Swaps (Permutas Cambiarias) and Currency Swaps (Permutas de Monedas).

87. According to the Law Regulating the Stock Market (Law 7732), clearing and settlement of operations of organised stock markets in Costa Rica must be carried out through the System of Clearing and Settlement of Securities, formed by the stock exchanges and the clearing and settlement companies. There is currently no clearing and settlement company operating in Costa Rica. Instead, BNV provides securities clearing and settlement for securities transactions, in cooperation with BCCR and the SINPE payment system for the monetary settlement of such transactions.

88. The National Book Entry System is an electronic book-entry system for monetary settlement used by the settlement members of the National System of Clearing and Settlement of Securities, as well as by its member institutions providing custody services. It is serviced by BCCR (for entries related to state and state-owned institution issuances) and Interclear (for entries of privately-issued securities). Interclear also provides securities custody services besides the account entries.

89. Costa Rican authorities performed a review of the System of Clearing and Settlement of Securities, which was evaluated by the IMF in 2013. As a result of the review, it was recommended that BCCR performs a stress test based on a scenario of the default of the largest participant and its affiliates in the payment system, so as to examine liquidity risk, and separate cash settlements for each market in the SIOPEL trading platform. The stress test was conducted by BCCR in 2015 and concluded that the main recommended action for the Costa Rican Securities Market is to migrate to a real time gross bilateral settlement, with liquidity savings mechanisms. BCCR is planning to separate the settlement of primary market transactions operated by BCCR from the rest of the settlements, to replace the current settlement system that is used by the National Stock Exchange for the settlement of all transactions.

90. Custodian services are offered by banks and brokerage houses with 23 custodians registered in Costa Rica as of 2019.

91. Price providers perform valuation of financial instruments and provide their valuations to the investor community. There are three price providers registered in Costa Rica as of 2019.

IV. Financial supervision and regulation

A. Institutional arrangement for supervision and regulation of financial market and intermediaries

92. The supervisory and regulatory structure of the Costa Rican financial system is composed of five different bodies: the National Council for Supervision of the Financial System (Consejo Nacional de Supervisión del Sistema Financiero CONASSIF), constitutes the senior steering body of the supervisory and regulatory system of Costa Rica. CONASSIF leads and coordinates the four superintendencies: General Superintendency of Financial Institutions (SUGEF), General Superintendency of Securities (SUGEVAL), Superintendency of Pensions (SUPEN) and General Superintendency of Insurance (SUGESE)⁴⁴. The superintendencies are autonomous bodies of the BCCR, operationally independent and financially assisted by the BCCR, while being under the direction of CONASSIF.

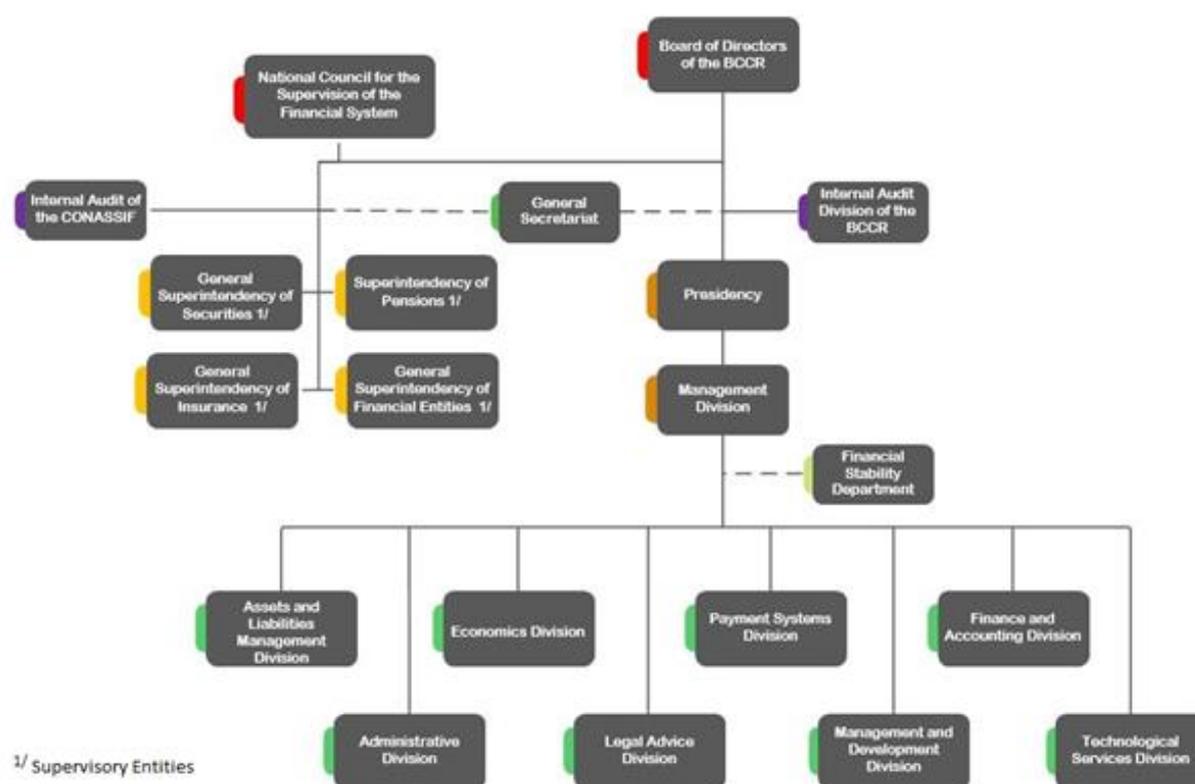
⁴⁴ SUGEF's supervisory role is prescribed mainly by Law 7558, Organic Law of the BCCR, Law 1644, Organic Law of the National Banking System, Law 4179, Law on Cooperative Associations and the creation of the Cooperative Development Institute, Law 5044 and Law Regulating the Non-bank financial companies; SUGEVAL's supervisory role is prescribed by Law 7732, Law Regulating the Securities Market; SUPEN's supervisory role is prescribed by Law 7983, Law on Worker Protection and Law 7523, Law of the Complementary Private Pensions Regime; and SUGESE's supervisory role is prescribed by Law 8653, Law Regulating the Insurance Market and Law 8956, Law Regulating the Insurance Contract.

93. A number of coordination and cooperation committees exist: (a) committees within CONASSIF between the different supervisory segments, (b) the Superintendents Committee, (c) a consolidated supervisory committee to review issues relating to financial groups and conglomerates, and (d) joint working groups for specific tasks, such as issuing and amending laws, or for research and analysis of specific issues.

94. The main accountability mechanism for superintendencies is the annual institutional report that they are required to provide to the government and the wider public pursuant to Article 171 of Law Regulating the Securities Market. Recently adopted legislation through Law No. 9398 (Ley para Perfeccionar la Rendición de Cuentas) establishes a mandatory annual accountability report for all Government entities.

95. A number of services, particularly IT and administrative, are provided to CONASSIF and the Superintendencies by BCCR. Although the superintendencies are deemed separate in technical terms, certain administrative, technological and logistical aspects must be coordinated with the BCCR.

Figure 1.16. Institutional arrangement for supervision and regulation of financial markets in Costa Rica



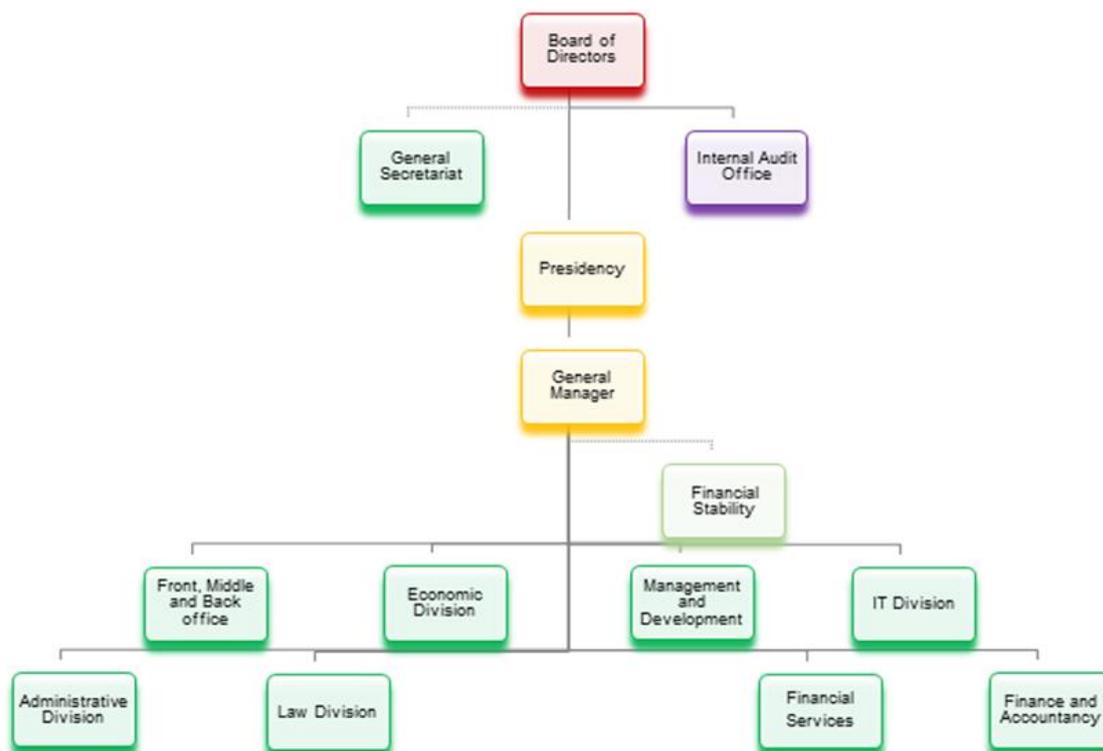
Source: BCCR.

Central Bank of Costa Rica (BCCR)

96. The Central Bank of Costa Rica (BCCR) is a public institution responsible for managing and defining the monetary and foreign exchange policy. It safeguards and administers the country's international monetary reserves; determines credit and financial policies; owns and operates the payment system; sets forth regulation for the creation, functioning, and control of financial intermediaries; oversees legal reserve requirements of financial intermediaries; acts as a lender of last resort; provides liquidity assistance to

markets and solvent institutions; promotes the strengthening of the national financial system; safeguards financial stability and coordinates macroprudential policy.

Figure 1.17. BCCR Organisation Chart



Source: BCCR, as of June 2019.

97. The organisational structure of BCCR is formed by four levels: superior or executive, divisional, departmental and area level. The highest authority of the superior or executive level is the Chairman of the Board of Directors (BoD), and that of the administrative level is the General Manager. The divisional level is responsible for policy execution and strategy implementation, while the departments are effectively subdivisions of the divisions and have a supportive role (administrative tasks, budgeting, stock-taking). The area level is in charge of operational and technical activities.

98. BCCR has 690 members of staff, distributed in the various divisions as follows: Presidency (4), General Manager (19), internal audit (27), general secretariat (12), economics division (143), management of assets and liabilities division (42), payment systems division (69), administrative division (105), legal advice division (13), finance and accounting division (20), organisational development division (37), and IT division (199).

Independence of the Central Bank and the conduct of monetary policy

99. BCCR is governed by a BoD, according to the Organic Law of the Central Bank of Costa Rica (Law No. 7558). Previously, the Chairman of the Board was appointed by the Governing Council for terms that begin and end with the constitutional term of the President of the Republic⁴⁵. The other six members of

⁴⁵ In case of resignation of the President, all prior appointments remain in place, including members of the Government Council and the Chairman of BCCR.

the Board were the Minister of Finance and five members⁴⁶ appointed by the Governing Council (or Cabinet of the Government) and confirmed by Congress. The duration of their appointments is 90 months with one member being appointed every 18 months. Causes for termination of BoD members are outlined in Article 21 of Law 7558⁴⁷. Until 2019, the Minister of Finance had a voting right.

100. Following the Accession Review of Costa Rica by the Committee on Financial Markets and the recommendation of the Committee, a set of reforms to the Organic Law of the Central Bank of Costa Rica were presented and approved by the Legislative Assembly in February 2019, seeking to increase the independence of the BCCR in managing monetary policy through the amendment of articles 17 and 25 of Law 7558 (Organic Law of BCCR). The reform, enacted under Law N° 9670, (i) delinks the designation of the Chairman of the Central Bank from the political cycle, as the appointment of the Chairman will be made 12 months after the Presidential term begins and for a 4 year term⁴⁸; (ii) introduces the need for designated reasons for the dismissal of the Chairman; and (iii) removes the voting rights for the Minister of Finance as part of the BoD.

101. According to the new law, the Chairman of the Central Bank can be removed by the Governing Council only by “justified cause” (legal term defined in Articles 81, 369 and 685 of Work Code Law No. 2 of 26 August 1943) due to a clear and grave breach of his professional duties (Article 17 of Law 7558) or to any of the causes for dismissal of any member of the Executive Board (Article 21 of Law 7558). These other causes include: i) non-compliance of requisites to be a member of the Executive Board (Article 18 of Law 7558); ii) incompatibilities with the appointment (Article 20 of Law 7558); iii) unauthorised absences from the country longer than 2 months or to 3 consecutive Executive Board sessions; iv) supervening legal incapacity; v) breaching of relevant laws or regulations for the Central Bank; vi) being found guilty of fraud or illegal activities; vii) disability that prevents carrying out the position during six months.

102. BCCR is subject to supervision by the General Comptroller’s Office of Costa Rica and by its internal audit unit. The Chairman of the BoD is required to present an annual report to Congress.⁴⁹

National Council for Supervision of the Financial System (CONASSIF) and the Superintendencies

103. CONASSIF has the authority to issue regulations regarding the authorisation, regulation, supervision, oversight and operations of the superintendencies and the entities supervised by them. Such

⁴⁶ According to Law 7558, members of the BoD need to be Costa Ricans, more than 30 years of age, of well-known and proven honour. Up to third degree relatives or partners of the same corporation, people declared guilty in a court of law during the past five years or not up to date with the payment of their obligations to supervised financial institutions cannot be appointed as members of the BoD, in accordance with the moral principle of fit and proper checks in place. Members or employees of the Supreme Powers of the government, managers/officials/employees of BCCR, shareholders/members of the BoD/managers/employees of supervised financial institutions and officials of international and regional financial organisations cannot be appointed as members of the BoD.

BoD members are terminated if they no longer fulfil the requirements set forth by Law 7558, are absent from the country for two months without prior authorisation by the Board, do not attend three consecutive ordinary sessions, infringes any law, decree or regulation, are responsible for illegal or fraudulent acts, unable to perform the role’s duties for more than six months due to disability, or declared incompetent (Article 21 of Law 7558).

⁴⁸ The next chairman in office after the enactment of the law will remain in office for an additional year to make the transition.

⁴⁹ Such report includes BCCR’s actions on: (i) monetary policy, exchange rate, credit and financial policies, and the usage of international reserves; (ii) decisions taken to achieve the inflation target through the year; (iii) results on financial intermediation; (iv) achievements and obstacles with the implemented monetary policy; and (v) results on promoting favourable conditions to liquidity, solvency and strengthening of the national financial system.

regulations are proposed and drafted by the superintendencies. Superintendencies issue resolutions and guidelines on their respective area of supervision (circulars, letters, resolutions, legal criteria and opinions).

Figure 1.18. Supervisory system of the Costa Rican financial markets



Source: Costa Rican authorities.

104. CONASSIF approves regulations regarding the authorisation, regulation, supervision and oversight of the four superintendencies. The main functions of CONASSIF with regard to the superintendencies are as follows (Article 171 of Law 7732):

- Appoint and remove the General Superintendents and the respective intendants, auditors and internal sub-auditors of the superintendencies of Costa Rica;
- Approve the provisions concerning the authorisation, regulation, supervision, control and surveillance that have to be enforced by the superintendencies. Requirements that unduly restrict the access of economic agents to the financial market, limit free competition, or include discriminatory conditions cannot be established;
- Approve the general rules of organisation of the superintendencies and internal auditors;
- Approve the annual operating plan, budgets⁵⁰ and submit them to the Office of the Comptroller General of the Republic for final approval;
- Approve the annual report of each superintendency as well as the annual sector reports that superintendencies submit on the performance of the respective parties supervised;
- Suspend or revoke the authorisation granted to parties regulated by the various superintendencies, or the authorisation for public offering;
- Order the suspension of operations and the intervention of parties regulated by the superintendencies, as well as decreeing their intervention and liquidation before the appropriate authorities;
- Hear and solve appeals filed against the resolutions entered by the superintendencies;

⁵⁰ Within the global limit fixed by the Board of Directors of the Central Bank of Costa Rica.

- Resolve any conflicts of competence that may arise between and among superintendencies;
- Regulate the exchange of information that can take place between and among the various superintendencies for the performance of their discretionary actions.

105. According to Article 169 of Law 7732, CONASSIF's governing body is composed of the Chairman of the BCCR (or its Manager), the Minister of Finance (or a deputy in his/her absentia), and five other members.⁵¹ These five members are designated by the Board of Directors of BCCR by a majority of at least five votes and for a five-year term (renewable once) and they cannot hold any other public sector employment post. One of these five members is elected by the body as President of CONASSIF for two-year renewable terms. Superintendents can attend CONASSIF meetings although they do not have the right to vote.⁵²

106. CONASSIF has a group of advisors serving in four areas: Legal Advisory (three lawyers), Economic Advisory (one economist), Macro-prudential Advisory (one economist) and Administrative Matters (one certified public accountant), as well as an Internal Audit Unit reporting to the CONASSIF. In addition, CONASSIF participates in a number of coordination and cooperation committees⁵³:

- Superintendents Committee;
- Consolidated supervisory committee for issues relating to financial groups and conglomerates;
- Joint working committees formed by technical staff of the superintendencies, CONASSIF and the BCCR to issue and amend laws, perform research and analysis around specific issues;
- Committees within CONASSIF, such as the audit committee and the budget and risk committee;
- Advisory committees formed by representatives of the supervised entities, investors or other economic sectors, to examine specific issues and issue non-binding recommendations.

General Superintendency of Financial Institutions (SUGEF)

107. SUGEF is the supervisor of all financial intermediaries operating in Costa Rica, including state-owned and private banks, non-banking financial companies, mutual savings and credit entities, as well as any other entity legally authorised to carry out financial intermediation activities.⁵⁴ Currency exchange transactions also fall under the supervisory remit of SUGEF.

⁵¹ There is a nationality requirement for members of CONASSIF, Superintendents and Intendents (pursuant to Articles 170 of Law 7732 and 18 of Law 7558).

⁵² According to Article 35 of Law Act 7523, CONASSIF's governing body for SUPEN is composed of the Chairman of the BCCR (or its Manager); the Minister of Work and Social Security or his representative; a member appointed by the Board of Directors of the BCCR, of the Working Assembly of the Popular and Communal Development Bank; and the same five persons appointed as members of CONASSIF mentioned above.

⁵³ CONASSIF can mandate specific matters to commissions composed of some of its members and designate consultative committees composed of representatives of the entities under supervision, the investors or other economic sectors, to examine specific subjects and issue non-binding recommendations.

⁵⁴ BANHVI acts as auxiliary supervisory body of SUGEF for the National Housing System, in accordance with the regulations issued by SUGEF (Article 90 of Law 7052). Operations undertaken by participants to the National Housing System with non-BANHVI resources are excluded from the auxiliary supervision of BANHVI and are directly supervised by SUGEF.

108. CONASSIF appoints the Superintendent and Intendent of each superintendency (the highest hierarchical positions) for a five-year term, potentially renewable (Articles 171 and 172 of Law 7732 regulating the securities market). Both the Superintendent and the Intendent report to CONASSIF with respect to the actions of their superintendency. The Superintendent and Intendent may be removed at any time by the CONASSIF by a majority of at least five votes if they no longer meet the requirements for appointment due to disability, incompatibility, termination of duties or negligence in the performance of their duties. Any dismissal is subject to the opening of an administrative proceeding and the issuing of a resolution explaining the grounds for the dismissal.

109. According to Article 131 Law 7558, the SUGEF Superintendent can: (i) propose regulation to CONASSIF; (ii) order the inspection of organisations within its supervisory scope; (iii) dictate corrective and precautionary measures; (iv) request CONASSIF to approve the administrative intervention of supervised organizations and supervise the intervention process; (v) sanction supervised organizations; (vi) order adjustment or correction of registered value of assets, liabilities, equity and other off-balance accounts of the supervised organizations; and (vii) assess the financial and economic situation of the supervised organizations. In addition, SUGEF can recommend the removal of any member of the management body, manager, deputy manager or internal auditor, for reasons prescribed by the law; restrict or prohibit the supervised entity from distributing profits, surpluses or other benefits of a similar nature to its members, shareholders or associates, as well as distributing bonds, incentives or other compensation to its officials or employees, when it is in some degree of financial instability or irregularity, or when their capital adequacy is adversely affected; and order supervised entities to cease or suspend activities or operations.

110. SUGEF has 204 staff members distributed as follows: Superintendent and Intendent Office (8); Supervision of Public Banks and Mutuels (36); Supervision of Private Banks and Financial Groups (39); Supervision of Financial Companies and Cooperatives (34); Technical Services (28); Legal Advice (12); Department of Analysis and Compliance with Act 8204 (42); Administrative Coordination (18); Overall Risk (6); and Quality Assurance (3).

111. SUGEF can also contract auxiliary supervisors for its supervisory work, the cost of which will be charged to the supervised entity. The conditions and requirements for the recruitment and contracting of auxiliary supervisors are provided in Article 134 of Law 7558. To date, no such auxiliary supervisor has been hired by SUGEF.

General Superintendency of Securities (SUGEVAL)

112. SUGEVAL's supervisory role is prescribed by Law 7732 Regulating the Securities Market in Costa Rica. SUGEVAL came as the successor of the National Securities Commission, created in 1990 by virtue of Law 7201 Regulating the Securities Market. The purpose of SUGEVAL is to ensure transparency in the securities markets, correct price formation, investor protection and dissemination of the necessary information so as to ensure the above objectives.

113. SUGEVAL's main functions are: (i) issuance of regulations; (ii) monitoring of public offering of securities; (iii) authorisation of participants and market products; (iv) overseeing of regulatory compliance; (v) suspension or revoking of the authorization and establishment of penalties under the Law Regulating the Securities Markets; and (vi) information provision to investors and the wider public.

114. The number of staffing positions available to SUGEVAL as of April 2020 was 87, of which 71 were occupied and 16 were unfilled. SUGEVAL staff members are distributed across six areas, as follows: Superintendent and their secretaries (6); Markets and Intermediaries Supervision Division (20); Mutual Funds and Issuers Supervision Division (15); Public Offering Authorizations Department (12); Legal Division (7); and Institutional Management Department (11).

Regulatory process

115. Any reform or development of new regulation by CONASSIF follows the process prescribed by CONASSIF resolution on the *Procedure for processing draft proposals that issue or reform Financial System regulations*⁵⁵. The following steps are to be followed for the issuance or reform of any financial regulation by CONASSIF:

- a) Submission of conceptual framework of the regulatory necessity and its scope to CONASSIF by the Superintendent's Office; CONASSIF may approve or oppose the process;
- b) Development of the proposed regulation by the Superintendent's Office;
- c) Proposal by the Superintendent's Office to CONASSIF for the issuance or reform of a regulation, including a letter indicating the period and process of public consultation to be undertaken, a legal and technical opinion as well as a cost-benefit analysis in accordance with the provisions of the Law 8220 for the Protection of Citizens from Excessive Requirements and Administrative Processes;
- d) Analysis of the proposed regulation by the Chairman of CONASSIF, a specific committee or the advisors of CONASSIF, and submission of recommendations to the Superintendent;
- e) Discussion by CONASSIF and approval of the proposed regulation to be submitted for external public consultation⁵⁶;
- f) Publication of the proposed regulation on the Superintendence's website;
- g) Submission by the Superintendent of final proposal for issuing the regulation or its reform. A matrix with the comments received during the consultation period, the comments by the Superintendents regarding such comments and the resulting text is published on the Superintendent's website and the final version is published in the Official Newspaper La Gaceta;
- h) Compilation and filing of a 'Regulations File' by the Secretary General of CONASSIF, containing all documentation related to the process.

Legal protection of supervisors

116. Providing legal protection to bank supervisors in line with international best practice is one of the pending recommendations of the 2008 FSAP.⁵⁷ Until September 2019, neither the General Superintendency of Financial Institutions (SUGEF) nor any of the other superintendencies of Costa Rica had legal (statutory) protection regarding their supervisory activity⁵⁸ and superintendents were liable to respond for their supervisory actions with their personal assets. According to the General Law of the Public Administration

⁵⁵ Approved at Meeting 1047-2013, Article 5, held on 18 June 2013.

⁵⁶ Consultation processes are addressed to entities regulated and supervised by the respective superintendency and the general public.

⁵⁷ The Basel Committee on Banking Supervision's Core Principles on Effective Bank Supervision Principle 2.9 states that the "[l]aws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith."

⁵⁸ The budget of some superintendencies and CONASSIF includes resources for legal assistance to their personnel for any judicial claims that they may face in relation to acts performed in the exercise of their duties.

No 6227, *"the Administration shall be liable for all damages caused by its legitimate or illegitimate, normal or abnormal operation, except force majeure, fault of the victim or fault of a third party"*. Officials have been sued in the past for actions as financial supervisors; however, no supervisor has been convicted as the courts judged that the actions had been taken in good faith and were technically correct.

117. Formerly, the legal defence provided to supervisors and regulators in case they are sued is not consolidated at the statutory level but depends on an agreement by the Board of Directors of the Central Bank or the CONASSIF. The Costa Rican authorities state that no official of the superintendencies has been convicted of his actions as a financial supervisor because the courts have pointed out that they have been taken in good faith and were technically correct.

118. In September 2005, a bill of law (No. 16.008) Amendments to the Organic Law of the Central Bank of Costa Rica was submitted to the Legislative Assembly. The initial draft⁵⁹ included the provision of adequate legal protection to bank supervisors in relation to acts performed in the exercise of their duty. This provision was later deleted as it was opposed by the Court and was further considered as contradictory to domestic and international legal commitments against corruption in the public service.

119. Following the Accession Review of Costa Rica by the Committee on Financial Markets and the relevant recommendation, legal protection for bank supervisors has been included in the bill of law (No. 21 293) that was submitted to the Legislative Assembly on 8 March 2019, was approved by the Special Commission on 5 August 2019, voted by the Plenary on 17 September 2019 and in force since 22 October 2019 (Law No. 9746). This law introduces modifications to the Law Regulating the Securities Market, No 7732 to create a statutory regime which ensures legal assistance to supervisors and regulators by their institutions and aims to provide them with greater certainty when they are sued. The provision also protects former supervisors and regulators for the activities related to supervision and regulation when they held the position.

Funding arrangements of supervision

120. The funding of supervision was heavily dependent on Central Bank funding. BCCR covered 100% of SUGESE's expenses incurred and 80% of the expenses incurred by SUGEF, SUGEVAL, SUPEN and CONASSIF, with the remaining 20% paid by supervised entities (Article 174 of Law Regulating the Securities Market-No. 7732 and Executive Decree N° 38292-H). According to BCCR, the superintendencies' budget accounts for around half of BCCR's total operational budget.

121. The 2008 FSAP assessment recommended that the funding of SUGEF should be aligned with international standards.⁶⁰

122. Following the Accession Review of Costa Rica by the Committee on Financial Markets, a bill of law (No. 21.293) was submitted to the Legislative Assembly amending the Law Regulating the Securities Market (No. 7732), which includes a change in the attribution of superintendencies' financing, moving from an 80%/20% split between the BCCR and supervised companies to a 50%/50% split. Such an amendment would apply to CONASSIF and all superintendencies. Bill of law no. 21.293, was presented to the Legislative Assembly on 8 March 2019, was approved by the Special Commission on 5 August 2019, voted by the Plenary on 17 September 2019 and in force since 22 October 2019 (Law No. 9746). Under this law, during the first two years following its enactment, there will be no change to the current distribution of

⁵⁹ The draft bill was stalled in Congress for eight years and was subsequently archived by the Legislative Assembly in July 2014, as its approval deadline was not met.

⁶⁰ In fact, the Basel Committee on Banking Supervision's Core Principles on Effective Bank Supervision Principle 2.6 states that "[It] is financed in a manner that does not undermine its autonomy or operational independence" which would indicate autonomy from government, but does not specify the method by which it is financed.

expenses. After that, the entities supervised by SUGESE would have to contribute 10% in year three and 20% in year four. For the following four years, all entities would increase their contributions by 7,5% per year until they reach, in year eight, 50% of the expenses incurred (to cover for the four superintendencies and the CONASSIF).

123. According to Article 175 of Law 7732 in force, supervised entities of SUGEF, SUGEVAL and SUPEN are required to contribute up to a maximum of two percent of their annual gross income to finance the expenses incurred by their respective supervisor.⁶¹ Entities supervised by more than one superintendency would only contribute to the expenses incurred by their main supervisor, according to the conditions in the by-laws.

124. According to the new legislation, every entity supervised by superintendencies will be required to contribute to the financing of expenses incurred by the corresponding superintendency. In the cases of SUGEVAL, SUGEF and SUGESE, the required contribution cannot exceed two percent of supervised entities' annual gross income. For SUPEN, the calculation basis was modified from gross income to managed assets, with a maximum allowed of 0.2% of managed assets. In order to reflect risk-based supervision, the bill allows the superintendencies to charge a higher amount to entities (although respecting the maximum described above) that have a higher risk profile and therefore entail a higher cost of supervision.

B. Supervision of financial institutions

125. Private banks must be established as corporations, cooperative union federation, or union of mutual associations, and no branching is thus allowed for the provision of banking services (see Section V.A).⁶² According to the Structural Law of the National Financial System (Law 1644), commercial banks are prohibited from participating directly or indirectly, on agricultural, commercial, industrial or other companies, or purchase products, goods and real estate which are not essential for their normal operation.⁶³

126. SUGEF Agreement 8-08⁶⁴ regulates the procedure and requirements for the authorisation of financial intermediaries. SUGEF receives and assesses applications for authorisation by financial intermediaries, while the actual authorisation is granted by CONASSIF, following the analysis of an assessment report provided by SUGEF. Financial institutions applying for authorisation have the right to file an appeal within eight days from the result notification. Authorisation requirements are the same both for domestic and foreign financial institutions or groups. The authorisation process comprises three steps: (i) authorisation for the constitution of an organisation; (ii) authorisation for the initiation of operations; and (iii) registration of the organisation.

127. Pursuant to articles 62, 63 and 65 of Law 7558, all supervised financial institutions must maintain a reserve requirement for deposits and funds received, with a maximum limit of 15%, in an unremunerated BCCR current account.⁶⁵ This minimum reserve requirement has been set by BCCR at its maximum level

⁶¹ In case of non-financial issuers, this contribution drops to a maximum of zero point one percent (0.1%) annually over the amount of issuance. This was maintained in the bill approved by the Legislative Assembly.

⁶² Based on provisions of Law 1644 and Law 7107 and their amendments.

⁶³ Credit cooperatives are allowed to participate in cooperative or other organisations up to a maximum of 25% of their own capital (Regulating Law of the Financial Intermediation by Cooperative Organisations No 7391).

⁶⁴ Regulations on the authorizations for institutions supervised by SUGEF and on the authorizations and functioning of financial groups and conglomerates.

⁶⁵ Banco Popular y de Desarrollo Comunal is subject to reserve requirements only for its deposits in current accounts, pursuant to article 63 of Law 7558.

since August 2005.⁶⁶ Short-term external debt operations and new operations of medium and long-term external debt were included as part of the reserve requirement respectively in September 2011 and July 2015. There is no differentiation by instrument or institution. Although this requirement does not apply to cooperatives, a minimum liquidity reserve of 15% is applied to a group of cooperatives based on their size. These reserves must be invested in financial instruments issued by BCCR in CRC.

128. Authorisation of public offerings of securities and of securities intermediaries is granted by SUGEVAL pursuant to the Law Regulating the Securities Market (Law 7732) and the Regulation on Public Offering of Securities. Authorisation of issuers, investment fund managements, public offerings made by investment funds, credit rating agencies and price providers is also granted by SUGEVAL pursuant to the applying rules and regulations.⁶⁷ In case of brokerage firms, the requirements for authorisation and operation are stipulated in the National Stock Exchange Rules and the authorisation is granted by the National Stock Exchange. Entities supervised by SUGEVAL must be established as corporations (*sociedades anónimas*) with the exception of foreign branches of investment fund management companies.

Capital adequacy regime

129. Capital adequacy of financial institutions operating in Costa Rica is prescribed by SUGEVAL Agreement 3-06 (Regulation on Capital Adequacy of Financial Institutions) and SUGEVAL Agreements 24-00 (Regulation to assess the economic and financial situation of the supervised entities) and 27-00 (Regulations to assess the economic and financial condition of savings and loans mutual associations for housing).

130. SUGEVAL Agreement 3-06 defines a minimum capital requirement of 10% for all financial institutions (banks, savings and credit cooperatives) operating in Costa Rica and describes the methodology to estimate the solvency of supervised entities. Reserves created with specific purposes, other than loss absorption, are not accepted for the calculation of solvency. Capital is required for credit risk, operational risk, exchange rate risk, counterparty and market risk in transactions with exchange rate derivatives and risk of changes in interest rates on operations with exchange rate derivatives.

131. Financial institutions are rated and categorised by risk level based on their capital adequacy levels, according to SUGEVAL Agreements 24-00 and 27-00. The same regulation prescribes remedial action and measures required in each of the different risk levels (see Section IV.C).⁶⁸

Table 1.10. Capital adequacy ratios and risk assessment

Risk level	Capital adequacy ratio (CAR) level
Normal	CA ≥ 10%
Level 1	9 ≤ CA < 10%
Level 2	8% ≤ CA ≤ 9%
Level 3	CAR < 8%

Source: SUGEVAL.

⁶⁶ These reserves are used as the base and guarantee for the clearing of checks and other redeemable securities.

⁶⁷ Regulation on Public Offering of Securities, General Regulations on Management Companies and Investment Funds, Regulations on Rating of Securities and Credit Rating agencies, Regulation on Valuation of Financial Instruments and the Law Regulating the Securities Market.

⁶⁸ Pursuant to Article 36 of the SUGEVAL 24-00 Agreement, SUGEVAL may require preventive actions when it determines a risk situation, even if the capital and other financial indicators do not reflect irregularity.

Transition to risk-based supervision

132. Implementation of a risk-based supervisory (RBS) model by all superintendencies has been the objective of the 2019-22 National Development Plan for the financial sector, measured by the number of supervised entities on which a risk-based supervisory approach will be applied by 2022. RBS implementation has, however, begun prior to this National Development Plan based on the Superintendencies' own schedule for implementation.

133. SUGEF has prepared for the transition to a RBS model since 2009 and started implementing it in June 2016 after successfully undertaking pilot programmes and training superintendency staff at a training centre established specifically for the development and implementation of a curriculum for RBS. The development of IT systems by SUGEF is underway with a view to further support RBS.

134. In the context of the transition to a RBS model, SUGEF has updated and issued new prudential regulations that are principles-based, moving away from the prescriptive forms. Under this approach, regulation provides guidance on the supervisor's expectations and empowers the BoD of supervised entities to define the ways in which the Principles contained in the standards are satisfied. Examples of such regulations include: Corporate Governance Regulation, Liquidity Risk Management Regulations, Operating Risk Management Regulations, Comprehensive Risk Management Regulations, Market Risk Management Regulations, Interest and Exchange Rates and the Regulation on Information Technology Management.

135. SUGEF has a set of tools, frameworks, procedures and guides that enable the application of risk-based supervision. The conceptual framework comprises a system that is based on continuous, dynamic and prospective analysis of risks assumed by supervised entities, which allows determining and evaluating the nature and impact that current and future events could have on the level of risk assumed by supervised entities and require corrective actions, when necessary. It includes:

- i) RBS guides: procedures applied by the superintendency and elements evaluated;
- ii) a conceptual framework for prudential supervision: approach, considerations, principles, evaluation methodology and supervision process applied;
- iii) a general supervision framework for supervisors, to guide RBS by SUGEF staff; and
- iv) governance of RBS: a number of committees supporting the supervisory work. These are the Supervisory Committee (approves institutional macro-planning during the monitoring cycle); the Rating Committee (approves the risk profile and supervisory strategy rating); the Committee for improvement of the risk-based approach (updates supervision guides and procedures so as to calibrate the methodology and assess the inclusion of international best practices); and the Advisory Committee on the Supervisory Process (evaluates and reviews the products generated during each supervision of the institution, namely planning, execution and reporting).

136. The supervision process includes the following steps:

- i) Macro-planning: defines supervision priorities and identifies which supervised entities will be supervised during the supervision cycle based on the rating of the risk profile, the systemic importance of the institution, its complexity of operations, changes in business, environment or industry profile. It also defines the types of visits (integral, monitoring, special, permanent, conglomerate and cross-border);
- ii) Monitoring and analysis: allows a continuous supervision of each supervised institution, including through on-site visits. It comprises the updating of information around the supervised institutions, verifying compliance with laws and regulations, analysing the financial situation and exposure to

risks, monitoring of warning alerts, updating of the risk profile and the strategy of supervision, control of requirements and monitoring of action plans of the institutions;

- iii) Inspection: includes the visit by a specialist team of supervisors to the institution and the preparation of a study applying RBS guides and rating the components established by the risk assessment methodology;
- iv) Reporting: issuance of final reports of the inspections, such as the internal report, the risk matrix, the risk profile report and supervision strategy, and the communication letter to the institution; and
- v) Evaluation of results: evaluation and review carried out by the superintendent and the senior management, as well as the support committees within the governance system of the superintendency.

137. SUGEVAL, with the assistance of the Toronto Center, concluded the development of its new supervision framework using a risk-based supervision approach (RBS) in December 2019. This new approach improves the supervisory procedures and inspection guidelines, and introduces an evaluation tool for the corporate governance framework of each supervised entity. This will allow the superintendency to focus its resources on riskier activities and entities.

Financial accounting and reporting

138. SUGEVAL 31-04 Regulation on the Financial Information of Entities, Groups and Financial Conglomerates regulates financial reporting of regulated entities⁶⁹ supervised by SUGEVAL and of financial groups and conglomerates supervised by any of the superintendencies. Supervised entities are required to prepare and submit to SUGEVAL quarterly financial reports and (consolidated) audited annual reports. The audited financial report must be approved by the BoD of the entity and disclosed publicly in supervised entity's website. All non-financial listed companies produce financial statements according to IFRS.

139. According to Article 171 of Law 7732, CONASSIF is responsible for setting the financial reporting (accounting and audit) standards for regulated entities. Financial institutions are required to prepare financial statements according to IFRS. Any amendments to the IFRS adopted by supervised entities, new IFRS or interpretations issued by the IASB require the prior approval of CONASSIF.⁷⁰ The Accountant General's office (Contabilidad Nacional, part of Ministry of Finance), is the technical body responsible for ensuring IFRS implementation in SOEs.

140. The continued use of IFRS 2011 by financial institutions in Costa Rica up until 2018 affected transparency and undermined the comparability with international financial institutions using current IFRS, particularly given the changes IFRS has undergone since 2011. Exceptions applied until then in the use of IFRS by financial institutions, such as credit risk provisioning and treatment of intangible assets.

141. Following the Accession Review of Costa Rica by the Corporate Governance and the Financial Markets Committees, CONASSIF decided to migrate accounting standards to the most recent version of IFRS for all financial sector participants, including all securities markets participants, through the enactment of new regulation prepared by the superintendencies. CONASSIF also decided to improve the process of

⁶⁹ Listed companies and financial sector entities (banking, financial companies, pension, and insurance).

⁷⁰ For unregulated entities, CONASSIF accepts the standards set by the Chamber of Certified Public Accountants (Colegio de Contadores Públicos de Costa Rica--CCPA) for private companies and the Ministry of Finance for state-owned enterprises. Through its Circular No 06-2014 of 2014, the CCPA ratified IFRS and its respective interpretations as the appropriate norm for private companies in Costa Rica. All companies accessing the capital markets through the BNV must report according to IFRS.

updating financial standards through a more dynamic process of adapting and adjusting new IFRS standards to the local regulation. A conceptual framework has been proposed by SUGEF and a formal consultation process with the industry on such regulation was undertaken in 2017.

142. In October 2018, CONASSIF and SUGEF passed a regulation entitled Regulation on Financial Information (Reglamento de Información Financiera--SUGEF 30-18). This regulation required the adoption of IFRS by regulated financial companies by January 1, 2020 and established a system for automatic adoption of new standards or reforms adopted by IASB. The accord permitted eight deviations⁷¹ from full IFRS. One of these gaps relating to IAS 12 (Income Taxes) and IFRIC 23 (Uncertainty over Income Tax Treatments) was addressed by Law No. 9635 (Law to Strengthen Public Finances) approved in December 2018 where a deadline was established for January 2024.⁷² Another two gaps⁷³ were addressed in the Law on Consolidated Supervision (Law No. 9768) voted by the Plenary of the Legislative Assembly on 16 October and came into force on 4 November 2019. CONASSIF plans to close the remaining gaps over the next few years to achieve full IFRS adoption.

143. There are currently two professional associations of public accountants, the Costa Rican Professional Association of Public Accountants (CCPA) created by Law 1038, and the Costa Rican Professional Association of Private Accountants (CCP) created by Law 1269.

144. In terms of non-financial reporting, Law 7732 Regulating the Securities Market establishes a requirement for disclosure of shareholdings of 10% and above of the total capital of a company to the stock exchange, the company itself, and the Superintendency. The same requirement applies to financial entities supervised by SUGEVAL.⁷⁴ Members of a BoD, supervisory committee or managers of companies registered in the National Registry of Securities and Intermediaries must report their shareholdings and any transactions of shares in said corporation, regardless of size.⁷⁵

⁷¹ The gaps related with IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations), that exists only for assets received in payment, and IFRS 9 (Financial Instruments – Recognition of Expected Credit Losses), that exists only in the banking sector (regarding countercyclical buffer requirements), will be both addressed by a reform to the Regulation on Capital Adequacy of Financial Entities and to the Regulation on Financial Information. Also regarding IFRS 9, there is another gap regarding loan portfolio in the banking sector, on recognition of expected credit losses that will be addressed by the issuance of a new regulation in accordance with expected credit losses. On the other hand, the gaps related with IAS 21 (Effects of Changes in Foreign Exchange Rates), that exists only when the entity operates under a functional currency different from Costa Rican colones, and IAS 1 (Presentation of Financial Statements), that applies to the whole financial sector, will be both addressed by a reform to the Regulation on Financial Information.

⁷² This deals with the moment of recognition of income tax payment. It exists only for 9 financial institutions. Law No. 9635 and the Regulation on Financial Information included a transitional provision to close the gap by January 2024.

⁷³ The law on Cross-Border and Consolidated Supervision addressed the gap related with IAS 38 (Intangible Assets), IFRS 10 (Consolidated Financial Statements) and IAS 28 (Investments in Associates and Joint Ventures). Regarding IAS 38, the reform of Article 151 of the Organic Law of the National Banking System eliminates the possibility of recognising organisation and installation costs for banking institutions that are in the process of initiating operations as an asset that is amortised within 5 years and eliminates the potential difference with regard to IFRS. Regarding IFRS 10 (Consolidated Financial Statements) and IAS 28 (Investments in Associates and Joint Ventures), the gap exists only for supervised cooperative associations, for consolidation of non-financial activities. The proposed reform to Article 141 of the Organic Law of the National Banking System will allow consolidation of financial statements for both financial and non-financial subsidiaries of supervised cooperative associations.

⁷⁴ Pursuant to Regulation on the Provision of Periodic Information, Relevant Events and Other Reporting Obligations.

⁷⁵ According to the Law of Protection to Minority Shareholders No 9392.

Corporate governance

145. The corporate governance regime applicable to financial institutions is established under the revised Corporate Governance Regulations issued by CONASSIF. In January 2016, CONASSIF circulated its proposed Regulation on Corporate Governance (Propuesta de Reglamento de Gobierno Corporativo) for consultation, which was approved in November 2016 and became effective in June 2017.

146. The new Corporate Governance Regulation draws upon leading international benchmarks for corporate governance including the instruments of the Bank for International Settlements (BIS), Basel Committee on Banking Supervision, International Association of Insurance Supervisors, the Financial Stability Board (FSB), the International Organization of Securities Commissions (IOSCO) and the OECD/G20 Principles of Corporate Governance. It is based on a principles-based model, moving away from the current rules-based model and guiding supervisory expectations regarding the management of regulated entities. Unlike past standards, which were enforced through the “comply or explain” principle, the new Regulation will be mandatory. It deals with the different characteristics and capacities of regulated institutions by allowing proportionality in its application, as its rules can be adapted to the size and nature of the institution.

147. The Corporate Governance Regulation applies to all organisations under the supervision of the four financial superintendencies (issuers, banks, market intermediaries, insurance companies and pension funds), including state-owned banks and banks created by special law. It covers a comprehensive set of governance issues including: (i) board member duties; (ii) board responsibilities; (iii) board composition; (iv) board member profiles; (v) nominations processes, (vi) documentation; (vii) board evaluations; (viii) conflicts of interest; (ix) committees; (x) risk management; (xi) audit; (xii) remuneration; (xiii) transparency; (xiv) subsidiary governance; (xv) shareholder rights and other.

148. Given the different legal nature of the entities covered, the composition of the financial institution’s BoD must be in accordance with the specific law that creates or regulates the entity or in the absence of a specific law, in conformity with the Commercial Code and the bylaws of the company (Article 4). A new regulation that was passed in May of 2018, Regulation on Suitability of Members of the Management Body and Senior Management of Financial Entities (Reglamento sobre Idoneidad de los Miembros del Órgano de Dirección y de la Alta Gerencia de las Entidades Financieras), applies to all financial companies including state-owned banks. It covers issues relevant to board member selection, including fit and proper testing, expected experience, the need to select board members in response to company needs, conflicts of interest, proper selection procedures and so on.

149. According to Costa Rican authorities, there is evidence of significant weaknesses in the qualifications and experience of some BoD members and senior managers, in particular in institutions with special legal regimes, such as state-owned banks and non-state banks created by law where designations are made by the Executive Power. Weaknesses in the structure of corporate governance have also been identified by SUGEF in the savings and credit cooperatives sector, for example designation of unsuited members to the BoD or weak accountability frameworks.

150. A new regulation was passed in May of 2018 that applies to all financial companies including SOE banks (see next section: Fitness and propriety). It covers fitness and propriety testing for board members, experience required, the need to select board members in response to company needs, conflicts of interest, and proper selection procedures.

151. According to the Costa Rican Authorities, deficiencies in corporate governance of supervised institutions will feed into the rating of the supervised institutions under the risk-based supervision model, increasing their risk profile accordingly. This will in turn lead to higher capital requirements or other requested action plans or corrective measures, in addition to disclosure requirements. The application of such

corrective measures was made possible after the reform of Law 7558 (the Organic Law of the BCCR). Such reform, in addition to providing a framework for consolidated supervision, granted SUGEF discretionary intervention powers by extending the scope and reach of its current intervention and sanctioning powers.

152. After the implementation of relevant measures within the context of a comprehensive action plan before the OECD Working Party on State Ownership and Privatisation Practices, further actions will be taken to continue improving the corporate governance of state-owned banks. In particular, Costa Rica will continue with the implementation of the OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOEs), following the priority recommendations made by the Working Party on State Ownership and Privatisation Practices. The results of the following actions apply to all SOEs, including State-owned banks (SOBs). The country is revising board remunerations in order to support competitive remuneration and promote incentives that are aligned with good board practices. A study is being conducted and will establish a fee scale for boards after analysing public and private sector labour market data. The country will also continue implementing actions to strengthen the functioning of boards. Important steps have been taken in order to assess SOE boards and promote their evaluation. The topic is addressed in Costa Rica's ownership Protocol, in the Strategic SOE Board Directive and in the General Policy for Board Performance Evaluation, which instruct boards to conduct self-evaluations. Costa Rica will also continue with the implementation of the SOE board member selection policy, that also applies for SOBs. The country is also preparing the regulation to the law on deposit insurance and banking resolution, which will continue promoting level playing field between private and SOBs.

Fitness and propriety

153. Pursuant to the new Corporate Governance Regulation, the senior management and Board of Directors (Governing Body) of supervised entities must be of recognised repute and with the experience, competencies and integrity necessary to manage and supervise the businesses and activities under their responsibility. The body responsible for electing BoD members must ensure that the candidates are qualified for such positions and free of conflicts of interest that could prevent them from acting in an objective and independent manner. To that end, this regulation provides that institutions must have a clear, formal and rigorous process to identify, evaluate and select the candidates of the management body (highest governing body of the organisation).

154. In addition to the Corporate Governance Regulation, CONASSIF approved a complementary regulation on the fitness and propriety of board members and executives, the Regulation on Suitability of Members of the Management Body and Senior Management of Financial Entities (*Reglamento sobre Idoneidad de los Miembros del Órgano de Dirección y de la Alta Gerencia de las Entidades Financieras*), which entered into force on 4 May 2018. This regulation is narrower in scope than the Corporate Governance Regulation, in that it applies only to organisations under the supervision of the Banking Supervisor (SUGEF), including both state-owned and private banks, and focuses principally on defining the profiles of board members and executives of banking organisations. The regulation focuses on: a) honesty, integrity, reputation and experience; b) the suitability of the profile with the needs of the bank; c) record keeping of information on the profile of board members; d) self-evaluations by boards; and e) external evaluations by SUGEF.

155. In addition, the Law on Consolidated Supervision (Law 9768), widens the supervisory perimeter of financial supervisors and establishes their power to recommend the removal of board members under certain circumstances. The law permits SUGEF to recommend removal of board members when omissions or actions contrary to laws and regulations that threaten the security, stability and solvency of the entity, as well as when breaches of eligibility requirements occur and are duly substantiated.

156. The Council of Ministers has the legal power to appoint BoD members and senior management of state-owned banks. The composition of these BoD and relevant requirements are prescribed by the Structural

Law of the National Banking System Law 1644 and the Council of Ministers is required to submit an administrative file to SUGEF following the appointment of a person as BoD member of a state-owned bank. The file provides their qualifications and evidence of compliance with the requirements set by Law. However, in accordance with Law on Consolidated Supervision (Law 9768), SUGEF can recommend the removal of the board member after appointment. Senior management members (Managers, Deputy Managers, Auditors and Sub-Auditors) are appointed and removed by the BoD of each state-owned bank, based on the provisions of Law 1644 and according to the requirements set forth in said law.

Large exposures and related party transactions

157. The maximum limit for direct or indirect lending to a single counterparty is 20% of the subscribed and paid-in capital of the financial entity, plus any non-redeemable capital reserves (Article 135 of Law 7558). Financial entities may set internally their own maximum limits, without exceeding the maximum limits set forth by the supervisor.

158. The following cases are exempt from these limits:

- i) For lending by Banco Hipotecario de la Vivienda (BANHVI), SUGEF can authorise a maximum limit of 40%;
- ii) Operations and investments made by financial intermediaries with BCCR, the Ministry of Finance and investments in sovereign debt of countries with an investment rating equal to or higher than AA are exempt from the maximum limit.
- iii) For direct and indirect lending operations carried out with the economic interest groups in which the Instituto Costarricense de Electricidad (ICE) participates, a maximum limit of 30% applies⁷⁶;
- iv) For direct and indirect lending operations made by trusts to finance public works projects to promote public administration, a threshold of up to 40% applies.⁷⁷

159. The same limit applies to direct and indirect lending operations carried out with related parties (“economic interest groups”: shareholders, representatives, directors, managers or their relatives up to the third degree by consanguinity or second degree by affinity, and companies associated with them). The total financing of related parties or economic interest groups associated with the financial entity, either through common ownership or management, cannot exceed eighty percent (80%) of the subscribed and paid-in capital stock and its non-redeemable capital reserves.⁷⁸

160. Lending or deposit operations with economic interest groups should be undertaken under the same conditions than those applied in the ordinary course of operations with third-parties. A sanction comprising a fine equal to 0.5% - 1% of its equity to be deposited in the National Treasury, applies to financial entities undertaking related party transactions on a non-arm’s length basis. Granting of loans to economic interest groups requires the respective agreement of the BoD of the bank and the express written approval of the Superintendent.

161. In case of financial groups or conglomerates, operations with companies that are part of the same financial group should be performed under the same conditions with those applied in the ordinary course of operations with third-parties (Article 146 of Law 7558). State-owned banks cannot engage in credit

⁷⁶ As of July 2017, no bank exposed to ICE has reached the maximum exposure limit.

⁷⁷ As of July 2017, no bank financing public work projects has reached the maximum exposure limit.

⁷⁸ Article 2 of Law 8770 of 2 September 2009.

operations, whether directly or indirectly, with (i) members of their own Board of Directors and their parents, children, spouses and other relatives by consanguinity or affinity up to the second degree, inclusive; and (ii) commercial or cooperative corporations of which the members of the Board of Directors or administrative officials of the same bank are legal representatives or otherwise, own shares, quotas or other capital participations, equal to or over 50% of that agreed (Article 117 of Law 1644). These entities are also prohibited from participating in the capital of other financial or non-financial companies.⁷⁹

162. According to Law 7983 (*Ley de Protección al Trabajador*) investment fund managers are prohibited from investing in securities issued or guaranteed by BoD members, managers or agents of authorized entities, relatives of these, or by natural or legal persons having a shareholding participation higher than five percent or any other with an effective control, or related persons integrating the same economic or financial group of interest.

Consolidated supervision of banking groups and cross-border supervision

163. According to the Organic Law of the Central Bank of Costa Rica, financial groups cannot include non-financial institutions in the group and a holding company must be established for a financial group to hold different financial entities (see Section I.D). The holding company must be a corporation whose sole purpose is to acquire and manage shares issued by the companies that make up the group.

164. The holding company is responsible for the relations of the group with the supervisory entity. It consolidates and submits the group's audited financial statements and provides information about operations carried out between companies of the financial group. It informs the supervisor on the composition of the capital stock of the financial group and the quality, risk and diversification of assets held by the group's companies.

165. Prior to the accession review process of Costa Rica by the Committee on Financial Markets, there was no legislation allowing for consolidated supervision of financial groups⁸⁰. New legislation introduced in the bill of law on Cross-border and Consolidated Supervision of Banking Group (Law No. 21355) and which entered into force on 4 November 2019 allows for consolidated supervision of financial groups. In the case of state-owned financial conglomerates⁸¹, its holding company must be a state-owned bank and whose supervisor is therefore SUGEF, both in their capacity as individual institutions and as holding companies.

166. According to SUGEF's Agreement 8-08, SUGEF is the supervisor of financial groups or conglomerates that include a financial intermediary (credit institution) domiciled in Costa Rica. For groups with no financial intermediary domiciled in Costa Rica, the group supervisor is the superintendency supervising the financial entity with the highest volume of assets.⁸² The supervisor may change as a function of changes in the financial group structure or the asset volume. CONASSIF may assign the supervision of a financial group or conglomerate to a different Costa Rican supervisor at its discretion.

⁷⁹ Activities of investment management companies are exempt from such provision.

⁸⁰ Defined as a group of companies that engage in financial activities, organised either as corporations or organisations of cooperative, solidarity or mutualistic nature, under common control, common management or functional link, and organised and registered in accordance with the provisions of the *Structural Law of Costa Rica's Central Bank* (Act 7558) and its reforms.

⁸¹ According to Article 60 of SUGEF Agreement 8-08, consolidated supervision by SUGEF is applied to state-owned financial conglomerates since all members of such conglomerates are part of the bank's assets, and therefore within the scope of supervision, even when they are abroad.

⁸² Based on the calculation of the company's own assets plus any assets administered on behalf of third parties who are subject to the supervision of the same superintendency.

167. SUGEF's Agreement 8-08 Regulations, establishes a series of guidelines to determine: a) the supervisor of the financial group or conglomerate, b) the requirements for acceptance of foreign banking centres, c) the proceedings for changing the residence or the license type for banks of Costa Rican supervised financial groups located abroad, d) the requirements for incorporation of foreign organisations that are not subject to supervision at their legal residence (home jurisdiction), e) the rules regarding the provision of services among organisations that form part of the group or conglomerate, and f) criteria for the identification of *de facto* financial groups. When the application relates either to organisations or financial groups supervised by different supervisors, the supervisor in-charge must coordinate with other supervisors to get any documentation, information or approval required for the authorisation process.

168. SUGEF is actively participating in the supervisory colleges of all banks in Costa Rica with global operations. These include the following financial groups: (a) Banco de Bogotá (BAC Credomatic) and Davivienda organized by the Superintendencia Financiera of Colombia; (b) Promerica and Lafise organized by the Superintendencia de Bancos of Panama; and (c) Scotia organized by OSFI. In addition, Costa Rica has Memoranda of Understanding (MoUs) with countries where banks operating in Costa Rica consolidate their financial statements (MoU with Central America, Panama and Dominican Republic and bilateral with Colombia, Panama and Canada).

169. Coordination between the superintendencies is coordinated by the Supervisory Committee (ad hoc committee comprising the Directors of Supervision of the four superintendencies) and the Superintendents Committee (ad hoc committee comprising the four superintendents). The Supervisory Committee of all four superintendencies and the Superintendents (Liaison) Committee participate in the Central American Council of Superintendents of Banks and Other Financial Institutions (Central America, Panama, Dominican Republic and Colombia) which are also platforms for the exchange of information about supervised entities.

170. A draft law empowering the SUGEF to conduct consolidated supervision (including offshore structures) was submitted in the past and was archived by the Congress. Consolidated supervision of banking groups remained to be resolved. To that end, the Costa Rican Authorities presented on 23 April 2019 to the Legislative Assembly a bill of law on Cross-Border and Consolidated Supervision (No. 21.355), it was approved by the Special Commission on 2 September 2019, voted by the Plenary on 15 October and in force on 4 November 2019 (Law No. 9768). This bill of law widened the supervisory perimeter of SUGEF to include not only local companies but also other group companies relative to information provision, financial and capital requirements applying to financial group companies, including power for the supervisor to visit these companies outside the country to the extent that this is required. It also reinforced the information exchange mechanisms with supervisors of other countries, with a view to facilitate the exchange of information covered under the MoUs that SUGEF has with home regulators of global banks active in Costa Rica. It also strengthened the current sanctioning framework and the definition of members of a financial group that are subject to consolidated supervision. In addition, the legislation grants SUGEF discretionary intervention powers, by extending the scope and reach of its current intervention and sanctioning powers.

171. Regulatory reform has already been implemented in relation to banking secrecy and the exchange of information on banking transactions, through the modification of SUGEF Agreement 8-08⁸³ in order to respond to IOSCO's evaluation on bank secrecy and exchange of information (see Section V.D). National supervisors are allowed to exchange information on supervised entities as needed for the discharge of their supervisory and enforcement functions and disclosure of information to third parties is allowed as long as the law and CONASSIF consider it in the public interest.

⁸³ Article 60 modified by CONASSIF in sessions 1273-2016 and 1274-2016 on 23 August 2016.

C. Financial stability oversight and macroprudential surveillance

172. BCCR has identified four banks as systemic⁸⁴, while SUGEF has identified 11 systemically important financial institutions⁸⁵ for internal purposes of supervision and based mainly on their size. The difference in the number of entities identified as systemic is due to methodological differences and scope in their application, and harmonisation of such methodologies has been agreed by BCCR and SUGEF, resulting in seven systemic institutions. Institutions considered as systemically important are not notified of their status. BCCR has also identified five systemic entities in the payments system.

173. For BCCR to receive information from the superintendencies about supervised entities, the BoD of BCCR needs to send a request directly to the superintendency, by agreement of at least five of its members and by virtue of being necessary for the exercise of their functions (Law 7558), as neither BCCR nor SUGEF are authorised to disclose information on audited financial institutions. As this might make the process of exchange of information unpractical, especially given that no deadline is set in the law, agreements for the exchange of information have been signed by BCCR with all superintendencies but these agreements are limited. The establishment of the Commission of Financial Stability (CEF, see below) was also aimed at providing an alternative mechanism to partially resolve this complexity in the exchange of information between BCCR and SUGEF.

174. According to the 2016 EDRC Economic Assessment (OECD, 2016)⁸⁶, actions were needed by Costa Rica to reinforce the macroprudential framework and bring it closer to current practices in OECD countries. According to the Assessment, accelerating the adoption of Basel III principles and publishing the results of the stress tests carried out by SUGEF would increase transparency and foster market discipline. The 2018 EDRC Economic Assessment (OECD, 2018) reported that progress has been made with regards to the adoption of Basel III principles and the Costa Rican authorities are on track with a schedule that foresees the implementation of most principles. Draft regulation to adopt Basel III definitions of capital, leverage ratio and loss absorbency of domestic and systemically important banks is ready. Consultation with the banking sector is expected to take place at the end of 2020. Regulatory capital and leverage ratio definitions are planned to be aligned with Basel III by the second half of 2021. Minimum capital requirements for credit and operational risk are planned to be compliant with Basel III in January 2022; and for market risk in January 2023. Risk management and supervision practices are planned to be compliant with Basel III by the second half of 2021. A draft regulation on the Net Stable Funding Ratio (IFNE in Spanish) will be developed starting from the second half of 2021, while there is currently no plan to revise the Liquidity Coverage Ratio.

175. In June 2016, CONASSIF adopted a number of decisions aimed at reinforcing credit risk management by taking into account the economic cycle, covering potential exposures related to foreign exchange risk and by enhancing the financial position of supervised entities. SUGEF adopted a regulation covering counter-cyclical provisions. It introduced a dynamic method for counter-cyclical provisioning which takes into consideration the growth rate of credit of each financial institution, instead of a broad measure based on the economic cycle. In addition, SUGEF incorporated an additional provision which is applicable to residential mortgage in foreign currency, corresponding to non-foreign currency generator

⁸⁴ Based on the Basel Committee on Banking Supervision G-SIBs methodology, excluding the cross-jurisdictional activity category.

⁸⁵ SUGEF has identified 10 systemically important financial institutions: Banco de Costa Rica; Banco Nacional de Costa Rica; Banco Popular y de Desarrollo Comunal; BAC San José S.A.; Banco Davivienda de Costa Rica S.A.; Banco Promerica de Costa Rica S.A.; Scotiabank de Costa Rica S.A.; Cooperativa de Ahorro y Crédito ANDE N° 1 R.L.; Mutual Alajuela; Caja de Ande.

⁸⁶ OECD (2016), OECD Economic Surveys: Costa Rica 2016: Economic Assessment, OECD Publishing, Paris.

(those without foreign currency income) debtors and included a loan-to-value (LTV) ratio in order to complement available microprudential tools.

176. As provided in the OECD Recommendation of the Council on a Policy Framework on Effective and Efficient Financial Regulation [C(2009)125], governmental authorities should have the requisite expertise and resources to conduct appropriate surveillance and analysis on a timely basis and formulate sound policy and regulation. In 2016, BCCR and CONASSIF approved⁸⁷ the creation of the Commission of Financial Stability (CEF), supported by the Financial Stability Department of BCCR (DEF) as its technical secretariat. The main objective of CEF is oversight and coordination of the macroprudential policy among the entities responsible for financial stability: BCCR, DEF and CONASSIF in coordination with the superintendencies. CEF is also responsible for coordination with other entities on the implementation of macroprudential policies. The CEF is composed of the Chairman of the BCCR, the Minister (or Deputy Minister) of Finance and the President of CONASSIF. In January 2020, CEF agreed an indefinite appointment of the Chairman of the BCCR as chair of CEF. In 2019, the governance of CEF was improved with the establishment of the Monitoring and Coordination Group (GSC in Spanish), which is composed by the four financial superintendents, the general manager of the BCCR, the deputy minister of finance, a technical adviser of CONASSIF and the director of the BCCR's Department of Financial Stability.

177. DEF was created by BCCR in 2013 with the following main tasks: analyse and monitor the general conditions and risks of the financial system and inform the BCCR and the CEF on the results of its analysis, propose macroprudential policies, improve integration and coordination between monetary and exchange rate policy and financial policy, facilitate coordination between BCCR and other regulatory and supervisory entities of the financial system, issue recommendations on regulations and laws, and issue studies related to the financial system. DEF has developed a number of matrices⁸⁸, indicators and indices⁸⁹, as well as stress testing (banking, securities and payments) and provides regular reporting on its results⁹⁰.

178. DEF performs biannual stress tests addressing market, credit, liquidity, funding and contagion risks. The results of those stress tests are presented to BCCR, CONASSIF and CEF, as well as the superintendencies. BCCR is not authorised to disclose information on the results of such stress tests for individual banks (Law 7558) and none of the financial stability reports issued are publicly disclosed. Stress test results on a consolidated basis for the entire market are disclosed to the four systemic banks, the associations of banking institutions, pension funds and investment funds. No corrective measures apply for entities failing the tests. Stress test scenarios are determined in a coordinated manner between BCCR and SUGEF.

179. Since 2015, SUGEF has carried out annual credit risk stress testing for financial institutions, with the bottom-up stress test (BUST) methodology. Sixteen out of the 49 supervised financial entities participated in the 2018 stress test exercise. The results were presented in November 2018 to CONASSIF and to participating entities. The stress testing procedure is an on-going process as entities have gained experience in the methodologies of internal models of credit risk. For this reason, specific capital requirements or estimates based on the results of stress tests are not yet imposed. Every year, SUGEF

⁸⁷ BCCR Board of Directors approval of session N°5733-2016 on 10 August 2016 and CONASSIF approval of sessions 1272-2016 and 1273-2016 on 16 August and 23 August 2016 respectively.

⁸⁸ Matrix of cross-sector financial flows, credit risk transition matrix, matrix of interconnections (contagion) in the financial system.

⁸⁹ Financial Stability Index, Financial Stability Map, Heat/color maps for liquidity, market and credit risk monitoring, network analysis of the financial system, systemic liquidity indicators, VaR to measure volatility of financing flows and refinancing risk in banking sector.

⁹⁰ Biannual Financial Stability Survey, Monthly Financial Stability Report (to Committee of Financial Stability and quarterly for the Board), Financial Stability Report (annually and confidential).

performs a strict quality control to measure the progress that the participating entities have made and provides technical advice throughout the process. Generally, entities have shown wide differences in their capacity to develop their stress tests and during the last four years, the BUST has resulted in the improved quality of the credit databases and the building of technical capacity and teams that can develop internal models. It should be noted, however, that SUGEF cannot impose specific requirements to increase capital or provisions based on the results of the stress tests.

180. In order to monitor the extent of cross-sector activity, DEF and the BCCR have developed, with technical support from the World Bank, a matrix of correlations and common exposures across institutions. Such matrix measures interconnections mainly between banks, securities and pensions sectors, and relationships in terms of contagion and liquidity risks. BCCR is coordinating an inter-institutional commission formed by the Economic Division of BCCR, DEF, SINPE, SUGEVAL, SUPEN and SUGEF in order to address such risks. CONASSIF has issued regulations aimed at addressing some risks related to such interconnectedness. SUGEVAL is amending the Rules of Management Companies and Investment Funds (RESOFO), while SUGEF is working on the development of a Stable Financing Index.

181. BCCR's BoD can impose credit limits to all commercial banks, according to Article 79 of Law 7558. This measure was applied on January 2013, when BCCR established a quantitative limit for growth of credit portfolios to the non-financial private sector of 9% between 1 February and 31 October 2013. The measure was repealed on 30 July 2013 as credit growth returned to normalised levels (see Section IV.C).

182. Under Law 7558, BCCR's BoD can also impose a maximum intermediation margin level and maximum rates that financial entities may charge their debtors for any credit operation for a term no longer than one year and through well-reasoned decisions (Article 81 of Law 7558). The maximum intermediation margin level is defined as the difference between the financial cost of the resources for the supervised entities, and the effective cost of credit for users, according to the definition and methodology of BCCR or the rates which, through commissions, expenses and others, financial entities may charge their clients. Such provision has not been applied since the mid-1980s.

183. Until 2018, BCCR could impose an unremunerated 25% deposit on foreign capital inflows allotted to investments in securities for investments by non-residents (Article 80bis of Law 7558). According to BCCR, this article was non-operational as no regulations on its application had been issued. The abrogation of the Law for Discouraging Foreign Capital Inflows (No. 9227), which added article 80bis to Law 7558, was included in a bill of law that proposed measures to strengthen public finances. The Legislative Assembly passed this bill of law on 3 December 2018, and Law No. 9635 is now in force. As a result, the unremunerated compulsory deposit for non-resident funds and the tax on non-resident financial assets established in Law No. 9227 have been eliminated.

Prudential and macroprudential policy to address the high dollarisation of the financial system

184. According to the Recommendation of the Council on a Policy Framework for Effective and Efficient Financial Regulation [C(2009)125], the functioning of the financial system and its broader macroeconomic and global linkages should be well understood, and surveillance tools and mechanisms should be established to ensure a comprehensive, on-going monitoring of domestic and international financial system developments, macroeconomic trends, and emerging risks. Given the importance of the stability of the financial system, top priority should be given to promoting confidence in the financial system and addressing systemic risks.

185. BCCR has implemented a number of macroeconomic and macroprudential measures to mitigate risks stemming from credit dollarisation, aiming at maintaining low and stable inflation and promoting exchange rate flexibility. Pursuant to articles 62, 63 and 65 of the Organic Law of the Central Bank of Costa Rica (Law 7558), financial institutions must maintain a minimum reserve requirement (RR) in the Central

Bank for deposits and funds received, with a maximum limit of fifteen percent (15%). Short-term external debt operations and new operations of long-term external debt were included as part of the reserve requirement respectively in September 2011 and July 2015. There is no differentiation by instrument, institution or currency. In 2013, BCCR introduced a set of temporary limits to the credit growth of the non-financial private sector (initially planned to last 9 months but in place only for 6 months) and a limit to the growth of foreign currency operations (from February to July 2013).

186. To reduce financial dollarization, three types of measures have been recently introduced by the financial authorities. First, the BCCR has been allowing for greater exchange rate flexibility, which should lead economic agents to better internalize currency risks stemming from taking FX loans. Second, in June 2019 the BCCR reduced the rate of the minimum reserve requirement (RR) for deposits in local currency from 15% to 12%, but let the rate on FX deposits at 15%. This differentiated RR should reduce the relative cost of conducting financial intermediation in colones vis-à-vis in FX, and was recommended by the IMF in its latest FSSR (2018). Finally, in order to reduce the incentives for the provision of FX loans to unhedged borrowers and address the associated risks, CONASSIF introduced higher capital risk-weightings on FX loans to unhedged borrowers⁹¹ In addition, the BCCR places a limit on the level of unhedged open FX positions by financial entities set at 100% of the capital base (numerator of the capital adequacy ratio) of the financial entity.

Macroprudential policy

187. In June 2016, a loan-to-value (LTV) ratio was introduced through the *Reglamento sobre la Suficiencia Patrimonial de Entidades*, adopting the LTV ratio as a risk indicator for residential mortgage loans. It also eliminates, as a prudential measure, the periodic updating of the value of lands and buildings according to inflation. Within the prudential framework, the level of LTV was combined with the weighting of credit risk for mortgages and whether the credit is hedged or not, applying higher weights for higher levels of LTV and for non-generators of foreign currency (unhedged).

188. As mentioned above, as of August 2013, the risk weight of unhedged FX debtors classified as highly exposed to exchange rate risk, according to internal methodologies of the financial entity, increased from 50% to 62.5% (for mortgages) and from 100% to 125% (for other foreign currency credits to unhedged borrowers) for capital adequacy requirement calculation purposes. The maturity matching requirement for entity's liquidity risk qualification was separated by currency and different limits were introduced by currency. The requirement of stress testing for payment capacity analysis, and the reinforcement of credit risk management practices with the requirement of a risk appetite statement, and the development of credit policies by the entities' board concerning FX credit to unhedged borrowers were also introduced. Stress tests will also need to test for FX and interest rate impact.

189. Following a CONASSIF decision in June 2016, the risk weights applicable to residential mortgages are allocated on the basis of the LTV of the exposure and are different for foreign currency loans to unhedged borrowers (Table 1.11). An additional generic provision of 1.5% will be applied to credits in foreign currency to unhedged debtors whose main source of income is in domestic currency. The risk weight for other foreign currency loans to unhedged borrowers remained unchanged at 125%.⁹²

⁹¹ Stricter provisioning will also be applied to household debt with income-to-debt service ratios above 30 percent. Other measures include counter-cyclical provisioning and higher risk-weightings for household mortgages with high loan-to-value and income-to-debt service ratios. Additionally, the coverage of the credit bureau should be extended to loans to households granted by non-bank entities to better assess household leverage and preserve asset quality.

⁹² Additional capital requirements apply according to the remaining contractual maturity of the loan, both in national and foreign currency. Additional capital requirement for consumption loans and credit cards with maturity over 5 years have

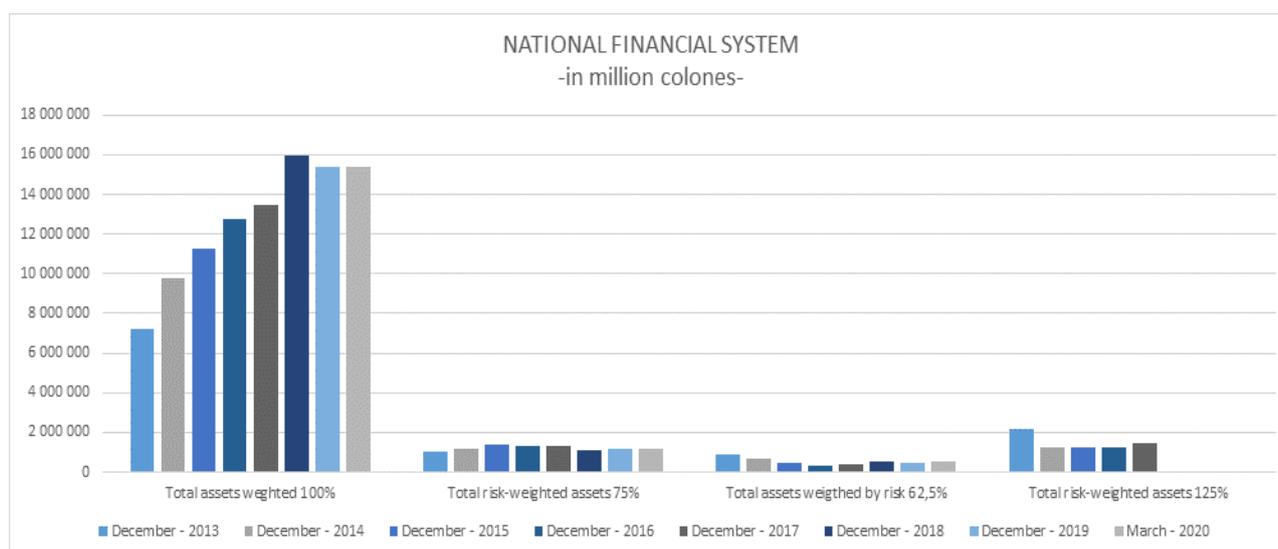
Table 1.11. Risk weights currently applicable to residential mortgages in Costa Rica

Description	LTV<40%	40%≤LTV<60%	60%≤LTV<80%	80%≤LTV<90%	90%≤LTV<100%	LTV≥100%
Other foreign currency loans	25%	30%	40%	50%	60%	80%
Foreign currency loans to unhedged borrowers	31.25%	37.5%	50%	62.5%	75%	100%

Source: Costa Rican Authorities.

190. Following the increase in capital risk-weighting of FX mortgage loans to unhedged borrowers and loans maturity, the risk weighted assets of the banking sector have increased (Figure 1.19). Credit granted in foreign currency to unhedged borrowers exposed to FX risk has been managed by banks with greater prudence (improvement of credit policies, establishment of degrees of appetite and tolerance to risk, change in methodologies for evaluation of unhedged borrowers exposed to FX risk, introduction of stress testing for credit qualification). However, part of the decline in foreign currency loans to unhedged borrowers might also be explained by market factors, such as the increase in interest rates and the exchange rate evolution (Figures 1.20 and 1.21).

Figure 1.19. Risk weighted assets in Costa Rica



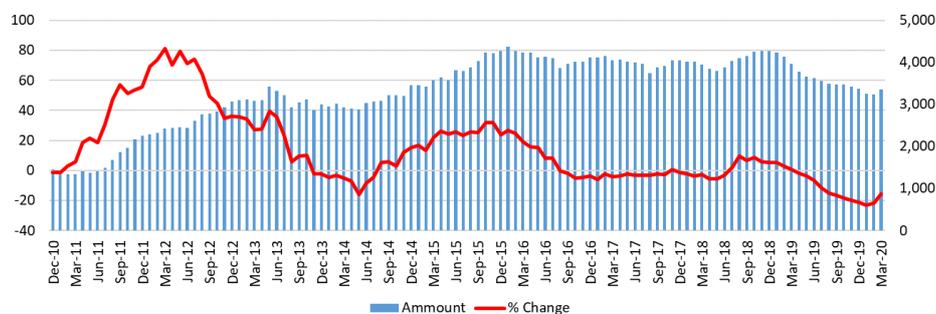
Source: Costa Rican Authorities.

191. The introduction of minimum reserve requirements to medium and long-term foreign bank borrowing in the second half of 2015 did not reverse the growth pattern of foreign bank lending to financial entities. Since then, the growth rate of external financing has slightly decreased while the lending rates in foreign currency have increased. It should be noted, however, that these changes can also be attributed to other factors. At the same time, the extension of these reserve requirements have reduced the rate of growth

an additional 20% risk weight, vehicle loans with maturity over 7 years have an additional 15% risk weight and mortgages with maturity over 30 years have an additional 10% risk weight.

of long-term liabilities and reduced the size of the short-term liabilities for a period of over two years (Figure 1.22).

Figure 1.20. Foreign bank loans granted to financial entities in Costa Rica, 2010-20

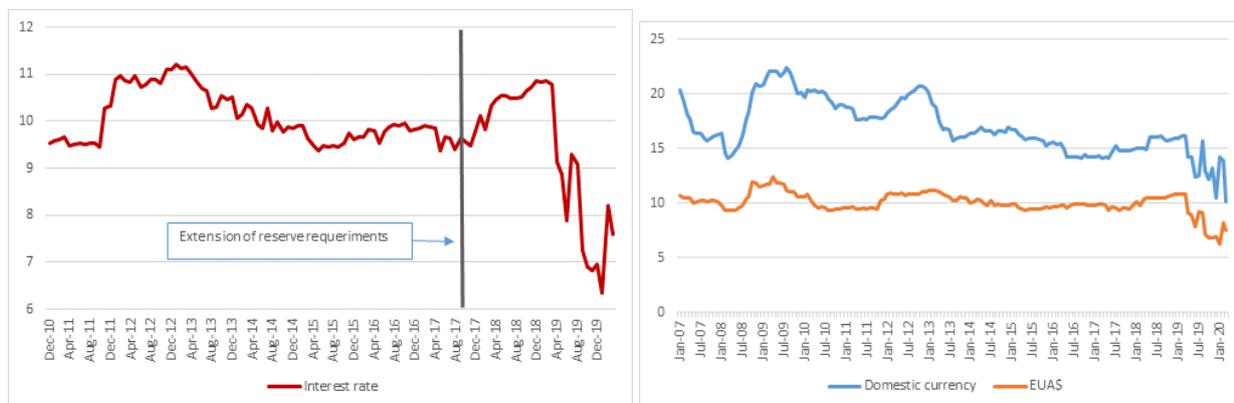


Source: Costa Rica Authorities.

Source: Costa Rican Authorities.

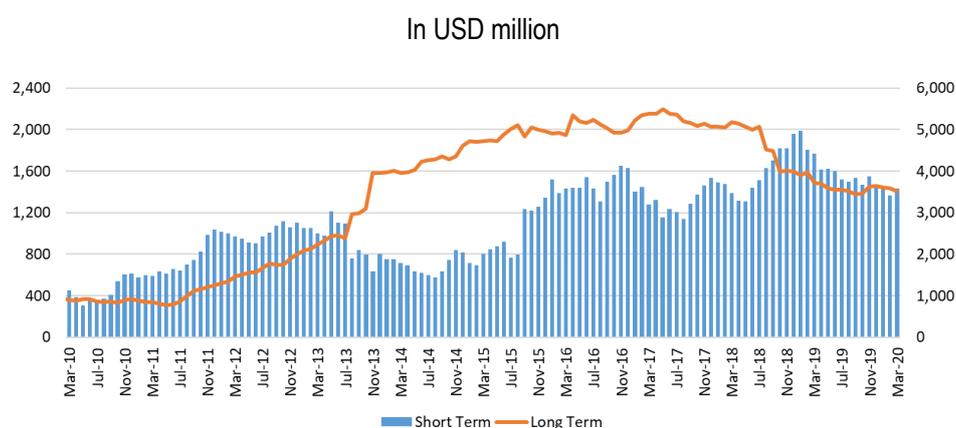
Figure 1.21. Average interest rates on FX loans and interest rate differential for credit to non-financial institutions in Costa Rica

In percentage points, average interest rate on FX loans (LHS) and weighted active interest rates by currency for credit to the private sector (RHS)



Source: Costa Rican Authorities.

Figure 1.22. Financial system foreign short-term and long-term liabilities in Costa Rica

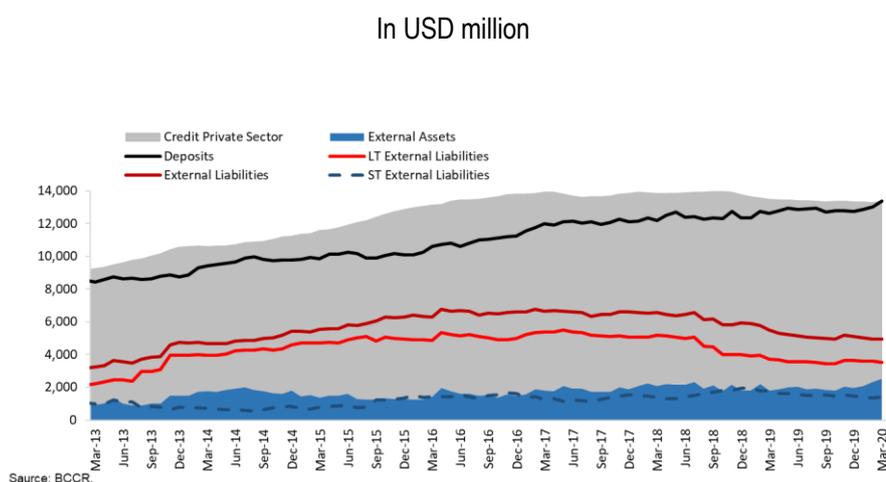


Source: BCCR.

Source: BCCR.

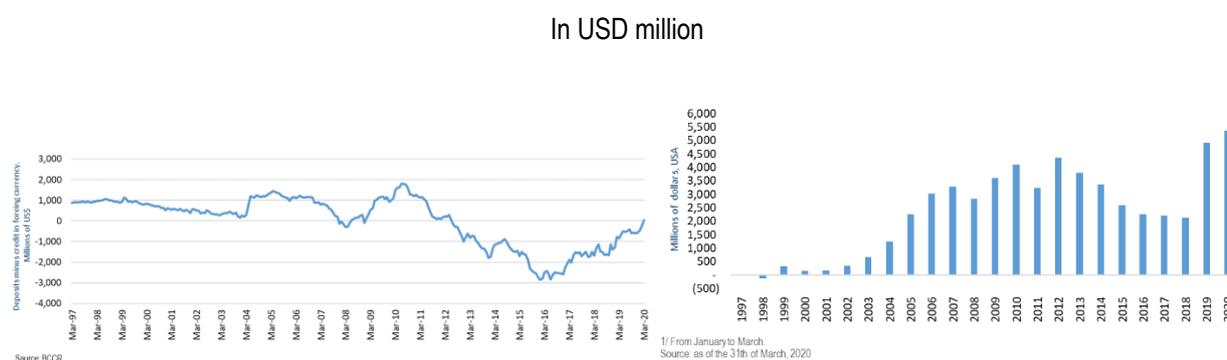
192. According to the Costa Rican Authorities, the measures introduced to tackle the high dollarisation of the Costa Rican financial system have had a gradual effect on the levels of foreign currency accounts. This can be observed in early 2016 with a moderation in the mismatch between credits and deposits to the private sector in foreign currency (Figure 24), the stabilisation of the level of external liabilities in the financial system in 2016 (zero increase on a year-on-year basis). The net international position of the system (difference between foreign assets and liabilities) also stabilised in 2016, after a persistent declining trend over the period 2013-15 (Figure 25).

Figure 1.23. Financial system of Costa Rica: main accounts in foreign currency



Source: BCCR.

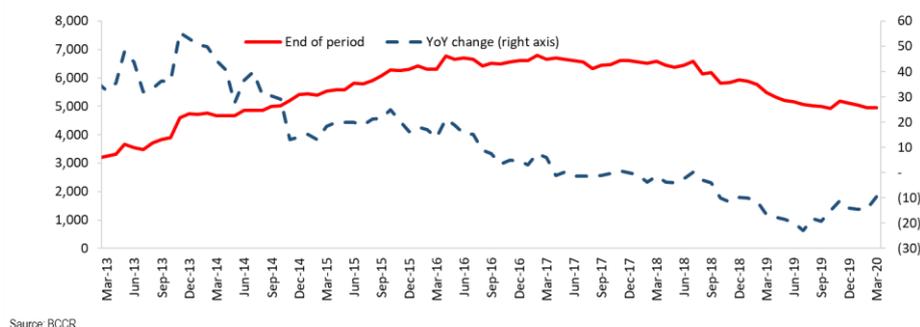
Figure 1.24. Mismatch between credit to the private sector and deposits in foreign currency (LHS) and net international position (RHS)



Source: BCCR.

Figure 1.25. External liabilities of Costa Rican financial system.

In USD million (LHS) and year-on-year percentage change (RHS)



Source: BCCR.

Basel III implementation

193. In 2013, CONASSIF approved the Regulation on Liquidity Risk Management, including a set of principles for liquidity risk management and the requirement of a liquidity buffer based on the Liquidity Coverage Ratio (LCR). The LCR methodology has been updated and slightly adjusted to incorporate structural features of the Costa Rican financial market (e.g. treasury bonds as high-quality liquid assets, under development of the market). The minimum requirement for LCR was set at 60% on January 2015, increasing by annual steps of 10 percentage points to reach 100% on 1 January 2019.

194. SUGEF is also working towards developing a more in-depth understanding of the liquidity market and is improving its tools for monitoring. Stress testing and early warning indicators based on market data are new tools SUGEF is focusing its efforts on.

195. Draft regulation on regulatory capital definition and leverage ratio is expected to be finalised by the end of 2020. According to 2019 data, the level and quality of bank capital in Costa Rica is compliant with the capital requirements set by the SUGEF; the minimum capital requirement in Costa Rica is 8% of

risk-weighted assets, and total equity mainly consists of common shares and legal reserves. A period of 24 months for monitoring and calibration of the minimum capital requirement could be considered in the regulation.

196. The proposed regulatory definition is based on the introduction of capital instruments able to absorb losses on a going concern, and instruments that will provide support on a gone concern. The regulation intends to define a Tier 1 Capital, which includes Common Equity Tier 1 and Additional Tier 1; and a Tier 2 Capital. The proposal sets minimum levels of capital as follows: minimum Common Equity Tier 1 of 7.0% of risk-weighted assets (RWAs); minimum Tier 1 Capital of 8.5% of RWAs; and Total Capital (Tier 1 Capital plus Tier 2 Capital) of at least 10% of RWAs. The proposed regulation raises additional capital requirements for systemically important entities in the form of Common Equity Tier 1. As there are no powers to apply profit retention, other supervisory actions could apply.

197. In July 2016, a new Regulation on Counter Cyclical Provisions came into force, imposing dynamic provisioning based on the growth rate of the lending portfolio of each financial institution (instead of a broad metric based on GDP). The use of regulatory tools for earnings retention purposes, such as conservation and counter cyclical capital buffers, requires a legal amendment. The legal powers for earnings retention can only be executed by a designated controller, in case of intervention of weak financial institutions. The corresponding legal amendment is part of the bill of law on Cross-Border and Consolidated Supervision (see Section IV.B).

Deposit insurance scheme and bank resolution regime

198. An unlimited state guarantee is provided in Costa Rica to state-owned banks and some private organisations⁹³. Prior to the accession review of Costa Rica by the OECD, there was no deposit insurance guarantee for deposits held at private banks in Costa Rica. Only a few OECD or Latin American countries lack an explicit deposit insurance scheme, such as New Zealand and the Plurinational State of Bolivia (Schich and Lindh, 2012, Demirguc-Kunt et al., 2014). The establishment of a deposit insurance scheme covering all banks, in line with international best practice, helps to level the playing field in the banking sector and introduce stronger competitive forces into the banking market.

199. Similarly, there was no regulatory framework for bank resolution that allowed for any form of resolution (e.g. purchase-and-assumption type techniques such as disposal of assets and liabilities) other than liquidation prior to the accession review of Costa Rica by the Committee on Financial Markets.

200. Draft legislation for Deposit Insurance and Banking Resolution was submitted to the Legislative Assembly in June 2010 (Bill No. 17766 - Bill of Deposit Insurance and Banking Resolution), proposing the following: (i) Creation of a Deposit Insurance System, defining a legal framework for a deposit guarantee scheme that would cover private banks, Banco Popular (special-law bank), financial institutions and cooperatives under the supervision of SUGEF; (ii) Control Bank Regulation, comprising of a set of procedures and measures carried out for the resolution of unviable financial institutions, under the scheme of exclusion and transfer of assets and liabilities. Such scheme would be applied only once all other preventive and corrective measures have failed; and (iii) Strengthening of the BCCR in its position as lender of last resort and incorporation of the requirements necessary for the bank resolution process. The four-year term for approval of such legislation expired in June 2014, and the legislation was officially archived on 23 October, 2018.

201. Following the recommendations by the IMF and the OECD, BCCR drafted a new bill of law establishing a deposit guarantee fund and bank resolution framework for all financial entities (private and

⁹³ A subsidiary guarantee is provided to mutual associations (*mutuales de ahorro y préstamo*) by the government through the Housing Mortgage Bank (*Banco Hipotecario de la Vivienda*).

public banks) supervised by SUGEF. This draft legislation was submitted to the Legislative Assembly, voted by the Plenary on 6 February 2020 and entered into force on 12 February 2020 (Law No. 9816). The Deposit Guarantee Fund (the Fund) framework establishes three different compartments: one for public banks; one for private banks and non-bank financial entities; and a third for savings and credit cooperatives supervised by SUGEF, as well as asociaciones solidaristas supervised by SUGEF, and *Caja de Ande*.

202. The Fund will be administered by the Central Bank, but as a separate estate from that of the Central Bank, and will have a manager that answers to the Board of Directors of the Central Bank. The regulations of the Fund will be issued by CONASSIF, including the investment policy. Investment in bonds of the Central Bank and member financial institutions; or bonds of the Central Government will not be allowed.

203. The maximum coverage of deposits⁹⁴ kept at financial institutions supervised by SUGEF, according to the draft legislation, will be six million colones (approximately USD 10,000) on a per person - per institution basis, and will be adjusted in line with inflation. The maximum contribution to the Fund will be 0.15% of the total financial intermediation liabilities covered. Within this maximum, a risk-based premium, established by regulation, will be applied based on the risk profile of the financial entity. Additionally, the Fund will be guaranteed by the assets constituting the minimum reserve requirement (RR) and the liquidity reserve (LR), up to 2% of the total liabilities subject to those requirements.

204. According to the legislation, the Fund will pay by an order of CONASIFF, upon a recommendation of the bank intervention manager of the entity in default. If a default event that triggers the pay-out occurs, where CONASIFF determines that it is necessary to use the Fund, resources will be used from the compartment of the Fund which the financial institution contributes to. Where the Fund is insufficient, the amounts will be met by the RR and LR guarantee.

205. The bill also established a bank resolution regime (see next Section).

Early intervention and bank resolution framework

206. In order to evaluate supervised entities, SUGEF issues an overall rating for each financial institution, composed of a quantitative and a qualitative rating. The quantitative classification consists of six elements subject to an analysis called ‘CAMELS’ including Capital; Assets; Management; Performance evaluation; Liquidity; and Sensitivity to market risks. The qualitative qualification results from an on-site evaluation carried out by SUGEF. The evaluation approach is currently being modified to align it with the risk-based supervision approach, with the qualitative part of the assessment being allocated a higher weighting in the overall rating of the bank and the supervisor assigning the final qualitative assessment of the financial entity. Areas such as corporate governance and risk management will receive higher weightings than the ones currently applying.

207. SUGEF’s discretionary intervention powers were recently enhanced through legislation reforming Law 7558 approved by the Legislative Assembly (Law no. 9768) (see Section IV.B), which includes the granting of discretionary intervention powers to SUGEF by extending the scope and reach of its current intervention and sanctioning powers.

208. There are three levels of financial instability or irregularity of SUGEF supervised entities corresponding to the rating assigned to them based on the ‘CAMELS’ analysis and the evaluation model (Law 7558):

⁹⁴ Demand deposits and term deposits of natural and legal persons, in any currency. DIF will not guarantee bearer deposits, deposits belonging to natural or legal persons linked to the entity in resolution, or deposits belonging to entities supervised by any of the superintendencies and which are held in entities of financial groups or conglomerates.

- Level one: slight instability or irregularity which can be overcome by adopting short-term corrective actions (e.g. additional capital);
- Level two: more severe instability or irregularity which can only be overcome by adopting and executing a recovery plan; and
- Level three: requires intervention of the entity. It comprises cases of Level two situation of instability which have not complied with the recovery plan; entities involved in fraudulent or illegal operations; entities having suspended or interrupted payments; refusal to provide SUGEF with information about the financial and operational status of the entity; management of the business in a way that endangers its security and solvency; involvement in money laundering activities; entities that have suffered losses which reduce their equity to an amount lower than half of its initial equity; and entities that are not complying with capital adequacy rules.

209. For supervised entities in a situation of financial irregularity of levels one or two, the Superintendent informs the BoD or management (manager and internal auditor) of the institution of the situation and requires the submission of an action or recovery plan within an established deadline. Such plan, once approved by the Superintendent, becomes of mandatory compliance by the institution. The Superintendent may request progress reports on the degree of compliance with the approved plan, without detriment to the on-site verifications carried out by the SUGEF to evaluate compliance with those commitments. If, in the Superintendent's view, the action or recovery plan is not adequate to remedy the institution's weaknesses, it shall order that the financial intermediary make the relevant adjustments within a reasonable and non-extendable period, in order to be presented again to SUGEF. In accordance with the degree of risk shown by the financial intermediary, SUGEF may require the institution to provide additional capital contributions as provided in Article 136 of Law 7558, or any other corrective measures to remedy the deficiencies as established by Article 131 of said law, what includes the possibility of requesting changes of staff members.

210. For institutions on level three of financial irregularity, CONASSIF orders the intervention of the supervised institution and designates the intervenors/administrators who assume the administration of the institution. The administrators must present a plan for the financial regularisation of the institution within the term established by CONASSIF, or recommend its resolution. The Superintendent monitors the intervention process and ensures compliance with the conditions of intervention agreed upon by CONASSIF.

211. SUGEF has a set of 40 early warning financial indicators that contribute to the analysis of the financial system, both with a micro and macro perspective: seven Key Performance Indicators covering the operations of the institution and 33 Key Risk Indicators covering emerging risks in solvency (5 indicators); credit risk (13); liquidity (9); interest rate risk (2); price risk (1); FX currency risk (2); and operational risk (1). SUGEF calculates a trend and an outlook for each of the indicators on an annual basis for each supervised entity. Thresholds are calculated based on homogeneous groups of financial entities.

212. The only available bank resolution options in Costa Rica were liquidation or voluntary purchase by another bank. All bank resolution decisions are currently made by CONASSIF. BCCR is currently involved in bank resolution through its vote in any bank resolution decisions made by CONASSIF, as the BCCR Chairman holds one of the seven permanent seats in CONASSIF. Although the intervention process is the same for both privately-held and state-owned banks, dissolution and liquidation of state-owned banks requires a special law to be created by the Legislative Assembly, as its operations are covered by individual laws.

213. There have been six cases of supervisory intervention in banks over the past 20 years: Banco Federado R.L. (1998), Banco Bantec CQ (2004), Banco Solidario Costarricense R.L. (2004), Banco Cooperativo Costarricense R.L. (1998), Banco Elca S.A. (2005) and Banco Crédito Agrícola de Cartago

(Bancredito, 2017). According to the Costa Rican authorities, these interventions were caused mainly by insolvency due to weaknesses in management, with the exception of Bancredito (see Box 3).

214. The legislation on deposit insurance established a bank resolution regime covering all entities participating in the Deposit Insurance Fund (i.e. state-owned banks, private banks, non-bank financial entities supervised by SUGEF, Banco Popular, savings and credit cooperatives). The resolution scheme also applies to entities that do not contribute to the Deposit Guarantee Fund, such as savings and credit mutuals (which have their own fund regulated by the Law of the National Financial System for Housing) and the Housing Mortgage Bank (non-deposit taking, second tier bank).

215. According to the legislation, the resolution regime will provide the resolution authority with the flexibility to apply different tools and mechanisms in resolving an insolvent financial entity, so as to maximise the value of the entity to protect its creditors, particularly depositors, as well as being at the lowest cost. The resolution will proceed in case the entity is in a level three irregularity or instability, as defined by Law 7558 (Article 136) (see paragraph 211 above). CONASSIF will issue the necessary regulations for each of these mechanisms. CONASSIF will be the resolution authority and, on the recommendation of the controller, will apply the resolution mechanism that best suits the situation if the entity is considered non-viable. The regime will apply to all financial intermediaries supervised by SUGEF. CONASSIF will order the Fund to use the resources either for the payout/liquidation of the financial entity or to support the resolution mechanism, whatever is less costly.

216. This legislation was submitted to the Legislative Assembly, voted by the Plenary on 6 February 2020 and entered into force on 12 February 2020 (Law no. 9816).

Box 3. The case of Bancrédito's resolution

Bancrédito (Banco Crédito Agrícola de Cartago) was a state-owned commercial bank, founded in 1918, with a network of 35 branches and 736 employees across Costa Rica. Bancrédito based its operations on stable, but low-growth, business generated by public sector companies.

Bancrédito's financial intermediation results were not strong enough to cover administrative expenses and provisioning requirements, resulting in a poor financial performance and lack of profitability. Inefficient management was coupled with loss of market share, such as the sale of BICSA shares and the loss of the administrative fees that Bancrédito earned from the managing the development banking system's fund.

In September 2016, SUGEF undertook an examination of Bancrédito, identifying financial weaknesses and deficiencies in corporate governance and risk management. The government became involved and a support group was formed between the government, the BCCR and the state-owned bank Banco Nacional de Costa Rica. The BoD of Bancrédito was informed about the situation and was proposed a number of measures to address identified weaknesses, which were deemed insufficient by SUGEF. Measures proposed by SUGEF, including reduction of staff by at least 200 employees, were not accepted by Bancrédito as the bank did not want to record severance and legal payments as expenses, thereby increasing losses that would bring the bank to a second degree irregularity according to SUGEF's framework.⁹⁵

A recovery plan was submitted in March 2017, which was approved by SUGEF in April 2017. Until then, Bancrédito had not fallen into "irregularity" that requires intervention by the supervisor, and the submission of a recovery plan (Level III). A two billion CRC financial assistance was agreed with state-owned bank Banco Nacional de Costa Rica, as an advance on the expected collection of the exit airport tax by Bancrédito (paid directly by airlines to Bancrédito).

Following the submission of the recovery plan in March 2017, illiquidity issues emerged for Bancrédito, as a result of the non-renewal of deposits by private and public institution clients, coupled with media coverage of its financial weakness. Liquidity considerations were not addressed by the recovery plan, as they had not yet arisen at the time of its approval. According to Costa Rican authorities, illiquidity is largely attributed to intense media pressure and the negative expectations regarding Bancrédito's potential for recovery.

Given this situation, SUGEF informed the President of the Republic twice on Bancrédito, for corrective actions to be taken in an effective and timely manner. The Council of Ministers (as Bancrédito shareholders) appointed a new BoD and issued Guideline 071-P, instructing other state-owned banks and public institutions to maintain their investments in Bancrédito. This Guideline was not followed by the state-owned banks and their investment committees.

Given that the measures adopted by the Council of Ministers did not prevent institutional investors from withdrawing their investments and deposits in Bancrédito⁹⁶, the fragility of the state finances and the high risk of investing further resources of the state to keep the entity afloat, the Council of Ministers decided in May 2017 to cease any financial intermediation activity performed by Bancrédito by the end of 2017. The Ministry of Finance injected CRC 118 billion to address funding issues faced by Bancrédito. The new BoD approved and submitted the action plan to SUGEF and Presidential Economic Council for its appraisal.

Despite Bancrédito administration's best efforts, by December 2017, the institution showed significant deterioration of its asset quality indicator. Consequently, on 22 December 2017, the National Council of Supervision of the Financial System (CONASSIF) decided to order a direct intervention of Bancrédito to determine whether it was insolvent. At that time, the institution had assets of over CRC 230 billion, had reduced its staff by 50% and had cancelled the total amount of its liabilities (except those liabilities with the Ministry of Finance, of over CRC 118 billion).

In March 2018, the interventors informed CONASSIF that the bank was insolvent. Consequently, SUGEF, per request of CONASSIF and in accordance with Article 161 of the Organic Law of the Central Bank of Costa Rica, sent an official notice to the Legislative Assembly on 23 March 2018 informing that Bancrédito was insolvent. In this communication, SUGEF attached a proposal to merge Bancrédito with another State-owned bank, the Banco de Costa Rica (BCR).

In September 2018, after analysing and discussing the proposal, the Legislative Assembly approved Law 9605, which authorises the merger between Bancrédito and Banco de Costa Rica (BCR), prevailing the latter.

217. SUGEVAL has a framework for financial restructuring by merger, division, acquisition, transfer of portfolio, changes in stock control, management body and key positions, or change in business for supervised securities market entities. Preventive agreements and reorganisation plans that entail the financial

restructuring of the entity are carried out in accordance with Laws 7558, the Commercial Code (Law 3284) and the Law Regulating the Securities Market (No. 7732).

BCCR as lender of last resort

218. Until November 2018, the BCCR's lender of last resort (LOLR) facility was available in CRC and USD with the total amount available in the USD facility being USD 500 million. Access to LOLR facility of the BCCR had restrictions, and the entity requesting resources had to present the BCCR with a set of corrective measures to resolve its lack of liquidity, in addition to the documentation required before requesting a disbursement. The disbursement of LOLR liquidity was decided by its BCCR's *ad hoc* BoD session. There was no recognised portfolio of assets that can be pledged as collateral when accessing the facility, and as such collateral was only valued post the request by a financial entity to access the facility. BCCR estimated that the time required for the activation of the facility is maximum six hours following the request by a financial entity, accompanied by all documentation required, including the list of proposed collateral. Given that the LOLR facility had never been triggered to that day, the speed in which it can be engaged remained untested.

219. Following the Accession Review of Costa Rica by the Committee on Financial Markets and the Committee's recommendations, in November 2018, the BCCR issued a new regulation to redesign the lender of last resort (LOLR) facility. Contingent facilities in foreign currency were eliminated and a new facility in local currency (*Crédito de Apoyo de Liquidez*) was established with a much faster approval procedure than the rediscount ("*Redescuento and Préstamos de Emergencia*") facilities established in the law. The new standing facilities have common collateral requirements, where most of the legal and operative procedures can be done prior to credit application, at a low cost and under a new legal framework (*Ley de Garantías Mobiliarias, N° 9246*). Moreover, strict collateral requirements (mortgage-backed loans with high haircuts - 60% for foreign currency collateral and 50% for local currency collateral) and quantitative and qualitative assessments of the financial entities (the financial entity must comply with SUGEF liquidity and capital adequacy minimum requirements) limit credit risks for BCCR.

Taxation

220. A 30% corporate income tax applies to all domestically incorporated privately-owned banks (either locally-owned or foreign-controlled) developing an economic activity in Costa Rica, including financial intermediaries. State-owned banks pay as well the 30% corporate income tax (CIT). For both, public and private banks, income tax is calculated over net income post reserves formed under Articles 10, 12 and 15 of Law 1644. Law 7293 provides 15% CIT for the Banco Popular. The profits of state-owned banks and Banco Popular are subject to a number of parafiscal contributions (see Section I.B). Cooperatives are exempt from income tax (article 3 of Law on Income Tax No 7092 and article 69 of Law 7052). With respect to *asociaciones solidarias*, article 6 of the Regulations of the Income Tax Law (Executive Decree N° 18445-H) states CIT must be paid in the proportion that corresponds to the financial returns from the investments and commercial transactions they make with third parties, outside the association.

221. A tax on capital gains applies over the distribution of dividends and over income generated from repurchase securities and cooperatives surpluses (earnings). The general tax rate for capital gains is of a 15%

⁹⁵ Instead of expensing severance payment, Bancrédito wanted to record them against its retained earnings, a recording not allowed by accounting principles applying in Costa Rica.

⁹⁶ According to press reports, in May 2017, the state-owned Banco Nacional withdrew CRC 71 billion invested in Bancrédito due to the lack of a financial rescue plan.

with several exceptions. Yields generated by local currency securities issued by Banco Popular⁹⁷ or by Savings & Credits Cooperatives⁹⁸ (*Cooperativas de ahorro y crédito*) are subject to the 15% rate. Yields generated by local currency securities issued by the National Housing Financial System (*Sistema Financiero Nacional para la Vivienda*) are subject to a 7% tax rate. Yields from savings⁹⁹ paid by saving and credit cooperatives to their associates are subject to 8% tax. Interests gain over check and savings bank accounts are exempt from this tax. As a general rule, interests generated from balances on savings or checking accounts are exempt from the tax on capital gains.

222. Dividends paid to other Costa Rican entities are not subject to taxation, provided the entity receiving the dividend is an active taxpayer in the country. A 15% withholding tax is levied on dividends paid to resident or nonresident individuals. The rate is 5% if the shares of the entity distributing dividends are registered in a local stock exchange market. Remittances of dividends abroad, to non-resident individuals or entities, are taxed at a 15%; this taxation applies when the remittance is made by a branch to its non-resident head office.

223. Acquisition of shares and interest paid on securities acquired by non-domiciled investors is subject to a 15% tax. The tax rate for such payments was 8% for Costa Rican residents until September 2017, when the Tax Authority started applying a non-discriminatory regime after the State Attorney issued a binding legal opinion that establishes that the tax rate applied to income from interest earned for securities shall not be affected by the domicile of the investor. The modification of Article 59h of the Income Tax Law (No 7092) eliminated the discriminatory tax on non-residents' fixed income and Law for the Strengthening of Public Finances (No. 9635) provided for non-discriminatory treatment between residents and non-residents, by establishing the same tax rate for both remittances and income tax (15%).

224. Up until December 2018, the Executive Branch could, by means of a decree, increase for a period of six months the rate of applicable taxes on interest paid or credited or discounts granted on promissory notes and all kinds of securities values, and applicable taxes on the returns and capital gains of investment funds, when these are granted to persons not domiciled in Costa Rica (Law to Discourage the Entry of Foreign Capital, Law 9227). The abrogation of Law 9227 was included in a bill of law that proposed measures to strengthen public finances. The Legislative Assembly passed this bill of law on 3 December 2018, and Law No. 9635 is now in force, eliminating the tax on non-resident financial assets established in Law No. 9227.

225. Interest, fees and other financial expenses paid or credited to entities or individuals abroad are subject to a general 15% tax (Article 59, Law No 7092). For amounts paid or credited by entities supervised by SUGEF to foreign entities equally supervised in their jurisdiction, the tax is of 5.5%. Interests, fees and other financial expenses paid as a result of a credit granted by a multilateral bank, or a multilateral/bilateral development entity are exempt from this tax.

⁹⁷ Due to a recent tax reform introduced by Law 9635, yields generated by securities of Banco Popular will be subject to a 7% during the first year of the law (2019) increasing 1% each year until reaching the full rate of 15%.

⁹⁸ Under Law 9635, a reduced rate of 7% applies over securities issued by Cooperatives, until these become stock-market; once the securities are part of the stock market, the rate will increase 1% per year, until reaching the 15% tax rate.

⁹⁹ Such earnings are exempt up to a 50% of a base salary (reference used in Costa Rica to calculate penalties, among others; is defined annually). For 2019, the base salary is ₡446.200.00 (approx. \$765) therefore, earnings that exceed \$382 will be taxed.

D. Financial consumer protection and education

226. Financial consumer protection in Costa Rica is established in Law for the Promotion of Competition and Effective Consumer Protection (No 7472), which prescribes consumers right to accurate and timely information on all goods and services.

227. There is currently no institution that specifically regulates financial consumer protection and there is no market conduct regulation for the financial intermediation sector. The National Consumer Commission (attached to the Ministry of Economy, Industry and Trade) oversees consumer protection without being specialised in financial products. To date, SUGEF has not performed any identification or evaluation of major risks of financial products for the Costa Rican market since that goes beyond their legal powers.

228. SUGEF does not have any mandate or power related to consumer protection and market conduct. It has not issued any regulatory requirement related to the operation, distribution or selling of financial products. The only related obligation that SUGEF can impose on financial intermediaries is related to disclosure of information established through prudential regulation¹⁰⁰, as well as disclosure of information on advertising of financial products and services (SUGEF Agreement 10-07 “Regulations on disclosure of information and advertising of financial products”).

229. According to SUGEF regulation 10-07, SUGEF can order, in writing, the suspension or clarification of financial services publicity assessed as erroneous or misleading. The financial intermediary is required to publish a correction with the clarification required by SUGEF within eight days from the communication of the suspension or request for clarification.

230. Supervised entities are obliged to attend to and resolve the complaints or claims of customers through resolution mechanisms of easy access and establish a unit or function that deals with customer complaints. There is no alternative dispute resolution mechanism available for disputes arising from the provision of financial services. The Costa Rican Banking Association has established the “Financial Consumer Protection Office” where clients can escalate complaints that have not been resolved by the supervised institution. Administrative and judiciary mechanisms are also available to financial consumers for the claim of their legitimate rights and interest. The administrative guardianship corresponds to the National Consumer Commission and the judiciary guardianship to the Judiciary Power (Article 46 of Law 7472).

231. A commission formed by the four superintendencies prepared and proposed a conceptual framework to promote an appropriate regulatory framework for financial consumer protection. Such framework aims to cover the regulatory gap around supervisory aspects of financial consumer protection. In 2018, following the Accession Review of Costa Rica by the Committee on Financial Markets and the Committee’s recommendations, this task was resumed by a working group formed by CONASSIF, the Superintendencies, the Ministry of Economy, Industry and Trade (MEIC), which has been working on the following actions:

- Examination of compliance with the G20/OECD Recommendation of the Council on High-Level Principles on Financial Consumer Protection;
- Definition of a work plan to close the gaps with the G20/OECD principles on financial consumer protection;
- Participation in the meetings of the G20/OECD Task Force on Financial Consumer Protection;

¹⁰⁰ Publication of financial information on the supervised entity’s website and on a newspaper of national circulation.

- Development of training workshops with the technical assistance of the World Bank;
- Analysis of proposed legislation on financial consumer protection;
- Participation in the drafting of an Executive Decree to create the National Consumer System, which includes the creation of a Financial System Committee for financial consumer protection.

232. In the securities sector, financial consumer protection is covered by the Law Regulating the Securities Market, which establishes that SUGEVAL is responsible for the safeguarding of transparency in securities markets, the correct price formation, the protection of investors and the disclosure and dissemination of information.

233. Investors and customers whose rights have been violated can appeal to SUGEVAL, which conducts investigations of supervised entities having breached regulations and imposes penalties or prudential measures to avoid further damage to the market. Article 8 of Law 7732 allows SUGEVAL to take all necessary and prudential measures to enforce the rights of investors, the legal duties of the participants in the securities markets, as well as any necessary and prudent measures to promote competition. Investors and consumers can also pursue the judicial route for their claims.

Credit cards

234. Credit card issuers and operators are not currently supervised in Costa Rica, besides anti-money laundering supervision applying to them. Credit Card issuers that simultaneously carry out financial intermediation are subject to integral supervision by SUGEVAL. Nevertheless, if they do not perform financial intermediation, but are part of a registered financial group, individually they are supervised solely on AML matters and will be subject to consolidated supervision of said financial group, as soon as the law on consolidated supervision is implemented.

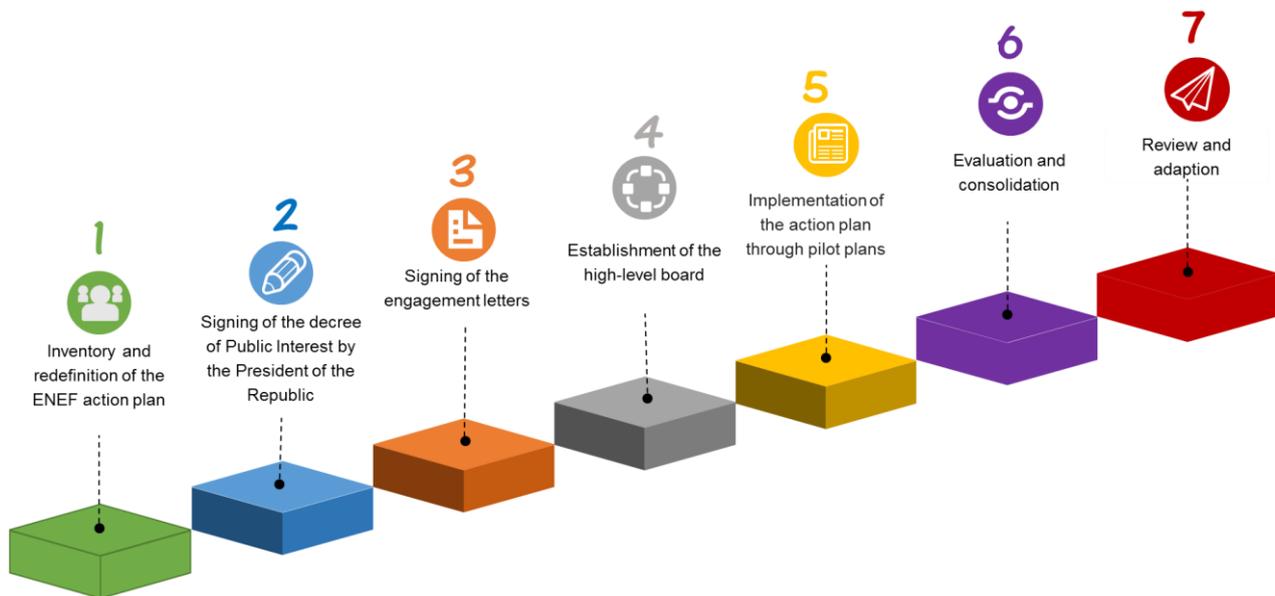
Financial education

235. According to Law 7472, consumer education and information programmes are an essential function of the State undertaken by the National Consumer Commission of the Ministry of Economy, Industry and Trade (MEIC).

236. Despite the fact that there has been no national diagnostic of the financial literacy level of Costa Ricans, the limited financial education evidenced by the numerous surveys and studies is a challenge. Survey results demonstrate that the majority of the population does think that they have formal access to financial services through state-owned banks (Costa Rican Banking Association survey, 2010).

237. In 2013, CONASSIF approved the implementation of the National Financial Education Strategy (ENEF) with the participation of all four superintendencies. The strategy included the development of a Financial Education Portal, the definition of programmes for different segments of the population in order of priority, as well as the provision of technical assistance, monitoring and evaluation. Cooperation between public institutions and private stakeholders and industry participants was envisaged in the strategy. An independent assessment of financial education programmes implemented in Costa Rica and their impact on the different segments of the population was included in the final stages of the project.

Figure 1.26. National financial education strategy of Costa Rica



Source: Costa Rican Authorities.

238. A new financial education strategy is currently being developed under the coordination of MEIC and the Ministry of Presidency, taking into account the 2013 ENEF and establishing a road map to implement concrete actions through pilot plans, which articulate efforts of different stakeholders from the industry, public sector, academia and civil society. The Executive Decree 41546-MP-MEIC creates a high-level task force in financial education integrated by the coordinating ministries and representatives of other institutions, such as the BCCR.

239. On January 30, 2019 the President of the Republic signed the executive decree that formalizes and declares of public interest this new financial education strategy. Various financial entities signed 37 letters of commitment to be included as part of the strategy. The new strategy aims to:

- Provide a more proactive role to the Government in the generation of public-private strategies;
- Articulate the financial education programs carried out by different stakeholders;
- Connect financial regulators with other public institutions;
- Integrate the academy and civil society;
- Define concrete actions through pilot plans for different population groups such as children, young adults, women, the elderly, public officials, State aid beneficiaries, among others.

1. On April 2, 2019 the National Board of Financial Education was established. It is composed by the Vice President of the Republic, the Minister of the Presidency, the Minister of Economy, Industry and Trade (MEIC) and the Director of Consumer Protection of MEIC. The board also includes the financial superintendencies, the Central Bank, industry associations, consumer organizations and institutions from the public sector including public education, labour and social security.

2. Finally, it is important to highlight the most significant achievements reached since the adoption of the financial education strategy. On April 1, 2019 the first pilot plan to establish a financial education program within the National Police Academy was launched, to provide financial skills training to police officers as a part of their training program. Since then, for the remainder of 2019 and the first two months of 2020, the Government signed another 10 pilot plans with banks, credit cooperatives and financial institutions -for a total of 11 pilot plans signed to this date-, in order to strengthen their efforts to reach the target population groups defined in the strategy. In addition, between 2019 and the first quarter of 2020, a total of 21 484 people has received financial education in the country, with banking clients being the sector most benefited from these trainings.

Industry associations

240. There are two industry associations in the banking sector, the Costa Rican Banking Association (14 members, private and state-owned banks) and the Chamber of Banks and Financial Institutions of Costa Rica (20 members, private and state-owned banks and savings and credit cooperatives).

241. A number of industry associations are active in the securities market: Chamber of Investment Funds (CAFI), Costa Rican Chamber of Issuers of Securities (CCETV), and the Chamber of Intermediaries Securities (CAMBOLSA). Membership in the above associations is voluntary.

E. International surveillance assessment

242. The International Monetary Fund (IMF) issued a Financial Sector Stability Report (FSSR) in 2018, with key recommendations and a roadmap of possible technical assistance. The 2019 Article IV Consultation by the IMF followed up on the 2018 FSSR, concluded that significant vulnerabilities persist, mainly from the weak fiscal position and sizable FX lending to unhedged borrowers.

243. IMF staff argued that, although substantial progress had been made in adopting risk-based supervision, advances towards the implementation of other key FSAP recommendations, such as crisis management and the bank resolution framework, have been slow due to the crowded legislative agenda. IMF staff also argued that the regulatory and risk management frameworks would benefit from gradually introducing Basel III capital requirements and liquidity standards, and that plans to act upon high/medium priority FSSR recommendations, such as enacting a deposit insurance and consolidated banking supervision laws, should be realised. According to the IMF Consultation, structural reforms, including those recommended in the context of the OECD accession process, should be implemented to improve competitiveness and foster inclusive growth.

V. International financial integration

A. Market access for foreign institutions and investors

Establishment and operation of financial institutions

244. The process and requirements for the establishment of financial institutions is the same irrespective of the type of legal entity (corporation or branch) or nationality of the capital, although branches of investment fund management companies are required to provide additional documentation when compared to subsidiaries. All financial institutions, both locally-owned and international, operating in Costa Rica, are required to be established as corporations or branches.

245. No branching was allowed for the provision of financial services in Costa Rica except for insurance¹⁰¹ and investment fund management companies¹⁰², which may operate through branches. Following the Accession Review of Costa Rica by the Investment Committee and the Committee on Financial Markets, Costa Rica took the policy decision to allow the provision of banking services in Costa Rica by branches of foreign banks. A bill of law (No. 21292) to modify Law 1644 was presented to the Legislative Assembly on 8 March 2019, adopted by the Legislative Assembly on 30 July 2019 and became law in August 2019.

246. Thus, no reservation is proposed under item I/A of the CLCM and under item E/7 of the CLCIO for foreign bank branching. There are no limits on the foreign capital in private banks established in Costa Rica.

247. A reservation under item E/7 (Conditions for establishment and operation of branches, agencies, etc. of non-resident investors in the banking and financial services sector) of the Code of Liberalisation of Current Invisible Operations (CLCIO), concerns the establishment of branches for banking institutions and financial services sector, except for banks, collective investment fund managers and collective investment funds portfolio management services.¹⁰³

Securities and other financial market instruments

248. Branching is not permitted for securities firms and other non-banking financial services, with the exception of collective investment fund portfolio management services and collective investment fund managers (SAFIs) (Regulation 762 of 2008).

249. Public offering of intermediation services for securities or financial instruments in international markets requires incorporation, as well as public offering of individual management of securities portfolios in the country (Article 2 of Law 7732 and Article 1 of Regulation of Intermediation and Complementary Activities).

250. Trust services for infrastructure projects require incorporation in the country via a special purpose vehicle and an authorisation as a securities issuer from SUGEVAL. Infrastructure trusts are created with the purpose of obtaining credit from investors to develop a specific infrastructure project (Article 11 Regulation 1124 of 2014).

251. Incorporation requirements also apply to participation in the stock exchange. In order to be a member of a stock exchange, the Law Regulating the Securities Market 7732 requires local incorporation as a stock brokerage firm in Costa Rica. This incorporation requirement is not deemed to be a restriction in terms of the Codes¹⁰⁴.

¹⁰¹ Reinsurance intermediaries, insurance and reinsurance companies and their auxiliary services.

¹⁰² Collective investment fund portfolio management services (Regulation 762 of 2008 arts. 30-31) and collective investment fund managers (SAFIs) (Regulation 762 of 2008 art. 2). SAFIs are controlling companies, which administrate and hire the services of other companies, such as collective investment fund portfolio managers. Most SAFIs hire individuals as collective investment fund portfolio managers, but the law allows SAFIs to contract these services with local companies or branches of foreign companies.

¹⁰³ According to the current reservation, the reservation applies only to: the establishment of branches for banking institutions and financial services sector, which must be locally incorporated; except for banks, collective investment funds portfolio management services and collective investment fund managers.

¹⁰⁴ DAF/INV/ACS(2017)4/REV1.

C. Cross-border provision of banking and financial services

252. Costa Rica maintains freedom for residents to avail themselves of banking and financial services when abroad (when initiated at the customer's own initiative); however, restrictions apply to the cross-border provision of a number of banking and financial services by non-residents in Costa Rica.

253. Cross-border provision of financial services for banking, securities firms and other non-bank intermediaries are not allowed in Costa Rica, with the exception of asset management and cash management, safekeeping of assets (item E/4 of the CLCIO), and advisory and agency services; credit reference and analysis; investment research; mergers, acquisitions, restructurings, management buy-outs, and venture capital (item E/5 of the CLCIO).

254. Payment services, including payment instruments and fund transfer services, are reserved for registered entities, whether resident or non-resident (Law 8204, Article 15), although this does not require incorporation in the country, but a registration process with SUGEF. The registration is for reporting purposes only.

255. Foreign exchange operations can be performed exclusively by authorised domestically incorporated financial intermediaries and/or foreign exchange intermediation businesses (casas de cambio) (Law 7558 of 1995). The restriction for the provision of foreign exchange payment services by non-residents has been reflected in a reservation to item E/1 of the CLCIO.

256. According to Law 1644, only locally incorporated financial institutions or foreign bank branches operating in Costa Rica are allowed to provide banking and investment services (item E/2 (Banking and investment services) of the CLCIO). This restriction extends to public offering of intermediation services for securities or financial instruments in international markets, as well as public offering of individual management of securities portfolios in the country, which are reserved for locally incorporated and authorised intermediaries (Law 7732).

257. Local non-bank financial institutions cannot grant credit, financing or sureties, guarantees or financial back-up facilities to non-residents (Law 5044, Article 12) (reflected in a reservation under item E/2 CLCIO and in reservations under items VIII(i&ii)/B (Credits directly linked with international commercial transactions or with the rendering of international services), IX/B (Financial credits and loans) and X(i&ii)/A(2),B(2) (Sureties, guarantees and financial back-up facilities) of the Code of Liberalisation of Capital Movement (CLCM).

258. Cross-border provision of underwriting and broker/dealer services covered under item E/2 by non-residents is not allowed in Costa Rica (Regulation 571 of 2006). Non-residents need to incorporate in Costa Rica and obtain authorisation by SUGEVAL. There is no specific regulation forbidding or regulating the provision of financial market information, communications and executions systems services, also covered under item E/2 of the CLCIO. The Costa Rican authorities have confirmed that, by interpretation of the Constitutional principles of non-discrimination and autonomy of free will, cross-border provision of these services by non-residents is allowed.

259. Incorporation is required for the provision of settlement, clearing, custodial and depositary services covered by item E/3 of the CLCIO¹⁰⁵ (Law 7732 and Regulation 1150 of 2015).

¹⁰⁵ The Users' Guide supplementary explanatory notes 1 and 3 to item E/3 of the CLCIO exclude from liberalisation obligations any incorporation requirements for settlement, clearing and depositary services. Thus, for provision of services, the proposed reservation under item E/3 of the CLCIO concerns only the provision of custodial services by non-residents in Costa Rica.

260. Cross-border provision of asset management cash management and safekeeping of assets services, covered under item E/4 of the CLCIO, is allowed by non-residents. Costa Rican residents can avail themselves of all services covered under item E/4 (asset management including cash management, portfolio management, pension fund management, safe keeping of assets and trust services) when abroad. Costa Rica does not allow for cross-border provision of collective investment fund portfolio management, pension fund management, trust services for infrastructure projects and public offering of individual management of securities portfolios by non-residents in Costa Rica.¹⁰⁶ If the agreement on the provision of services has been concluded abroad at the initiative of the customer, the provision of the service is considered as not having taken place in Costa Rica and is unrestricted.

261. The provision of advisory and agency services, credit reference and analysis services, investment research, mergers, acquisitions, restructurings, management buy-outs and venture capital services by non-residents on a cross-border basis is allowed in Costa Rica (item E/5 of the CLCIO). For public offer of investment advice, incorporation is required (article 2 of Law 7732 and CONASSIF Regulation 1259-2016 of 17 June 2016) (item E/5 of the CLCIO). Securities credit rating agencies require incorporation in the country (article 22 of Regulation 571 of 2006).

262. A reservation under item E/5 has been lodged for the incorporation requirement for public offering of advisory services on securities or financial instruments (including securities credit rating agencies). For item E/6, which covers transfers for payment of fees, commissions and other charges in relation to any international banking or financial services which has been authorised or can be performed without authorisation, the Costa Rican authorities have confirmed that there are no measures in force that would need to be reflected in reservations.

263. Additionally, according to article 147 of Law 7558, subsidiaries abroad of Costa Rican financial groups were not authorised to carry out any operations or payment services in CRC. This restriction was enacted in 1995 for market transparency purposes and to counteract illegal operations performed in the past by subsidiaries abroad as part of Costa Rican financial groups, which are not subject to monetary control by Costa Rica's Central Bank or to supervision by national institutions. Costa Rica abrogated this measure as part of bill of law on Cross-Border and Consolidated Supervision (No 21.355), voted by the Plenary on 15 October 2019 and in force on 4 November 2019; and thus did not to lodge a reservation under the Codes.

264. This measure applied to foreign subsidiaries of Costa Rican public banks. According to the Costa Rican authorities, currently there is only one subsidiary abroad which is part of a private Costa Rican Financial Group (BCT Bank Panamá, S.A.) and one subsidiary abroad part of a public Financial Conglomerate (BICSA bank). Since SUGEF was not able to supervise directly the operations of the foreign subsidiary, enforcement of this provision was carried out by reviewing the information reported quarterly by the entity, and through audits and staff consultations to the locally incorporated holding company.

265. Although the provision of safekeeping services for securities requires incorporation in Costa Rica, according to CONASSIF Safekeeping Regulation¹⁰⁷, the cross-border provision of safekeeping of assets is authorised, as long as the foreign safekeeping company institutes an agreement with a locally incorporated and supervised company.

¹⁰⁶ [DAF/INV/ACS(2017)4].

¹⁰⁷ Articles 31-33 of CONASSIF Safekeeping Regulation, session 1150-2015 of 23 February 2015.

Table 1.12. List of reservations for financial services in Costa Rica

E/1	Payment services
	<i>Remark: The reservation applies only to the provision of foreign exchange payment services by non-residents.</i>
E/2	Banking and investment services.
	<i>Remark: The reservation only applies to:</i> i) <i>provision of banking and investment services, including public offering of intermediation services for securities or financial instruments, by non-residents in Costa Rica, except if the service is taken out at the resident's initiative;</i> ii) <i>credit granting and financing to non-residents by local non-bank financial institutions;</i> iii) <i>underwriting and broker/dealer services by non-residents in Costa Rica, except if the service is taken out at the resident's initiative, and is related to foreign securities;</i>
E/3	Settlement, clearing and custodial and depository services.
	<i>Remark: The reservation only applies to:</i> i) <i>the provision of custodial services by non-residents in Costa Rica, except if requested by resident's initiative and is related to foreign securities or if the service is provided to a Costa Rican custody.</i>
E/4	Asset management.
	<i>Remark: The reservation only applies to:</i> i) <i>cross-border provision of collective investment fund portfolio management services, pension fund management and trust services for infrastructure projects by non-residents in Costa Rica;</i> ii) <i>establishment of pension fund management companies and trust services for infrastructure projects, which must be locally incorporated;</i>
E/5	Advisory and agency services.
	<i>Remark: The reservation only applies to the public offering of advisory services on securities or financial instruments (including securities credit rating agencies).</i>
E/7	Conditions for establishment and operation of branches, agencies, etc. of non-resident investors in the banking and financial services sector.
	Annex II to Annex A, paragraph 1 <i>Remark: The reservation on paragraph 1 concerns the establishment of branches for banking institutions and financial services sector, which must be locally incorporated; except for banks, collective investment funds portfolio management services and collective investment fund managers.</i>

Source: OECD report on International Investment Policies in Costa Rica (<https://www.oecd.org/investment/OECD-Review-of-international-investment-in-Costa-Rica.pdf>).

D. Trade Agreements and MoUs

266. Costa Rica has been a member of the World Trade Organization (WTO) since 1994 with adherence to the Uruguay Round Agreements which is generally concentrated in the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS).

267. Costa Rica has commitments in the sector of the financial services in the context of its GATS commitments¹⁰⁸ for the establishment of companies in the form of affiliated companies or subsidiaries by financial intermediaries (see Annex III).

268. Since 2007, SUGEVAL is working to bring domestic regulations closer to international standards set by the International Organization of Securities Commissions (IOSCO), which include regulatory principles to ensure the protection of investor rights, an effective, fair and transparent marketplace, and the reduction of systemic risks.

¹⁰⁸Appendix 3 available on the following web page: http://i-tip.wto.org/services/DetailView.aspx?id=Costa%20Rica&isGats=1§or_code

269. Costa Rica has been unable, to date, to become a signatory to the IOSCO MMoU. Following the IOSCO evaluation, a number of legal amendments are required, such as the modification of the rules on bank secrecy and the level of confidentiality and the use of information that is shared and received from foreign counterparts. Such amendments were approved by Law 9746 (16 October 2019).

270. Costa Rica has also in force the following trade agreements which include commitments in financial services: the Dominican Republic-Central America-United States FTA (CAFTA-DR), the Association Agreement between Central America and the European Union (AACUE), the European Free Trade Association- Central American States Free Trade Agreement (EFTA-CA FTA), the FTA between Colombia and Costa Rica, the FTA between Panama and Costa Rica, and in the FTA with Korea.

VI. Willingness and ability to implement OECD legal instruments on financial markets

271. Costa Rica accepts all legal instruments under the Committee's purview with timeframes for implementation as indicated below and has demonstrated a willingness and ability to implement these legal instruments.

OECD/LEGAL/0453: Recommendation of the Council concerning Consumer Protection in the Field of Consumer Credit

Costa Rica accepts this Recommendation, with timeframe for implementation until end of 2020.

OECD/LEGAL/0394: Recommendation of the Council on High-Level Principles on Financial Consumer Protection

Costa Rica accepts this Recommendation, with timeframe for implementation until the end of 2023.

OECD/LEGAL/0377: Recommendation of the Council on a Policy Framework for Effective and Efficient Financial Regulation

Costa Rica accepts this Recommendation, with timeframe for implementation until the end of 2023.

OECD/LEGAL/0370: Recommendation of the Council on Good Practices on Financial Education and Awareness Relating to Credit

Costa Rica accepts this Recommendation, with timeframe for implementation until the end of 2022.

OECD/LEGAL/0338: Recommendation of the Council on Principles and Good Practices for Financial Education and Awareness

Costa Rica accepts this Recommendation, with timeframe for implementation until the end of 2022.

2 ANNEX

I. Overview

A. Macroeconomic context

272. Real GDP growth decelerated in 2018 to 2.7% (3.4% in 2017) as a result of external shocks (high oil prices, decline in export prices, social and political tensions in Nicaragua) and the uncertainty surrounding the fiscal situation. Economic activity has continued to decelerate in 2019, and unemployment remains very high (11.3% in March 2019). The country's fiscal deficit remains high, and public debt levels continue to increase (53.6% of GDP). A fiscal reform was approved by the Legislative Assembly in December 2018 to boost revenue (introduction of VAT and expansion to services; reforms to income tax) and contain the growth of expenditures (reforms to public sector remuneration and earmarked expenditures, and adoption of a fiscal rule). According to the Costa Rican Authorities, if its provisions are fully implemented, this reform should put public debt on a sustainable long-term footing.

Table 2.1. Costa Rica: selected macroeconomic indicators

	2012	2013	2014	2015	2016	2017	2018	2019
GDP	4.8	2.3	3.5	3.6	4.2	3.9	2.7	2.1
Private consumption	6.1	2.9	4.2	4.6	4.0	3.6	2.0	1.6
Government consumption	0.2	3.2	2.9	2.4	2.4	3.1	0.5	4.9
Gross fixed capital formation	9.9	-0.3	3.3	3.0	4.8	-2.5	3.0	-6.4
Final domestic demand	4.9	3.0	3.9	4.1	3.6	3.5	1.6	2.3
Stockbuilding ¹	-0.3	-0.6	-0.2	0.3	0.3	1.3	-0.7	0.6
Total domestic demand	5.6	1.7	3.6	4.2	4.1	3.8	1.2	1.3
Exports of goods and services	5.6	3.3	5.0	2.6	9.4	4.0	4.7	2.6
Imports of goods and services	7.8	1.7	5.0	4.5	8.9	3.7	0.1	0.4
Net exports ¹	-1.0	0.5	-0.2	-0.7	0.1	0.1	1.5	0.8
Unemployment rate ²	10.2	9.4	9.6	9.6	9.5	9.1	10.3	11.8
Consumer price index ³	4.5	5.2	4.5	0.8	0.0	1.6	2.2	2.1
Current account balance ⁴	-5.2	-4.9	-4.9	-3.5	-2.2	-3.4	-3.3	-2.5
General government financial balance ^{4,5}	-4.3	-5.4	-5.6	-5.7	-5.2	-6.1	-5.9	-7.0
General government debt ^{4,5}	34.3	36.0	38.6	41.0	45.1	48.4	53.2	58.5

Source: OECD Economic Outlook 98 Database as of May 2016.

Notes: 1. Contribution to changes in real GDP, actual amount in the first column. 2. Average of quarterly data. 3. Annual average per cent change.

4. As a percentage of GDP. 5. It correspond Central Government.

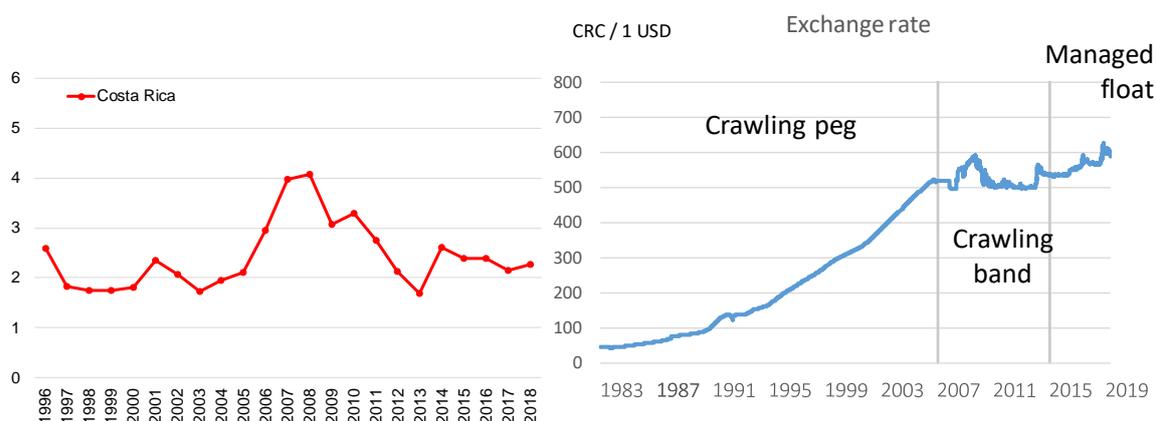
273. Annual inflation stood at 2.2% close to the lower range of the target inflation range (see Figure 11). With inflation projected to remain well within the target range over the forecast horizon, and significant and persistent deflationary pressures arising from a negative output gap and unemployment well above the

non-accelerating inflation rate (estimated at around 8%), the Central Bank has twice reduced its monetary policy rate, by 25 bps in March 2019 and another 25 bps in May, taking it to 4.75%

274. The domestic currency, Costa Rican Colón (CRC), depreciated between September and November 2018, as a result of uncertainty over the fiscal situation. Calm returned to the exchange rate market after the approval of the fiscal reform in December 2018, and the CRC appreciated somewhat. In 2019 the exchange rate has fluctuating around a relatively horizontal trend.

Figure 2.1. GDP per capita and exchange rate evolution of CRC

In percentage change and in CRC per USD



Source: BCCR.

275. The international reserves of BCCR stood at USD 7.7 billion (12.8% of GDP) as of June 3, 2019. During H1 2019, reserves have increased by USD 224 million, due to increased deposits by the Central Government.

Figure 2.2. BCCR foreign net reserve holdings

In USD million



Source: BCCR.

B. Recent trends in financial markets

276. Banks are adequately capitalised and liquid; however, profitability has been declining over the past decade, with the return on assets of the sector declining from 1.67% in 2008 to 0.73% in March 2020. This drop in profitability can be attributed to the increased provisioning following the implementation of new prudential supervision from 2010 onwards, the impact of the global recession on Costa Rica and the cooling-off of the economic growth experienced in the early 2000s.

Table 2.2. Financial soundness indicators for the Costa Rican banking sector, March 2020

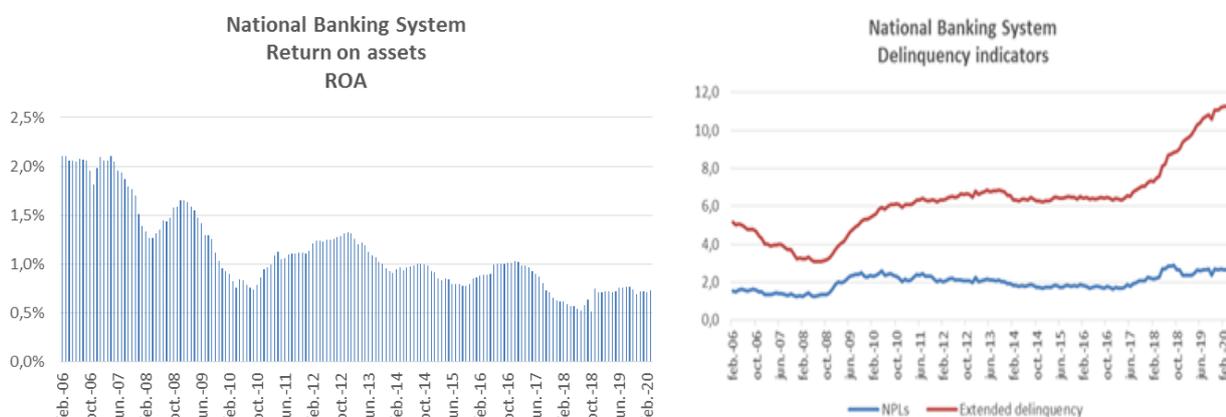
Banking ratio	All banks	State-owned	Private, local	Private, foreign
Capital adequacy				
Total capital / RWA	13.40	13.06	13.94	13.42
Asset quality				
NPLs/ total loans	2.6	3.2	1.4	2.1
FX loans/ total loans	44.8	29.6	85.7	69.9
Funding				
Deposits / total liabilities	78	83	72	78
Deposits / total loans	107	126	98	100
Profitability				
ROA (after-tax)	0.7	0.5	0.8	1.0
ROE (after-tax)	6.6	4.7	7.4	9.9
Liquidity				
Liquid assets / total assets	33	33	28	36
Liquid assets / short-term liabilities	152	151	153	170
Sensitivity to market risk				
Net FX exposure / capital	27	11	89	58

Source: SUGEF, IMF.

277. Asset quality has been stable with a low level of non-performing loans remaining low and below the 3% threshold established by SUGEF (Agreement 24-00).

Figure 2.3. Profitability and asset quality of the Costa Rican banking sector

In percentages



Note: NPLs defined as 90 day past due loans, extended delinquency defined as settled credits/written off credits and assets taken as payments of debts, in addition to 90 day past due loans.

Source: Costa Rican Authorities.

278. The level of public sector involvement in the debt markets is significant. Eighty-three percent of outstanding debt securities in Costa Rica are issued by the public sector (Ministry of Finance and BCCR) and other state-owned institutions issue securities, such as Central Bank, state-owned banks (Banco Nacional de Costa Rica and Banco de Costa Rica), and banks created by Law (Banco Popular and Banco Hipotecario), the Costa Rican Electricity Institute and the Costa Rican Oil Refinery (RECOPE).

279. Costa Rican banks have a significant exposure to sovereign debt, with bank claims on central government and Central Bank standing at c. 6.9% of GDP¹⁰⁹, as of March 2020.

¹⁰⁹ SUGEF.

II. FSSR and WHD Cluster Surveillance Report Recommendations

Table 2.3. Costa Rica: Detailed 2018 FSSR Technical Assistance Roadmap

Key vulnerabilities and Objective	Technical Assistance Activities
<p>Banking Supervision HIGH PRIORITY Insufficient implementation of an effective approach to risk-based supervision. Objective: Effective prudential risk-based supervision</p>	<p>IMMEDIATE</p> <ul style="list-style-type: none"> • Define the risk appetite of the supervisor. • Provide assistance in the development of regulations on risk management that are still lacking. • Provide support for the analysis of which macroprudential inputs could be considered in the supervisory planning process and incorporate these into the relevant risk-based supervision guidelines. • Contribute to the analysis and redesign of the elements of the risk matrix.
<p>Banking Regulation and Supervision HIGH PRIORITY Current organic law of the BCCR does not allow effective consolidated supervision. Objective: Improved regulation and supervision</p>	<p>Within six months after the draft law on consolidated supervision is approved</p> <ul style="list-style-type: none"> • Assist in the development of regulations improving the transfer of significant ownership regime and establish a regime of prior authorization for bylaw changes applicable to all supervised institutions. • Assist in the development of regulations complementing the current regime of capital adequacy measurement, to include the consolidated basis, and in the revision of the supervisory information package, to adapt it to consolidated supervision.
<p>Financial regulation and supervision HIGH PRIORITY The law regulating the securities market does not provide powers to request changes in boards and senior management of supervised institutions. Objective: Improved regulation and supervision</p>	<p>Within 12 months after the draft law amendments on fitness and properness are approved.</p> <ul style="list-style-type: none"> • Assist in the review of the design and contents of SUGEF, SUGEVAL, SUPEN, SUGESE Roles Register to adapt it to become a supporting tool in the new ex ante regime for the assessment of fitness and properness. • Training may also be provided on fitness and properness ex ante assessment.
<p>Banking Regulation Gaps with international standards provide room for unhealthy practices as well as for regulatory arbitrage, hence weakening the financial system's reliability. Objective: Set out roadmaps for the progressive implementation of Basel II/III and of international standards on remunerations.</p>	<ul style="list-style-type: none"> • Assist in the analysis of the potential impact of Basel II/III framework and in the design of the roadmap for its progressive implementation. • Assist in the analysis of the potential impact of Basel Committee's disclosure standards on remuneration and in the design of the roadmap for its progressive implementation. • Training may also be provided on remuneration practices.
<p>Crisis management HIGH PRIORITY Ineffective emergency liquidity facility at BCCR Objective: Implementation of an emergency liquidity facility limited to solvent institutions</p>	<p>IMMEDIATE</p> <ul style="list-style-type: none"> • Provide consultancy on collateralization and valuation of pledged assets. • Develop a framework to analyze payment system liquidity and operational risks, and introduce mechanisms for prevention and mitigation of systemic liquidity risk.
<p>Deposit insurance, crisis management and bank resolution HIGH PRIORITY Lack of practical experience in Costa Rica Objective: Capacity building</p>	<p>MEDIUM-TERM</p> <ul style="list-style-type: none"> • Train on best practices for bank intervention and resolution, including the use of the Purchase and Assumption methodology. • Train, including simulations, on crisis management. • Conduct Bank Resolution Simulation workshop.
<p>Crisis management Lack of a well-articulated crisis management arrangement Objective: Establish a framework for crisis management.</p>	<p>Within three months of the approval of the draft deposit insurance and bank resolution law:</p> <ul style="list-style-type: none"> • Develop operating policies and establish an inter-government coordinating committee responsible for preparing for and coordinating actions during a financial crisis. • Develop a national contingency plan. • Develop operating procedures for nationalized or bridge bank managers.
<p>Deposit insurance Potential loss of public confidence resulting in delays in payment of depositors in the event of a bank failure Implement a deposit insurance scheme for all deposit-taking institutions. Objective: Implement P&A resolution transactions to avoid suspending bank operations and delaying payment of insured deposits.</p>	<p>Within 3 months of the approval of the draft deposit insurance and bank resolution law:</p> <ul style="list-style-type: none"> • Develop a project plan to establish the DGF. • Develop policies and operating procedures for a DGF including but not limited to: calculation of premiums, investment policy, fund accounting policies, allocation of cost, provisioning for potential losses, and payment of insured deposits. • Develop resolution planning and practices to ensure prompt payment to insured depositors. • Conduct bank resolution simulation workshop. • Consult on the establishment and operations of a DGF. • Develop staffing plans based on the organizational structure of the DGF.

	<ul style="list-style-type: none"> • Develop resolution planning and practices to ensure prompt payment to insured depositors.
<p>Financial Stability HIGH PRIORITY</p> <p>Lack of clarity on the responsibilities of each participant in the financial stability</p> <p>Objective: To have a responsibilities matrix between macroprudential, microprudential, fiscal, and monetary issues</p>	<p>IMMEDIATE</p> <ul style="list-style-type: none"> • Articulate a roadmap for the preparation of new systemic risk indicators. • Elaborate a matrix identifying specific responsibilities. • Clarify the interrelationships and concomitant responsibilities between the policy and instruments. • Provide training to participants.
<p>Financial Stability</p> <p>Leave out insurance and pension in the stress analysis</p> <p>Objective: To improve capacities to elaborate stress test for pension and insurance (bottom-up and top-down)</p>	<ul style="list-style-type: none"> • Review the data, relevance, and capacities in the central bank and regulated entities. • Develop scenarios, communications, proofs, and strategies. • Analyze the results, improve the tool. • Send feedback to the central bank and regulated entities.
<p>Balance Sheet Approach (BSA) Assessments</p> <p>Current cross-sectoral financial relationships</p> <p>Objective: Complete information on cross-sectoral financial relationships (BSA matrix) to make more comprehensive assessments of economic vulnerabilities and to take proper corrective measures at the micro- and macroprudential levels.</p>	<ul style="list-style-type: none"> • Build and validate the sources of information used to compile and update the BSA matrix. • Improve the information used for the construction of nonfinancial sectors' balance sheets. • Develop skills to assess BSA matrix for detection and measurement of economic vulnerabilities. • Link such assessments with other tools used to monitor financial stability (FSIs, stress testing, etc.).
<p>Stability issues under dollarization</p> <p>HIGH PRIORITY</p> <p>High degree of dollar credit granted to non-generators of dollars (households and non-tradable firms)</p> <p>Objective: Reduce significantly the amount of credit to non-generators of dollars.</p>	<p>IMMEDIATE</p> <ul style="list-style-type: none"> • Design measures to encourage de-dollarization • Assess existing macroeconomic models and develop a plan to incorporate currency mismatches into the models used by the BCCR. • Incorporate foreign exchange sensibility and impact in credit risk. • Measure foreign exchange credit risk in the banks.
<p>Stability issues under dollarization</p> <p>Stress on banking sector with regulation on de-dollarization</p> <p>Objective: Measuring the impact of macroprudential measures already taken to calibrate them properly and verifying that they comply with its goal of promoting a gradual but permanent reduction of financial dollarization</p>	<ul style="list-style-type: none"> • Analyze existing regulations on banking sector with the aimed of reducing the dollarization. • Develop tools to measure the impact of these regulations and achievement of results. • Recommend how to improve those measures.
<p>Financial deepening and inclusion</p> <p>HIGH PRIORITY</p> <p>Lack of coordination and leadership regarding financial inclusion</p> <p>Objective: Advancing the national agenda for financial deepening and inclusion</p>	<p>MEDIUM-TERM</p> <ul style="list-style-type: none"> • Design a roadmap for the NSFI and for the NSFEE, identifying main steps to be taken. • Help with diagnosis and identify key topics to be included in the NSFI and in the NSFEE.
<p>Financial deepening and inclusion</p> <p>Weak data structure for financial inclusion</p> <p>Objective: Advancing the national agenda for financial deepening and inclusion</p>	<ul style="list-style-type: none"> • Enhance supply-side data: review existing information and develop a set of key indicators that should be monitored. Suggest relevant dimensions (gender, age, geographic location, other). • Enhance demand-side data: identify key issues to be included in a survey on financial inclusion. Propose a set of specific questions that should be included in a survey.
<p>Financial deepening and inclusion</p> <p>Weak legal powers to supervise the shadow banking sector</p> <p>Objective: Strengthening the regulatory environment</p>	<p>Propose amendments to the law to enhance SUGEF's ability to include institutions under the regulatory perimeter, with a proportionate approach.</p>
<p>Financial deepening and inclusion</p> <p>Weak legal powers for financial consumer protection</p> <p>Objective: Strengthening the regulatory environment</p>	<ul style="list-style-type: none"> • Review the legal framework to enhance consumer protection, particularly for SUGEF but also for the BCCR; the Ministry of Economy, Industry, and Trade (MEIC); and other superintendencies. • Within 12 months after the consumer protection law is enacted: build a harmonized framework for consumer protection in the regulated financial sector.

Note: Excludes insurance-related parts of the roadmap.
Source: IMF, 2018 FSSR.

Table 2.4. 2018 Costa Rica FSSR: Strategic Objectives and Related Key Recommendations

<p>Strengthening the regulatory environment (CONASSIF, SUGEF, SUGESE, SUPEN)</p> <ul style="list-style-type: none"> • Pass the law that allows SUGEF to exercise effective consolidated supervision (¶20, 26) • Enhance legal and regulatory frameworks that support corrective measures (¶23, 25) • Implement fit and proper rules (¶21, 27) • Review the regulatory perimeter of SUGEF (¶84) 	
<p>Strengthening the supervisory framework (SUGEF, SUGESE, SUPEN)</p> <ul style="list-style-type: none"> • Provide legal protection for the supervisors (¶24, 29, 31, 40) • Consolidate the newly introduced risk based supervisory approaches (¶22, 24, 28, 30, 40) • Strengthen insurance and pension RBS with stress testing and forward looking tools (¶41) 	
<p>Fostering secondary markets that allow for pricing and liquidity (SUGEVAL)</p> <ul style="list-style-type: none"> • Align primary markets with secondary markets liquidity needs (BCCR, MoF) (¶50) • Review current valuation and price formation processes (¶45, 51) • Implement specific market trading mechanisms for fixed income securities (¶47, 52) • Improve post-trading settlement failures management (¶48, 53) 	
<p>Strengthening financial safety nets (BCCR, MoF, CONASSIF)</p> <ul style="list-style-type: none"> • Implement an ELA facility at BCCR to provide support to illiquid but solvent banks (¶75) • Use P&A resolution transactions to avoid delaying payment of insured deposits (¶73) • Create a crisis management committee to formalize decision-making (¶76) • Implement a deposit insurance scheme for all deposit taking institutions (¶67-71) 	
<p>Mitigating risks related to high dollarization (¶64, 65)</p> <ul style="list-style-type: none"> • Allow for higher exchange rate volatility (BCCR) • Recalibrate prudential regulation to accelerate reduction of dollarization (SUGEF) • Increase liquidity and reserve requirements in foreign exchange (BCCR) 	
<p>Mitigating risks related to the sustainability of pensions (SUPEN) (¶35, 38)</p> <ul style="list-style-type: none"> • Introduce reforms for sustainability of first pillar with solutions that consider the second pillar (1) • Close critical gaps in the regulation and supervision of the first pillar pension plans (2) • Introduce held to maturity valuation for some pension fund assets 	
<p>Strengthening the monitoring of financial stability (BCCR, CONASSIF)</p> <ul style="list-style-type: none"> • Coordinate efforts and sharing information issues (¶55, 56, 59) • Empower the newly created Financial Stability Commission (¶57, 60) • Establish a matrix of responsibilities for macro prudential policy (¶59) 	
<p>Advancing the national agenda for financial deepening and inclusion</p> <ul style="list-style-type: none"> • Create a national coordination mechanism for financial inclusion (BCCR) (¶78, 83) • Develop and approve a National Strategy for Financial Inclusion (BCCR) (¶83, 84) • Enhance the legal framework for financial consumer protection. (CONASSIF) (¶82, 86) 	
<p>(*) Impact on financial stability if left unaddressed: HIGH MEDIUM-HIGH MEDIUM </p> <p>Notes: (1) Government, first pillar providers and SUPEN; (2) Attorney General of the Rep. of Costa Rica</p>	

Source: IMF. Monetary and Capital Markets Department. Costa Rica: Financial Sector Stability Review. November 2017.

Table 2.5. Summary of recommendations in the WHD Cluster Surveillance Report on Financial Integration in CAPDR

As of June 2017

A. Micro-prudential regulation	
Regulatory Perimeter	<ul style="list-style-type: none"> • Designate a Lead Supervisor in each country. • Adopt a broad definition of financial conglomerate and economic group. • Develop and periodically update a map of existing financial conglomerates. Empower supervisors to regulate holding corporations. • Agree on a common scope of supervision to minimize regulatory arbitrage.
Capital Adequacy	<ul style="list-style-type: none"> • Bridge existing different capital definitions across countries. • Adopt common definition of capital consistent with international best practice. • Harmonize the calculation of financial conglomerates' capital on a consolidated basis. • Adopt common loan classification criteria, at least applicable to regional entities.
Corporate Governance	<ul style="list-style-type: none"> • Regulate the organization structure of conglomerates to facilitate their supervision. • Reinforce legal authorities for the identification of ultimate ownership of financial conglomerates and economic groups. • Harmonize regulations on market entry and participation. • Establish minimum regional standards on risk management systems.
Credit Limits	<ul style="list-style-type: none"> • Adopt common thresholds on credit concentration and exposures to related parties. • Empower supervisors to inquire about ultimate owners' identities beyond financial corporations that are part of the financial conglomerates. • Grant sufficient legal protection to supervisors.
B. Macro-financial Regulation and Instruments	
Regional Supervision	<ul style="list-style-type: none"> • Implement a Regional Financial Stability Council with a broad mandate for regional financial stability, building from existing forums and Ministries of Finance. • Extend responsibility of supervising regional conglomerates to principal supervisors. • Harmonize financial data exchange in line with international accounting standards.
Macroprudential Regulation	<ul style="list-style-type: none"> • Ensure full integration of systemic risk in the regulatory and supervisory frameworks. • Develop national and regional frameworks to identify SIFIs. • Calibrate micro-financial regulatory instruments to address macro-prudential risk. • Agree on a common set of macro-prudential instruments to be used to induce a reduction of systemic risk from financial conglomerates. • Reinforce regional macro-prudential surveillance, including by regional authorities.
Lender of Last Resort	<ul style="list-style-type: none"> • Adopt minimum country requirements on LOLR facilities. • Re-examine regulation for ring-fencing to ensure it addresses liquidity pressures transmitted across borders through financial conglomerates. • Develop macro-prudential metrics for liquidity in foreign exchange. • Reassess national frameworks on reserve requirements for foreign currency liabilities.
Remedial Actions and Resolution	<ul style="list-style-type: none"> • Extend legal regimes for corrective and remedial actions to non-bank financial institutions, and also specifically for SIFIs and financial conglomerates. • Adapt resolution frameworks to take into account regional implications.
Deposit Insurance	<ul style="list-style-type: none"> • Harmonize deposit insurance facilities. • Establish explicit coverage of deposits in off-shore banks with a specific regime.

Source: IMF (2017 Article IV Consultation), Superintendence of Financial Institutions of Costa Rica.

III. Commitments by Costa Rica on GATS (General Agreement on Trade in Services)





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7 FINANCIAL SERVICES		
7.B Banking and other financial services (excl. insurance)		
(a) Acceptance of deposits and other repayable funds from the public.		
(b) Lending of all types, including, inter alia, consumer credit, mortgage credit, factoring and financing of commercial transactions.		
(c) Credit card services: services consisting in the financing of the purchase of products using credit cards or other types of plastic money.		
<p>Limitations on Market Access</p> <ol style="list-style-type: none"> 1) Unbound 2) Unbound 3) None, except that; Only the establishment of companies in the form of affiliated companies or subsidiaries is permitted, and other forms are excluded, particularly branches. This does not prevent the operation of representative offices, which may not provide financial services in Costa Rica. The commercial presence shall be carried out in accordance with the purpose specifically authorized for the affiliated company or subsidiary concerned, which must adopt the corporate form required by the Costa Rican legal system for that purpose. 4) Unbound, except as indicated in the horizontal section 	<p>Limitations on National Treatment</p> <ol style="list-style-type: none"> 1) Unbound 2) Unbound 3) None 4) Unbound, except as indicated in the horizontal section 	
(e) Financial leasing services		
<p>Limitations on Market Access</p> <ol style="list-style-type: none"> 1) Unbound 2) Unbound 3) None, except that commercial banks and non-bank finance companies may not provide financial leasing services, since there are legal restrictions on the acquisition of movable and immovable property by such entities. Only the establishment of companies in the form of affiliated companies or subsidiaries is permitted, and other forms are excluded, particularly branches. This does not prevent the operation of representative offices, which may not provide financial services in Costa Rica. The commercial presence shall be carried out in accordance with the purpose specifically authorized for the affiliated company or subsidiary concerned, which must adopt the corporate form required by the Costa Rican legal system for that purpose. 4) Unbound, except as indicated in the horizontal section 	<p>Limitations on National Treatment</p> <ol style="list-style-type: none"> 1) Unbound 2) Unbound 3) None 4) Unbound, except as indicated in the horizontal section 	
(d) Provision and transfer of financial information, and financial data processing and related software by providers of other financial services.		
<p>Limitations on Market Access</p> <ol style="list-style-type: none"> 1) None 2) None 3) None, except that; Only the establishment of companies in the form of affiliated companies or subsidiaries is permitted, and other forms are excluded, particularly branches. This does not prevent the operation of representative offices, which may not provide financial services in Costa Rica. The commercial presence shall be carried out in accordance with the purpose specifically authorized for the affiliated company or subsidiary concerned, which must adopt the corporate form required by the Costa Rican legal system for that purpose. 4) Unbound, except as indicated in the horizontal section 	<p>Limitations on National Treatment</p> <ol style="list-style-type: none"> 1) None 2) None 3) None 4) Unbound, except as indicated in the horizontal section 	

Source: http://i-tip.wto.org/services/DetailView.aspx?id=Costa%20Rica&isGats=1§or_code

V. The role of CONASSIF

Table 2.6. Article 171 of Law 7732 on the role of CONASSIF

Functions of the National Council for Supervision of the Financial System. The National Council for Supervision of the Financial System shall have the following functions:

- a) To appoint and remove the General Superintendent of Financial Entities, the General Superintendent of Securities and the Superintendent of Retirement Funds, as well as the respective intendants, auditors and the internal subauditor of the Superintendency of Financial Entities.
- b) To approve the provisions concerning the authorization, regulation, supervision, control and surveillance which, in accordance with the law, have to be enforced by the General Superintendency of Financial Entities, the General Superintendency of Securities and the Superintendency of Retirement Funds. No requirements that unduly restrict the access of the economic agents to the financial market, limit free competition, or include discriminatory conditions, can be established.
- c) To order the suspension of operations and the intervention of the parties regulated by the Superintendencies, as well as to decree their intervention and request their liquidation before the appropriate authorities.
- d) To suspend or revoke the authorization granted to the parties regulated by the various Superintendencies, or the authorization for public offering, whenever the respective entity fails to comply with the legal requirements or the regulations issued by the National Council, or when the continuity of the authorization may affect the interests of savers, investors or affiliates, or the market integrity.
- e) To approve the rules applicable to the procedures, requirements and terms for the merger or transformation of financial entities.
- f) To approve the rules concerning the organization, transfer, registration and operation of financial groups, in accordance with the Structural Law of the Central Bank of Costa Rica.
- g) To hear and solve the appeals filed against the resolutions entered by the Superintendencies. The resolutions entered by the Council exhaust administrative proceedings.
- h) To hear the appeals filed against the resolutions entered by stock exchanges concerning the authorization of brokerage firms and the imposition of sanctions to brokerage firms and stock brokers, under the Stock Market Regulatory Law. Any person with a lawful interest shall be entitled to appeal.
- i) To regulate the exchange of information and cooperation that can take place between and among the various Superintendencies whether for prudential consolidated supervision, market conduct, international cooperation based on agreements with foreign counterparts or any other aspect it considers important for the performance of the duties. The superintendencies that share information must maintain the corresponding confidentiality obligations, including the obligation related to the request for information in the case of international cooperation. Members of CONASSIF, superintendents, intendants, other officials of the Superintendency or any other natural or legal person that renders services to the superintendency and fails to comply with the confidentiality duties, shall be subject to the corresponding administrative, civil and criminal sanctions (amended through article 3 of Law No.9746).
- j) To approve the general rules of organization of the Superintendencies and internal auditors.
- k) To approve the annual operating plan, the budgets, their modifications and the budgetary liquidation of the Superintendencies within the global limit fixed by the Board of Directors of the Central Bank of Costa Rica, and submit them to the Office of the Comptroller General of the Republic for final approval thereof.
- l) To approve the annual report of each Superintendent as well as the annual reports that Superintendents shall submit on the performance of the parties supervised by the respective Superintendency.
- m) To designate at the appropriate time and for the terms it may deem convenient consultative committees composed of representatives of the entities under supervision, the investors or other economic sectors, to examine specific subjects and issue non-binding recommendations.
- n) To approve rules defining which individuals or legal entities related by ownership or management with the parties under supervision shall be considered as part of the same economic interest group, for the purpose of ensuring an adequate diversification of portfolios and solving and avoiding conflicts of interest.
- ñ) To approve the provisions concerning accounting and auditing standards, in accordance with generally accepted accounting principles, as well as the frequency and diffusion of the external audits to which the entities under supervision shall be subject. In case of conflict, these provisions shall prevail over those issued by the Professional Association of Public Accountants of Costa Rica.
- o) To approve the provisions concerning the periodicity, the scope, the procedures and the publication of the reports submitted by the external auditors of the entities under supervision, in order to achieve as much reliability as possible from these audits. Audit firms or independent professionals providing these services must be registered in the Register of External Auditors. CONASSIF shall establish the operational rules of this register through regulations, including the requirements and procedure for registration, suspension and de-registration, as well as the superintendence that will manage this register, among others (amended through article 30 of Law No.9768).
- p) To approve the provisions applicable to the internal auditors of the entities supervised by the Superintendencies, in order that they may duly perform the duties characteristic of their activity, and see that such entities comply with the legal provisions.
- q) To approve the provisions that guarantee the supervision and the safeguard of the financial soundness of the retirement systems of the Judicial Branch and any others created by law or collective bargaining agreements.
- r) To solve any conflicts of competence that may arise between and among Superintendencies.

s) To exercise any other powers vested in it by the respective laws over the parties supervised by the General Superintendency of Financial Entities, the General Superintendency of Securities and the Superintendency of Retirement Funds.

The National Council can delegate the knowledge of specific matters to commissions composed of some of its members, in accordance with the rules established by it.

t) To establish through regulations, the fees or fees for specific procedures or services, such as, but not limited to, authorization, registrations and certifications procedures or records to be issued by the superintendencies following a request made by a regulated, supervised or audited entity, or from third parties, according to the rules prescribed in the legal framework. The amounts defined for these fees shall reflect the cost of the service and shall be transferred to the Central Bank of Costa Rica (amended through article 3 of Law No.9746).

Source: National Council for Supervision of the Financial System (CONASSIF).