FOR AGENDA

SM/11/86
Correction 1

May 19, 2011

To: Members of the Executive Board

From: The Secretary

Subject: **Bolivia—Financial System Stability Assessment—Update**

The attached corrections to SM/11/86 (4/29/11) have been provided by the staff:

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Page 14, Table 5: Replaced as data has been revised.

Page 26, para. 37, line 5: for "AFP" read "APS"

Questions may be referred to Ms. Zanforlin, MCM (ext. 38783).

This document, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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10. **The insurance market is small and highly concentrated** (Table 3). With US$205 million in gross premium income (GPI) in 2010, it is one of the smallest insurance markets in the region. Nonlife and life companies operate in the market with a penetration of 0.9 percent and 0.3 percent of GDP respectively, and insurance density of only US$16 and US$5 per capita.[11] About 60 percent of the market is controlled by three companies, part of financial conglomerates, while one third of the market is represented by small family-owned companies.

Table 3. Bolivia: Insurance Market Summary Indicators

	2004	2005	2006	2007	2008	2009	2010
Penetration	1.8	1.8	1.6	1.2	1.1	1.2	1.2
Life	0.8	0.8	0.7	0.3	0.3	0.3	0.3
Non Life	1.1	1	0.9	0.9	0.9	0.9	0.9
Density (in U.S. dollars)	18	18	19	16	19	21	20
C2 1/							
Life	Na	74	73	59	56	57	55
Non Life	Na	62	61	59	52	48	46
HHI 2/							
Life	Na	3,724	3,720	2,302	2,174	2,212	2,250
Non Life	Na	2,294	2,288	2,322	2,040	1,990	1,940

Source: Staff computations based on Bolivian authorities' data.
1/ C2 represents the two largest companies assets over total assets.
2/ Hirschman-Herfindahl Index

B. Commercial Banks

Performance

11. **Following deep distress in 2003–04, strong economic performance has allowed the banking** sector to improve profitability and strengthen its capital base (Figure 4, Table 4). Not directly affected by the international crisis, the banking sector has remained profitable and net-interest margins have been stable and high since 2008, and in line with other countries (Figures 5 and 6).[12] Banks have restructured their corporate loan portfolios and complied with provisioning requirements for restructured and nonperforming loans. The system had an average CAR of 12 percent at end-2010 against a 10 percent regulatory minimum.[13] While several public funding schemes supported the banks through the crisis by providing subordinated debt, these liabilities have mostly expired.[14] Leverage has increased recently as a result of the recent rapid credit growth.

Table 4. Bolivia: Banks Revenue, Costs, and Return on Average Assets, 2003–10
(In percent)

	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10
Revenue from Interm.	6.5	6.4	7.6	7.7	8	8.4	7	6.1
Cost from Intermediation	-2.7	-2.1	-2.5	-2.6	-2.7	-2.8	-2.7	-1.4
Net income from Noninterm.	1	0.9	1.2	1.6	1.9	2.8	2	2.1
Valuation Adjustments	2.3	2.3	1.6	1.3	0.8	1.9	1.7	2.2
Total Gross Income	**7.2**	**7.5**	**8**	**8**	**7.9**	**10.2**	**8**	**8.9**
Personnel Cost	-1.5	-1.5	-1.8	-1.9	-1.9	-2	-1.8	-2
Administrative Cost	-2	-2.1	-2.4	-2.3	-2.3	-2.4	-2.1	-2.2
Loan Loss Provisioning	-3.4	-3.2	-2.4	-2.1	-1.8	-3	-2.2	-2.9
Other Costs	0	-0.5	-0.3	-0.3	0.2	-0.8	-0.3	-0.2
Pretax Return on Assets	**0.2**	**0.2**	**1**	**1.5**	**2.1**	**2.1**	**1.6**	**1.6**

Source: Bolivian authorities.

[11]Gross premium income (GPI) over GDP.`

[12]Although, significant variations may be observed among the returns of individual institutions

[13]Capital is defined as Tier I and Tier II. CAR ratios are computed as total capital over total risk-weighted assets. Subordinated debt only represents 10 percent of the total capital of the banking system, while Tier I capital averages 80 percent of total capital. Some minor deviations persist with respect to international practices for computing CAR ratios, in particular with respect to the treatment of subordinated debt, which is subject to a weighting factor depending on the increase in the loan portfolio since June 2009.

[14]The main public funding scheme was the "Fondo de Apoyo al Sistema Financiero."

12. **The banking sector appears fairly efficient and competitive, broadly in line with regional peers (Box 1).** Most banks in Bolivia were found to be efficient, as measured by standard econometric techniques, although, commercial banks were found to be slightly more efficient than microfinance banks. Average competitiveness, as measured by the H-Statistics, was estimated to reach 0.65, which is somewhat higher than that of Paraguay (0.61), while slightly below the Latin American average (0.76). However, the banking sector in Bolivia appears to be more competitive than banking sectors in other regions, such as East Asia, Middle East & Northern Africa, and Sub-Saharan Africa.[15]

13. **Credit quality indicators appear strong**. NPLs have been declining markedly and reached 2.2 percent at end-2010, in part because the recent high credit growth.[16] At the same time, provisioning coverage for NPLs has been steadily growing, reaching 200 percent at end-2010. The provisioning coverage for high-risk loans also appears strong (Table 5).

Table 5. Bolivia: Financial Institutions Selected Indicators, 2010

	Commercial Banks	FFPs	Mutuals	Cooperatives
Capital adequacy ratio	12.0	11.3	40.7	21.2
Total provisions/NPLs	121.8	142.0	88.7	149.7
Total provisions/problem loans 1/	72.6	124.3	91.7	118.4
NPLs/total loans	2.9	1.4	3.9	2.6
Problem loans /total Loans	4.9	1.6	3.8	3.2
Tier I/regulatory capital	81.9	84.7	92.2	92.1
Tier II/regulatory capital	18.1	17.7	7.8	7.9
Total loans/total deposits	62.7	96.6	69.8	90.5
Liquidity I 2/	24.8	23.6	5.1	12.1
Share of total loans	60.4	10.0	4.7	6.2

Source: Bolivian authorities and IMF staff estimates and calculations.

1/ Loans included in classification categories C to F.

2/ "Disponibilidades (immediate liquidity)" to total deposits.

[15] H-Statistics values close to one indicate perfectly competitive behavior while negative values indicate monopolistic behavior (see Box 1 for further details).

[16] As a result of the increased lending, the denominator of the ratio increases therefore lowering the share of NPLs.

System (SIPAV), it is the backbone of the payments system.[34] Due to the high volume of payments that it settles and its unique position as sole entity to provide settlement in central bank accounts, SIPAV is considered a systemically important payments system. While SIPAV is broadly in observance of most Core Principles for Systemically Important Payments Systems (CPISIPS), some key issues are yet to be adequately addressed:

- its legal basis includes the main features of a modern payments systems,[35] but the absence of a Payments System Law, which is currently being drafted, is an important shortcoming;
- access to SIPAV is restricted to entities either supervised by ASFI, or discretionarily authorized by BCB's Board of Directors;
- there is presently no formal consultation mechanism, such as a National Payments Council, to ensure that all parties are consulted and informed on decisions affecting the design and operations of the NPS;
- there is no formal cooperation mechanism with ASFI; and
- BCB's oversight is not yet fully separated from the system's operation.

30. **The BCB is currently working on a new integrated payments settlement system, Sistema de Liquidacion Integral de Pagos (LIP), which will improve the interconnection between the various subsystems of the NPS.**

31. **There is only one clearing house for checks (CCC), managed by a private company owned by banks (ACCL) and the Association of Private Banks of Bolivia (ASOBAN).** Checks are not primarily retail payment instruments, and are used mainly for commercial transactions between companies.[36] There is also an automated clearing house (ACH) for transfers and direct debits also managed by ACCL, which started its operations in 2006, but volumes still remain low. Over time, the authorities hope to transfer the operations of the CCC to either the ACH, or to SIPAV.

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[34] It provides settlement services for the Cheques Clearing House (CCC), the Automated Clearing House for Direct Debits and Transfers (ACH) for credit transfers and direct debits, the treasury accounts (SPT), and the central securities depository (EDV).

[35] BCB Resolution 131/2009.

[36] The average value cleared at BCB is fairly high (averaging between US$3,800 and US$5,550 during 2005–09).

32. **The central securities depository (EDV) handles government and corporate securities, and provides DVP services, settling at the RTGS in T+0.** The system has introduced mechanisms to manage credit risk, but it is still lacking a liquidity facility.[37]

33. **Two networks managing credit and debit card transactions are expected to join SIPAV in the near future.** They are technically interoperable, but there is no sharing of Point of Sale (POS) and ATMs infrastructure, and cardholders are discouraged from using the competing network. Nevertheless, the use of debit cards has been steadily increasing.

34. **The disbursement of international remittances in the country is operated mainly through banks, but nonsupervised entities, such as money transfer operators, are also active.** These entities should be supervised, as they might pose the risk of noncompliance with AML/CFT requirements, and leave consumers without protection in case of default, fraud, or mismanagement.

III. Strengths and Challenges of the Regulatory and Supervisory Frameworks

A. Macro Prudential Framework

35. **There is currently no macro prudential policy framework in place.** In the absence of a more formal framework, the capacity of the BCB in this area would be enhanced by closer monitoring of the corporate and household sector balance sheets, as well as of housing and real estate market developments. Household and corporate indebtedness continues to increase, encouraged by the low interest rate environment. A residential property retail price index could be developed to monitor price developments in the real estate sector.

B. Regulation and Supervision

36. **Since 2004 the supervisory framework has been strengthened, but the new constitution approved in 2009 has changed the role of the supervisory authorities.** Notably, social policy objectives have been introduced into the regulatory and supervisory framework. Provisioning requirements have been reduced to foster lending to key sectors of the economy, but they have been weakening prudential buffers.

37. **Legal protection of supervisors, while discharging their functions, is essential to ensure operational independence and effectiveness of supervision.** The legal protection of supervisors was lifted after the enactment of the law on combating corruption and illicit enrichment. Consequently, civil, administrative, and criminal actions can be brought against ASFI and APS staff during performance of their duties.

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[37] "Mecanismo de Liquidación de Operaciones Retrasadas" (MELOR) and "Mecanismo de Liquidación de Operaciones Diferidas" (MELID).