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**LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM**

**Session III: Addressing Competition Challenges in Financial Markets**

**-- Contribution from Costa Rica --**

**4-5 April 2017, Managua, Nicaragua**

*The attached document from Costa Rica (COPROCOM) is circulated to the Latin American and Caribbean Competition Forum FOR DISCUSSION under Session III at its forthcoming meeting to be held on 4-5 April 2017 in Nicaragua.*

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# LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM



**15th Latin American and Caribbean Competition Forum**  
**4-5 APRIL 2017, Managua, Nicaragua**

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## **Session III: Addressing Competition Challenges in Financial Markets**

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### **-- CONTRIBUTION FROM COSTA RICA (COPROCOM) --**

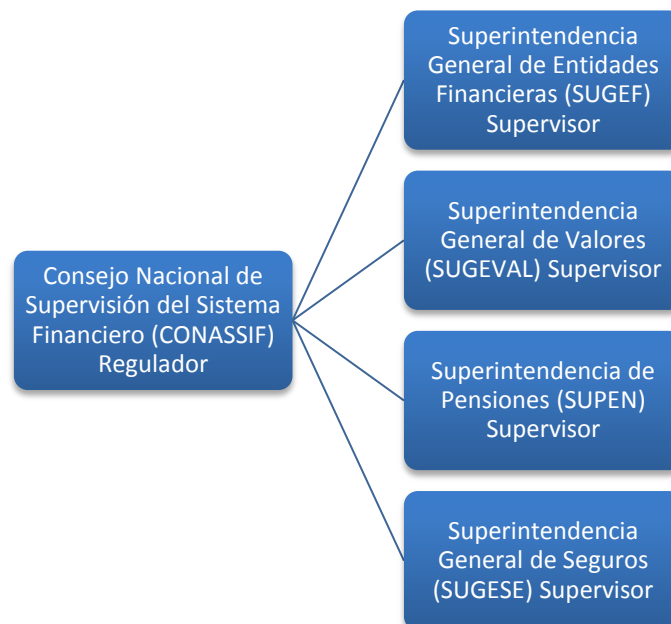
1. In the Costa Rican legal system there are two legal assets that sometimes face a trade off, in which there is no clarity as to which of the two should stand or else, the solution would be to resort to a third option that gives a balance to the financial market.

#### **1. General Framework**

2. On one side, Law No. 7472 establishes the obligation of the Commission for the Promotion of Competition (COPROCOM or Commission) to ensure the free competition process while the sectors laws of the financial system (Law No. 7558 Organic Law of the Central Bank of Costa Rica, Law No. 7732 Regulating Law of Securities Market, Law No. 7983 Workers Protection Law and Law No. 8653 Insurance Market Regulatory Law) establish the obligation not only of the supervisory bodies of the financial system, but also of the regulator of the System to ensure the stability, solvency and smooth operation of this.

3. In Costa Rica the regulation and supervision of the financial system is organized as shown in the following figure 1:

Figure 1



4. In year 2008, article 27 bis was introduced into Law No. 7472, which up to this day sets the guidelines for the interaction between the Commission, the regulators and supervisors of the financial system, in terms of authorization of mergers of the financial system and the imposition of sanctions for non-compliance with the rules related to competition.

**“Article 27 bis.- Relationship with the supervisors of the Financial System**

The relationship between the Commission to Promote Competition and the General Superintendence of Financial Entities, the General Superintendence of Securities, Superintendence of Pensions and the General Superintendence of Insurances, hereinafter the superintendencies, shall be governed by the following norms:

**a) Merger Processes:**

It is incumbent upon superintendencies the obligation to authorize, in advance, the assignments of portfolios, mergers, acquisitions, changes in stock control and other merger processes defined in this Law, which are performed by the entities under its supervision.

Once the request for authorization has been received, the superintendencies should consult with the Commission to Promote Competition in relation to the effects that such merger processes may have on the level of competition.

The opinion of the Commission shall be rendered within a maximum period of fifteen business days, counted from the request of the Superintendence. **This opinion is not binding, however, the Superintendence should motivate its resolution in case it decides to deviate from such an opinion.**

### **b) Opening of Sanctioning Procedures**

It is incumbent to the Commission to Promote Competition, the powers to determine and sanction vertical or horizontal monopolistic practices in the markets supervised by superintendencies.

Upon the opening of a sanctioning procedure by the Commission for acts contrary to this Law and in which some supervised entity of the Financial System has participated, criteria will be requested from the respective superintendence. Said report shall be rendered within a maximum period of fifteen working days, counted from the request of the Commission.

**The opinion of the Superintendence shall not be binding on the Commission; however, in cases where the Superintendence expressly warns of the need to prevent a sanctioning action from jeopardizing the stability of the Financial System, the Commission must give reasons for its decision to be validly separated from the opinion of the technical body.**

### **c) Obligations of Superintendents**

**Superintendents must report to the Commission to Promote Competition**, the anti-competitive practices typified in this Law that come to be known by supervised entities and from companies that are members of, or related to, the groups or financial conglomerates to which they belong. The Superintendence may intervene as an interested party in the corresponding proceedings.

*(As added by article 56 of the Regulatory Law of the Insurance Market, No. 8653 of July 22, 2008)*

5. The cited article establishes that the power to authorize the mergers that are given in the financial system, corresponds to the superintendence's, however, it requires the non-binding opinion of COPROCOM. On the other hand it is also pointed out that it is the Commission's power to sanction the entities subject to the supervision of the supervisory bodies of the financial system when these engage in conducts contrary to the competition process, however, in order to protect the financial stability of the financial system, should request an opinion from the corresponding supervisory body, and in case of separating from what the supervisor indicates, the Commission shall give reasons for its resolution.

6. The question that arises is: when does an entity present problems of financial stability? Article 119 of Law No. 7558, which regulates financial intermediaries, states that the purpose of the General Superintendence of Financial Institutions is to ensure the stability, solvency and proper functioning of the system, therefore, the same Law establishes in the Article 136 that a regulation should be issued to judge the financial situation of the financial institutions.

7. The Agreement SUGEF 24-00 "Regulation to judge the economic situation of financial institutions" establishes the following classification, which is based on the qualification obtained in the indicator card called CAMELS<sup>1</sup>:

- |  |   |
|--|---|
| <ol style="list-style-type: none"><li>1. Entities in the level of financial normality.</li><li>2. Entities in the level of financial irregularity 1</li><li>3. Entities in the level of financial irregularity 2</li></ol> | } Qualify as entities with financial stability problems |
|--|---|

4. Entities in the level of financial irregularity 3

8. Law N° 7558 in the same article 136 establishes the seriousness with which to assess the financial irregularities of the financial institutions:

“c) Description of the assumptions that imply the existence of situations of instability or financial irregularity of the audited entities. Situations of instability or financial irregularity will be classified in three grades, according to the seriousness of the situation. Grade one will be applied to situations of slight instability that, according to the Superintendence, can be overcome with the adoption of short-term corrective measures. Degree two will apply to situations of instability of greater severity that, according to the Superintendence, can only be surpassed by the adoption and execution of a sanitation plan. Grade three, which will require the intervention of the entity, (...)

9. Thus, irregularity 1 is considered mild, 2 the middle and the 3 is the most serious, since they require the intervention of the financial institution. Therefore the financial irregularity grade 1 and 2 financial irregularities can be treated with action plans or reorganization plans that are proposed by the same entity, which could include mergers, sale of assets (credit portfolio, capitalizations, etc.), while grade 3 implies a critical situation for both the supervisory body and the financial institution, since the entity is taken by the financial controller who must determine whether or not it has financial viability to continue operating. In this type of situations, measures of the type of administrative resolution may be required, within which are included: mergers, capitalization, sale, exclusion of assets and liabilities, liquidation, etc.

10. All this should be known by the Commission so that when carrying out the corresponding competition analysis, the particularities of each case are taken into account however, due to problems of confidentiality of information this does not reach to COPROCOM.

11. Another factor that could be extremely important for the analysis of this type of situations is the issue of systemic risk. The Agreement SUGEF 19-16 *"Regulations for the determination and recording of estimates against cyclical"* defines it as:

“1. Systemic risks: Risks with the potential to cause instability, liquidity problems or insolvency in the financial system are therefore common to all or a significant part of the system"

12. This type of risk is generally related to the size of the entity and the level of interconnection with the rest of the financial system.

13. In relation to competition analysis, these factors must be assessed in order to determine if the situation is so serious as to sacrifice the competition process, or else, if there may be other measures that achieve an adequate balance between financial stability and competition.

**2. Experience of Costa Rica**

14. Since the year 2009, the Commission has expressed an opinion in 37 cases of mergers, which have been made in the financial system, it should be noted that none of them was alerted on competition issues. Of the total cases, 84% corresponded to SUGEF consultations, 8% SUGESE, 5% SUPEN and 3% SUGEVAL.

15. The operations performed can be seen as follows in chart No 1.

Table 1

Operation	Number of Procedures
Mergers	12
Purchase of portfolios	13
Stock Transfer	3
Mergers in financial groups	9

16. In relation to the previous criterion for sanction, also established in article 27 bis already mentioned, the proceedings of three sanctioning procedures stand out, two of them in which banks were investigated, reason why the criterion of the Superintendence of Financial Institutions, and one in the year 2014 in which an insurance company was investigated, which to this day maintains the largest participation in the insurance market, in which the criteria of the Superintendence of Insurance was necessary; however, in none of the three cases arguments related to financial stability were submitted.

17. Transactions that can be considered as merger processes are usually used as short- and medium-term remedies to solve problems of financial stability, however, the Law prohibits the Superintendence of Banks from providing the degree of irregularity of the supervised entities, and to be excepted from this rule, it is required that it expressly be pointed out to the Commission within the law, thus to date there has been no such information. In addition, no evidence has been found to demonstrate problems in the process of free competition within the processes that have been referred to the Commission for consultation.

18. There is a case that draws attention, is the purchase of assets and liabilities made by the Banco Popular y Desarrollo Comunal a COOPEMEX R.L. As antecedent one has that in 2009 this Cooperative was intervened by the SUGEF; given the results obtained during the intervention, in 2010, the Assembly of Associates of the Cooperative decided to sell part of its assets and liabilities to Banco Popular in order to recover part of its resources.

19. At the time of intervention, COOPEMEX RL was the third most important cooperative, taking into account the level of assets of the cooperatives of savings and credits, while Banco Popular is a bank created by special law and is ranked within the ten most important banks of the system, according to the assets level.

20. According to the data provided at the time, Banco Popular portfolio was equivalent to 10.81%, while that of COOPEMEX R.L. was 0.92%, this in relation to the total credit of the national financial system. In addition, the Superintendence reported that both entities were mainly engaged in personal credit, on the one hand, Banco Popular allocated 73% of its portfolio to this type of credit, while COOPEMEX R.L., had 94%. That is, at that time, COOPEMEX RL owned 1.49% of the total personal credit while the Bank had 13.52%, which implies that after the merger the joint participation that acquired the Bank was 14,9% of the personal credit market. As a result, the Commission, through vote No 26-2010 of 8:50 hours on July 5, 2010, issued a favorable criteria for the purchase of proposed assets and liabilities

21. This is an example of the existence of a problem of financial stability of a financial institution that was solved through one of the mechanisms that allows to concentrate the market, that is why, the competition authorities must be vigilant and have some participation in the process of authorization of the merger processes carried out in the financial system. This is even recognized in the principles of Basel, a frame of reference in the banking financial system in principle 7 which states:

“Principle 7 –Substantial acquisitions: the supervisor has the power to approve or reject (**or recommend to the responsible authority the approval or rejection**) and establish prudential conditions regarding the acquisitions or substantial investments made by a bank, according to prescribed criteria, including the performance of cross-border transactions and to determine that the structure of the group or entity does not expose the bank to unnecessary risk or impede effective supervision "bold font added and emphasis are not on the original)

22. Until today, in Costa Rica, there has not been a severe conflict between the protection of free competition and the financial stability of financial institutions, however, the issue is latent, and will only be with a close job and coordinated with sector regulatory and supervisory authorities that a balance can be established that will depend on each case and the circumstances surrounding it.