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COSTA RICA

FINANCIAL SECTOR STABILITY REVIEW

April 2018

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INTERNATIONAL MONETARY FUND

Monetary and Capital Markets Department

COSTA RICA

FINANCIAL SECTOR STABILITY REVIEW

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December 2017

Contents **Page**

GLOSSARY

AML/CFT	Anti-Money Laundering and Counter Financing of Terrorism
BCCR	Banco Central de Costa Rica (Central Bank of Costa Rica)
BCP	Basel Core Principles for Effective Banking Supervision
BNV	Bolsa Nacional de Valores (National Stock Exchange)
CAMELS	Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to Market Risks
CONASSIF	National Council of Financial System Supervision
DGF	Deposit Guarantee Fund
DT	Deposit Takers
ELA	Emergency Liquidity Assistance
FPJ	Judicial Sector Pension Fund
FSAP	Financial Sector Assessment Program
FSC	Financial Stability Committee
FSD	Financial Stability Department
FSI	Financial Soundness Indicators
FSSR	Financial Sector Stability Review
GDP	Gross Domestic Product
IADI	International Association of Deposit Insurers
IMF	International Monetary Fund
MCM	IMF's Monetary and Capital Markets Department
MoF	Ministry of Finance
NSFE	National Strategy for Financial Education
NSFI	National Strategy for Financial Inclusion
P&A	Purchase and Assumption Agreement
RBS	Risk-Based Supervision
RCC	Collective Contributing Regime
RIVM	Disability, Survivor, and Death Regime
STA	IMF's Statistics Department
SUGEF	Superintendencia General de Instituciones Financieras
SUGESE	Superintendencia General de Seguros (insurance supervior)
SUGEVAL	Superintendencia General de Valores (securities supervisor)
SUPEN	Superintendencia de Pensiones (pensions supervisor)
TA	Technical Assistance

PREFACE

At the request of the Costa Rican authorities, a Financial Sector Stability Review (FSSR) mission from the Monetary and Capital Markets Department (MCM) visited San José, Costa Rica, during September 11–28, 2017. The mission was led by Antonio Pancorbo (MCM), and included André Caccavo, Paul Castillo, James Hambric, Jose María Lamamié de Clairac, Cristina Pailhé, Ignacio Santillán, Rodolfo Wehrhahn (all MCM Experts), and Martín Auqui (STA Expert). Aditya Narain, Deputy Director, MCM, joined the mission for the closing meeting.

The FSSR is a recently launched demand-driven technical assistance (TA) instrument, providing a baseline diagnostic and proposing prioritized medium-term action plans to deliver sound financial sector reform in support of financial stability, deepening, and inclusion. The scope of this mission was agreed to with the authorities during the scoping discussions held in San José, Costa Rica, during March 20–22, 2017, and comprises: banking supervision, securities markets, insurance and pensions, bank resolution and deposit insurance, monitoring of financial stability, financial stability issues under dollarization, and financial deepening and inclusion.

The mission met with policymakers, staff from the supervisory agencies, senior executives from financial institutions and other market participants, associations and professional bodies, the stock exchange, financial sector experts, and analysts. The mission is thankful to all their counterparties for the time dedicated and their openness in the discussions. The mission presented its findings and recommendations, including the country TA Roadmap, to the Central Bank of Costa Rica (BCCR), National Council of Financial System Supervision (CONASSIF), the four sectoral supervisors (banking, SUGEF; insurance, SUGESE; pensions, SUPEN; and securities, SUGEVAL), and the Ministry of Finance (MoF).

The mission team wishes to express its appreciation to the authorities for the attention and support they provided to the mission and for their collaboration and hospitality during the work.

This report was prepared by Antonio Pancorbo with contributions from members of the team.

EXECUTIVE SUMMARY

An FSSR is a new TA instrument offered by the IMF and conducted jointly with a country's government authorities to provide a comprehensive diagnosis of financial sector issues upon which reform programs can be built and implemented. As one of the first projects of the new FSSR initiative, this report—based on a September 2017 mission by an IMF team to Costa Rica—succinctly presents the mission's evaluation of the adequacy of institutional frameworks and financial policies that may have implications for financial stability, deepening, and inclusion.

Despite progress, the financial stability framework in Costa Rica is not well prepared to handle a potential systemic financial crisis without seriously compromising fiscal resources. Supervision of the financial sector is becoming risk-based and intensive, but it lacks key legal powers, tools, and responsibilities for the effective oversight of institutions and markets. Serious vulnerabilities in the pension sector, the secondary markets, and financial-crisis safety nets need urgent attention. Key recommendations have been made by previous missions but remain unimplemented. One of the main reasons for this inadvertence is that introduced legislation to support these changes has not had sufficient backing so its enactment is still pending. The efforts of the FSSR can only be successful if the needed legislative reforms find strong political support for their swift adoption.

The FSSR baseline assessment calls the authorities' attention to the following main gaps that, if left unattended, may affect the stability and smooth functioning of the financial sector:

- The general framework for banking supervision lacks legal powers and tools essential for the early identification of risks and for a proactive approach to adopting corrective measures. These deficiencies have long been identified, and detailed lines of work are in place—namely, a draft law on fit-and-proper requirements, already finalized, and a draft law on consolidated supervision, which also affects corrective measures and sanctioning powers, is being developed. The authorities need to decisively commit to these projects.
- The risk-based supervisory approach presents an important paradigm change for the four financial sector supervisors and regulated entities, one which calls for careful management. A stronger risk-based framework needs to be supported by legal protection for the supervisors.
- Public safety nets are incomplete and crisis management mechanisms are not in place. The BCCR needs to implement a timely emergency liquidity support mechanism, and there is a need to formally establish crisis management protocols for planning and implementing solutions in the event of a crisis. The BCCR has been working for years on establishing deposit guarantees and on improving bank resolution.
- The state-run defined-benefit pension schemes are under severe stress and require urgent parametric changes to achieve sustainability. These should be implemented without delay, guided by the equity principle among the different stakeholders and generations. In addition, the supervision of these state-run pension plans is limited, or is under judicial dispute.

- Dollarization generates solvency risks and liquidity risks in the banking system. At the same time, banks' managers and customers perceive exchange-rate risk as low, partly due to the BCCR's intervention in the foreign-exchange market. The measures recommended by this FSSR mission for market participants to internalize risks and for the BCCR to contribute to de-dollarization need to be put in place.
- Public debt securities are dominant in the securities market. The design of the primary public debt markets and its issues prevent secondary markets from developing: secondary markets are illiquid; pricing is essentially fixed and does not reflect relevant market information; trading is inefficient, and post-trading requires improvement. Measures needed to promote the securities market are well known by the authorities. Strong policy commitment and coordination needs to be strengthened.
- The monitoring and mitigation of risks to financial stability require that the authorities have appropriate powers and mechanisms. The authorities should also be conscious of their collective roles to protect financial stability and to coordinate within their respective areas of responsibility. Clear distribution of responsibilities should be sought, and gray legal areas should be uncovered and clarified.
- Finally, Efforts to increase financial inclusion should be supported by the development of a well-designed and inclusive National Strategy. Coordinated work among the authorities and stakeholders is necessary to establish a shared diagnosis, to concentrate efforts, and design evidence-based policies. Financial inclusion in the regulated sector is severely constrained by competition from the non-regulated sector, particularly with respect to consumer loans. This may have potential consequences for financial stability through interconnection channels and by over-indebtedness of customers. Improvements to the legal, regulatory, and supervisory framework in the financial sector are needed to promote more effective financial inclusion and consumer protection.

This report does not deal with fiscal matters; nevertheless, addressing persistently large fiscal deficits and associated increases in public debt should also be considered an urgent national priority from a financial stability point of view. Fiscal reforms are preoccupying the legislature, preempting consideration of financial sector reforms. Financial institutions are increasingly exposed to sovereign risk, and fiscal deficits pressure the financial sector to lend to the government. In addition, a conflict of interest between implementing effective financial policies and the government's public deficit weakens political will and delays action. Financing public deficits and managing increasing public debt are widely known and accepted by all stakeholders as stumbling blocks to building a financial sector that better serves the country.

Table 1 summarizes the mission's key recommendations to achieve the main strategic objectives. Key recommendations are referred to the relevant paragraphs (¶) of the report. For those recommendations where the authorities would benefit from external assistance, the mission—in collaboration with the Costa Rican monetary and financial authorities—has proposed targeted TA that constitutes the FSSR TA Roadmap presented in Table 2.

Table 1. Costa Rica: FSSR Strategic Objectives and Related Key Recommendations	(*)
Strengthening the regulatory environment (CONASSIF, SUGEF, SUGESE, SUPEN)	
Finalize the law that allows SUGEF to exercise effective consolidated supervision (¶19, 25).	
Enhance legal and regulatory frameworks that support corrective measures (¶22, 24).	
Implement fit-and-proper rules (¶20, 26).	
Strengthening the supervisory framework (SUGEF, SUGESE, SUPEN)	
Provide legal protection for the supervisors (¶23, 28, 30, 39).	
Consolidate the newly introduced risk-based supervisory approach (¶21, 23, 27, 29, 39).	
Strengthen insurance and pension RBS with stress testing and forward-looking tools (¶40).	
Fostering secondary markets to improve pricing and liquidity (SUGEVAL)	
Align primary markets with secondary markets' liquidity needs (BCCR, MoF) (¶49).	
Review current valuation and price formation processes (¶44–5, 50).	
Implement specific market trading mechanisms for fixed-income securities (¶46, 51).	
Improve post-trading settlement failures management (¶47, 52).	
Strengthening financial safety nets (BCCR, MoF, CONASSIF)	
Implement an ELA facility at BCCR to provide timely support to illiquid but solvent banks (¶74).	
Use P&A resolution transactions to avoid delaying payment of insured deposits (¶72).	
Create a crisis management committee to formalize decision-making (¶75).	
Implement a deposit insurance scheme for all deposit-taking institutions (¶66–70).	
Mitigating risks related to high dollarization (¶63, 64)	
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).	
Mitigating risks related to the sustainability of pensions (SUPEN) (¶34, 37)	
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.	
Strengthening the monitoring of financial stability (BCCR, CONASSIF)	
Improve coordination mechanisms and information-sharing arrangements (¶54, 55, 58).	
Empower the newly created Financial Stability Commission (¶56, 59).	
Establish a matrix of responsibilities for macroprudential policy (¶58).	
Advancing the national agenda for financial deepening and inclusion	
Create a national coordination mechanism for financial inclusion (BCCR) (¶77, 82).	
Develop and approve a National Strategy for Financial Inclusion (BCCR) (¶82, 83).	
Review the regulatory perimeter of SUGEF (¶83).	
Enhance the legal framework for financial consumer protection (CONASSIF) (¶81, 85).	

(*) Impact on financial stability if left unaddressed: **HIGH** **MEDIUM-HIGH** **MEDIUM**

Notes: **(1)** Government, first pillar providers, and SUPEN; **(2)** Attorney General of the Re. of Costa Rica

I. Introduction

A. Scope of Work

1. **This report was prepared in the context of the FSSR mission that visited Costa Rica in September 2017.** To determine the areas of engagement, the mission held scoping discussions with the monetary and financial authorities of Costa Rica in March 2017. According to the agreed-upon scope of work, the mission conducted a broad diagnostic that highlighted key gaps affecting the financial sector and proposed a targeted TA roadmap that will support the authorities' efforts to address the key vulnerabilities and areas for improvement identified by the mission. Based on the scoping discussions, Costa Rica's FSSR did not include an evaluation of payment systems and AML/CTF (an evaluation by the Financial Action Task Force is in progress).

2. **The diagnostic review for financial sector reforms was organized around seven areas of work.** Annex I briefly introduces them. In addition, Annex II presents the evaluation of the IMF's Statistics Department (STA) of key statistics for assessing financial stability risks and vulnerabilities, including a review of financial soundness indicators (FSI). This work by STA supported the mission's diagnostics. Finally, based on this diagnostic review discussed in Section II and Annex II, Section III and Annex III present the proposed roadmap that outlines and prioritizes key areas of possible TA engagement for addressing the identified gaps where the authorities would benefit from external assistance.

3. **The diagnostic review is based on existing standards and methodologies, which are employed selectively, depending upon country circumstances.** The evaluation of financial sector supervision was guided by self-assessments based on the Basel Core Principles (BCP), Insurance Core Principles, and the Principles of the International Organization of Securities Commissions (IOSCO). The analysis of macroprudential policies used the IMF *Staff Guidance Note on Macroprudential Policies*. Authorities' stress testing capacity was evaluated against IMF established toolkits. Evaluating resolution regimes and safety nets was done against the framework of the Key Attributes of Effective Resolution Regimes and the Revised Core Principles for Effective Deposit Insurance (International Association of Deposit Insurers (IADI)). Enhancements of the compilation of FSI were done according to the IMF's *Financial Soundness Indicators Compilation Guide*. Market sector overviews and questionnaires were also provided to complement existing methodologies. Financial inclusion and deepening were reviewed using the *G20 Principles for Innovative Financial Inclusion*; the Basel Committee *Guidance on the Application of the Core Principles for Effective Banking Supervision to the Regulation and Supervision of Institutions Relevant to Financial Inclusion;* the OECD-G20 *High-Level Principles on Financial Consumer Protection;* and the OECD *High-Level Principles on National Strategies for Financial Education.*

4. **The FSSR is a key TA instrument for the IMF, with a different scope and purpose than FSAPs.** The Costa Rican authorities presented to the mission self-assessments of international standard-setting bodies' principles as a reference point for the diagnostic of the reform needs to improve financial sector resilience and compliance with international standards.

The FSSR does not include graded assessments of international financial sector standards. IMF TA work is building local capacity for stress testing and a stress test exercise was deemed unnecessary. While FSSRs are different from FSAPs and do not replace them, FSSRs provide an evaluation of needs to strengthen financial stability frameworks and prepare jurisdictions for an FSAP at a later stage.

B. Institutional and Market Structure

5. **Banking, insurance, securities, and pensions are supervised by dedicated agencies under the aegis of the BCCR and the authority and coordination of the National Council for the Supervision of the Financial System (CONASSIF).**[1] CONASSIF, founded in 1998, is the only authority to issue guidelines and regulations as proposed by the four financial sector supervisors: SUGEF, for financial intermediaries; SUGESE, for insurers; SUGEVAL, for securities; and SUPEN, for pensions. The BCCR defines and manages the monetary and exchange-rate policy, and promotes favorable conditions for the liquidity, solvency, and proper functioning of the financial system. New financial stability arrangements with no macroprudential powers are in place, as discussed in Section V. The mission can attest to the professionalism and excellent quality of the technical staff of Costa Rica's financial and monetary authorities.

6. **The financial system is highly dollarized and dominated by the banking sector**. With a large proportion of public banks, banks concentrate 80 percent of the financial system assets. Twenty-seven percent of bank credit in Costa Rica is in US dollars to non-generators of foreign currency, amounting to 17 percent of GDP and 140 percent of all the capital in the banking sector. The insurance sector produces a premium of $1.2 billion approximately. It opened in 2008 and is dominated by the state-owned Instituto Nacional de Seguros (INS).

7. **Recent actuarial studies show significant gaps in pensions that could have social and fiscal impacts if parametric changes are not introduced.** The pension sector in Costa Rica is a multipillar system managing a large amount of third-party assets (34 percent of GDP). The main provider of the first pillar is Caja Costarricense del Seguro Social. It provides the national disability, survivor, and death regime (RIVM). Since 2011, current RIVM individual contributions do not cover the benefit payments; the reserve is projected to start being deployed around 2023 and become exhausted around 2030. The two other providers are the teachers' pension fund, and the Board of Pensions and Retirement of the Magisterium National (JUPEMA), which provides the collective contributing regime (RCC); and the judicial sector pension fund (FPJ). The latest actuarial report of the FPJ shows a $10 billion reserve gap, and while the RCC shows actuarial stability, the indexation of the benefits is below inflation. The second pillar is administered by six pension administrators and covers over 2.4 million

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[1] The board of CONASSIF comprises the president of the BCCR, the Minister of Finance, and five independent directors nominated by the BCCR for five years, one of whom chairs the board. CONASSIF acts as a decision-making board, without administrative functions. The Title X of the Law 7732 of the securities markets regulates CONASSIF's composition and functions: www.sugeval.fi.cr/normativa/Paginas/LeyReguladoradelMercado.aspx.

participants. The third pillar, a voluntary scheme with individual accounts, is now also administered by pension administrators.

8. Securities markets are dominated by the public debt market. Public debt was $21.7 billion in October 2017. The primary market is very active, with the MoF issuing in a public deficit scenario and the BCCR issuing monetary stabilization bonds. The secondary public debt market is managed by the National Stock Exchange (BNV), which has a mechanism for cash trading and a mechanism for repos. Securities sold in the repo are blocked, which limits liquidity. The repo market accounts for the largest volume of trading in the BNV. Nevertheless, it involves only a small percentage of the public debt in circulation. The secondary market is severely illiquid due to specific primary market practices, a pernicious price formation process, disincentives for large public investors to trade, and rigid trading arrangements. Post trading needs improvement in dealing with settlement fails.

9. The legal framework governing the financial sector is highly fragmented. General laws define the responsibilities for the central bank, the supervisory authorities, and participants in the market. Those laws coexist with a number of organic laws governing financial institutions, such as laws establishing state-owned institutions (banks, the systemic insurer, and some pension funds), financial cooperatives, and several "special regimen entities" (*entidades de régimen especial*) in the banking, insurance, and pension sectors. This is a somewhat unbalanced situation, as not all entities are governed by the same rules, with implications regarding the promotion of a level playing field and limiting the regulatory and supervisory powers. The legal framework is deep-rooted, and to pass any legal change is not a simple process. Nevertheless, the authorities are encouraged to conduct a comprehensive review of the organic and specific laws that govern the financial system, and whether the reasons by which they were originally created still apply.

10. Public safety nets need to be strengthened. State-owned banks enjoy an explicit government blanket guarantee for depositors, while other deposit-taking institutions have no protection. Illiquid but solvent banks do not have timely access to emergency liquidity assistance (ELA) at BCCR, which may exacerbate bank solvency problems. Finally, crisis management decisions would be on an ad hoc basis, given that there are no formal protocols in place.

11. In the past decades, the financial system opened up to competition and private sector participants; however, Costa Rica still has the largest presence of state-owned financial institutions in Latin America.[2] In 1995, the banking sector eliminated the state banks' monopoly on current and savings accounts. Similarly, in 1996 the pension system was reformed, allowing the creation of private complementary pension plans. Finally, with the CAFTA-DR (Dominican Republic – Central America – United States Free Trade Agreement), the public monopoly in insurance was eliminated in 2008. Nevertheless, the banking and insurance sectors are dominated by large state-owned institutions (50 and 80 percent of total

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[2] For example, IADB: *Public Banks in Latin America*, www.iadb.org/res/publications/pubfiles/pubS-490.pdf.

assets, respectively), and some competitive distortions still persist.[3] Further work is needed to create a level playing field for all banking and insurance market participants.

C. Main Macrofinancial Vulnerabilities

12. The mission considered the following top-down macrofinancial vulnerabilities as the chief concerns governing diagnostics and recommendations:

- **High dollarization generates systemic risks.** These risks are associated with the BCCR's limited capacity to be a lender of last resort in providing dollar liquidity, and with solvency risk linked to the issuing of dollar credits to non-generators of dollars, whose reduced ability to pay back their debts in scenarios involving a sudden depreciation of the colón, could significantly undermine the quality of the banking sector's credit portfolios.
- **High household leverage.** Terms for consumption and mortgage loans have been lengthened substantially to maintain loan affordability, with a substantial share of consumption loans now at 10-year maturity and mortgage loans above 30 years. The negative effects of high household leverage can be compounded by high dollarization of unhedged borrowers and high unemployment levels.
- **Legal and regulatory frameworks do not support effective supervision.** The legal framework does not provide enough powers to conduct effective supervision and is prone to divergent interpretations. The legal framework is deep-rooted, and to pass any change to the law is not a simple process.
- **There are weaknesses in the public-sector safety net.** These are due to the legal framework and the limited ability of bank supervisors to implement enforcement and sanctions for preventing unsafe and unsound banking. The lack of deposit insurance within the private financial sector and a blanket guarantee for state-owned banks create an unfair market advantage and place the financial burden on the government instead of the industry. BCCR's operational procedures do not provide timely ELA for solvent but illiquid banks. In the absence of formal protocols, crisis management decisions are taken on an ad hoc basis, creating risks that require mitigation.
- **Dysfunctional public debt markets** do not allow price formation, have rigid trading mechanisms, and make the secondary market extremely illiquid. Thus, institutional investors, including pension funds and insurers, with significant public debt portfolios might face liquidity tension and unrealized losses.
- **Sustainability of pensions.** Only major parametric changes will guarantee sustainability of the whole first pillar pension scheme. Fiscal contingent liabilities, some of which have

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[3] For example, private banks have the obligation to lend to state-owned banks at below-market rates at 17 percent of their sight deposits and 30-day term deposits (Art 59 of the Organic Law of the National Banking System, Law 1644). In addition, state-owned banks have an explicit guarantee from the government (Art 4 of Law 1644), while private banks have neither a similar explicit guarantee nor deposit insurance, which reduces the private banks' capacity to compete for colón deposits.

become explicit to support these pension schemes alongside large fiscal deficits, exacerbate the financial-fiscal nexus.

13. Macrofinancial vulnerabilities are compounded by the government's large and persistent public deficit—a feedback loop that impedes the implementation of effective financial policies. This situation weakens political will and delays needed reforms, as the mission has noted in the different areas discussed in this report. Solving current level of fiscal deficit is widely known and accepted by all stakeholders as a critical factor that will contribute to building a financial sector that better serves the economy. Financing public deficits and managing public debt narrow options to implement effective financial reforms. Addressing fiscal deficits should be considered a national priority for financial stability.

14. Weak interagency coordination does not help macrofinancial vulnerabilities. In areas such as macroprudential monitoring, it is important to implement coordination mechanisms that avoid overlapping with microprudential supervision. To this end, a clear distribution of responsibilities should be sought. Gray legal areas should be uncovered and confidentiality requirements should not prevent sharing of information regarding financial stability issues among the relevant authorities. Crisis management demands coordination among all supervisors and other relevant authorities; coordination is needed in order to avoid contagion and to avoid creating systemic risks. In the case of securities markets, coordination is particularly important, as the authorities have also the role of issuers. Therefore, they should be involved with policies concerning price formation transparency and the liquidity of markets.

15. Finally, the dominant and distortive role of the state-owned institutions in the financial sector has worsened the macrofinancial environment. This has promoted a fragmented market and exacerbated competitive disadvantages. In addition, state-owned financial institutions, pension funds, and insurers are main buyers of public debt at prices that, as discussed in Section II.C below, do not respond to market mechanisms and conditions. This exposes these institutions to sovereign risk, as they have significant public debt concentration in their portfolios, which, given its significant size and opaque pricing, has the potential to create systemic risk to the financial sector. This dominance of the public sector in the financial system is an endemic factor in Costa Rica, and its normalization was beyond the scope of the mission.

D. The IMF's Surveillance and Previous Technical Assistance

16. The 2017 Article IV highlighted some key topics for financial stability that are further analyzed in the FSSR.[4] The Article IV mission pointed out that large dollarization of lending to unhedged borrowers, high net foreign liabilities of banks, rising household leverage, and sovereign exposure linger as key financial sector vulnerabilities. Further tightening of prudential requirements is encouraged if there is no evidence of a reduction in banks' foreign exchange exposures within a reasonable time frame, or if the deceleration of credit in foreign currency proves temporary. Implementation of pending 2008 FSAP recommendations and adoption of Basel III standards (gradually introducing capital requirements and liquidity

[4] Article IV discussions can be consulted at "Costa Rica and the IMF": www.imf.org/en/Countries/CRI.

standards) would improve the resilience of the financial system, as well as facilitate the implementation of the framework for cross-border consolidated supervision. Regarding financial deepening, competition in the banking sector would help reduce comparatively high interest rate spreads, thereby boosting credit, investment, and growth. Financial development would also be supported by more market-friendly public debt management and by issuance strategies that promote larger secondary markets for government securities, by refined loan-provisioning rules that prevent high collateral requirements from being used as a substitute for proper credit-risk analysis, and by better protection of investor rights.

17. In preparing the current diagnostic, previous TA was studied in order to determine the impediments to achieving desired results, and to support a realistic and pragmatic roadmap. The IMF has had a positive engagement delivering TA over the past two decades (provided either through headquarters or the Central America-Panama-Dominican Republic Regional TA Center (CAPTAC-DR), and the mission has made recommendations to take this past work forward. Some of the previous TA supported efforts to develop strategic banking regulations concerning corporate governance, credit risk management, and the liquidity coverage ratio. The IMF also provided considerable support in other areas. In banking supervision, some of the past TA addressed market risk capital requirements, credit risk supervisory tools, and consolidated and cross-border supervision. TA was also provided to enhance the central bank’s capacity to buttress financial stability and to assess vulnerabilities arising from dollarization, as well as to strengthen deposit insurance, debt management, and stress testing design. Finally, since 2004, STA has provided five TA missions to improve monetary statistics, including augmented data for and analysis of the financial sector, in support of the balance sheet approach.

II. THE DIAGNOSTIC REVIEW

A. Banking Supervision and Regulation

Baseline Diagnostic

18. While some progress has been made in several areas, the general framework under which banking supervision is carried out in Costa Rica still has serious weaknesses. Limitations in the legal framework are the main stumbling block to further progress. The mission encourages the authorities to consider decisive and timely action in drafting laws to support banking supervision.

19. The legal framework does not currently support consolidated supervision. Legal shortcomings were previously identified in the 2007 BCP assessment. The supervisor has no authority to supervise onsite non-regulated entities that are part of a financial group. This is significant in the case of cross-border activities, considering the unlimited and subsidiary liability borne by the holding company for the obligations of its subsidiaries. SUGEF is preparing a draft law on consolidated supervision to be submitted to CONASSIF for approval and subsequent submission to the Legislative Assembly. The draft law that was presented to the mission would address almost all current weaknesses related to consolidated supervision. It should also be augmented with provisions addressing shortcomings identified in the authorization, transfer of significant ownership, and substantial acquisitions regimes. Finally, SUGEF has made progress in its capital adequacy framework on an individual basis, although there are still gaps vis-à-vis Basel Committee standards. Moreover, constraints arising from existing limitations to consolidated supervision weigh heavily on the capital framework.

20. Regulation and supervision of corporate governance has received significant attention from the authorities in recent years, although reform efforts have yet to materialize. The substantial TA previously provided by the IMF is starting to be implemented with the recent enactment of the new regulation on corporate governance. The legal framework, however, does not give authority to the supervisor to object to the appointment of banks' directors and senior managers or to force their removal, nor to require minimum criteria for fitness and properness. The reform of the law regulating the securities market may offer an opportunity to provide the authorities with supervisory powers to object to the appointment of directors and senior managers and to order their removal. Regulation of compensation is currently minimal to nonexistent.

21. In 2016, the new risk-based supervision (RBS) approach came into force along with its risk-profile rating system, coexisting with the CAMELS[5] rating system of 2000. RBS implementation is ongoing and developing, both in terms of issuing risk management standards adapted to the new approach and of assessing its effectiveness, which will be evaluated once the first supervisory cycle is completed. At the same time, SUGEF operates a CAMELS rating system that is obsolete and poorly predictive. Corrective measures, however, can only be undertaken with legal consequences based on CAMELS. This duality raises considerable legal and reputational risks. SUGEF has an incipient regulatory project to replace its CAMELS system with the new RBS-based rating system.

22. The current legal framework shows important shortcomings in terms of available corrective measures and the sanctioning regime. The framework shortcomings were previously identified in the 2007 BCP assessment. Essentially, it does not provide a range of corrective measures broad and flexible enough to quickly address situations that require the early adoption of preventive or reactive measures. In addition, the sanctioning framework does not adequately support the corrective measures available, and sanctions are barely dissuasive. Nonetheless, the ongoing legislative project on consolidated supervision previously alluded to proposes a substantial reform of the current situation, by empowering the sanctioning framework to adequately address both regulatory breaches and non-compliance with corrective measures ordered by the supervisor. The legislative project should be strengthened by making directors and senior managers personally liable to sanctions.

23. The mission identified other weaknesses in SUGEF's supervisory approach that require due attention. SUGEF's organizational structure is not yet adapted to the functional requirements of the RBS approach, and its supervisory resources may prove to be insufficient for the adequate implementation of RBS. Regulations on the management of credit risk, country and transfer risks, and concentration risk have not yet been issued. A self-imposed pressure to

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[5] CAMELS: Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to Market Risks.

comply with a three-year monitoring cycle may divert supervisory attention from considering all relevant risks. The supervisory approach lacks a macroprudential overlay to complement the risk assessment and planning process. In addition, the legal framework does not provide adequate legal protection for supervisors who take actions in the discharge of their duties, which is critical to the success of a RBS approach.

Main Recommendations

24. The main recommendations concern the implementation of legal reforms, many long overdue, to provide SUGEF and CONASSIF with essential supervisory tools. Efforts in this direction are currently underway, including a draft law on fit-and-proper requirements that is already finalized, and a draft law on consolidated supervision, which also affects corrective measures and sanctioning powers, that is close to finalization. The mission encourages the authorities to give decisive impetus to these projects.

25. The mission emphasized the importance of finalizing and passing the current draft law that would allow SUGEF to exercise effective consolidated supervision. To support this effort, the authorities should consider limiting to domestic subsidiaries the unlimited liability of the parent company of article 142 of the Organic Law of the BCCR (Law 7558). The authorities should also incorporate, with the same urgency and purpose, improvements in reinforcing the procedures for the transfer of significant ownership regime, by enabling the supervisor to make a prior ruling on any substantial variation in the chain of holdings, and to establish generally the prior authorization regime for banks' bylaws amendments. Such would enable, in both circumstances, regulatory developments to determine which cases could be exempted from authorization. The current authorization for the establishment and acquisition of financial institutions abroad should be reviewed and clarified, differentiating the steps and requirements among different types of cross-border transactions.

26. The authorities should complement the legal framework on corporate governance with fit-and-proper evaluations of directors and senior managers. SUGEF should review the design and contents of its Register of Roles to support fit-and-proper evaluations. Also, CONASSIF should approve the regulation that enhances fit-and-proper requirements for authorities of institutions supervised by SUGEF within the existing legal framework, which was supported by IMF TA. In the medium term, authorities should consider and analyze implementation of the Financial Stability Board principles on sound compensation practices, as well as the Basel Committee disclosure requirements on remuneration. For the latter, the mission recommends analyzing the establishment of a roadmap for its progressive implementation, so as to avoid undesired impacts.

27. SUGEF should continue implementing the RBS approach while winding down its CAMELS rating system. In the short term, the authorities should re-evaluate SUGEF's organizational structure in order to adapt it to the RBS requirements, as well as to identify the needed supervisory skills and staff necessary to implement it. Waiting to finalize the three-year supervisory cycle may be too late to gauge the necessary resources for the upcoming supervisory cycle. Regulations on credit risk management and concentration risk should be prepared consistently with the RBS approach. Supervisory planning under the RBS approach should incorporate macroprudential risk factors.

28. To support effective supervisory actions, the relevant legislation should provide for the legal protection for supervisors according to best international practices. The RBS approach and corrective measures imply a high level of supervisory judgment and qualitative assessment. To support the supervisor in taking timely needed actions that are based on their expert judgment, a comprehensive level of legal protection is required, as stated in Core Principle 2 of the BCP. This legal protection should be balanced adequately with the existence of an accountability framework, and with a process of appeal in place concerning supervisory decisions.

B. Insurance and Pension Sectors' Oversight

Baseline Diagnostic

29. As in the case of banking, the regulation and supervision of insurance and pensions are evolving into a stronger risk-based framework. Both SUGESE and SUPEN have drafted several regulations that allow them to apply an RBS approach. This presents an important paradigm change for the supervisors and for the regulated entities, a change that needs to be carefully managed. TA has supported SUGESE and SUPEN in the initial implementation of a generic RBS approach and the needed regulations. The calibration of the risks and the associated risk capital, as well as the calibration of the early warning indicators (insurance), or the development of such an instrument (pensions), is still pending.

30. The lack of legal protection for the supervisors weakens the use of expert judgment to enforce preventive measures. As in the case of banking, the current legislative framework does not provide the adequate legal protection for supervisors when taking actions in the discharge of their duties, as required by the international standards of supervision. This situation does not support SUGESE's and SUPEN's plans to develop a robust risk-based supervisory approach.

31. Supervisors' resources are scarce and limit the supervision intensity that the market requires, particularly in a modern market conduct supervision. The supervision of the INS requires an important amount of supervisory attention, as it accounts for just over 80 percent of the market. Supervising companies offering a full range of insurance services requires specialized resources, and the international character of the majority of private sector insurers requires not only the understanding of the local operation but also of the home offices of their international parent companies. Further, SUGESE and SUPEN, as the market conduct supervisors, need to allocate sufficient resources to cover this area. In addition, both are the designated AML/CFT supervisors for insurance and for pensions. With this responsibility, dedicated resources should be allocated to AML/CFT supervision, and carried out with the required frequency.

32. The prudential regulation of the insurance and the pension sectors needs further development. The insurance capital regime contains important risk-sensitive elements and goes beyond Solvency I, but its calibration to meet the risk appetite of SUGESE is lacking. The solvency ratio is calculated using the risk capital that captures investment risk, operation risk, insurance risk, reinsurance risk, and catastrophic risk. The investment risk capital calculation is consistent with the banking sector methodology. The risk capital calculation for the other risks is not calibrated to any specific metric and uses different international ranges. The pension risk capital is indicated in a recent regulation, but lacks specifics required for its calculation.

33. The use of reinsurance is critical for sound competition and to diversify risks internationally; reinsurance regulation and supervision should be enhanced. SUGESE has introduced prudential requirements on the use of reinsurance. These solvency requirements assess a risk capital for credit risk and concentration risk when using reinsurance. However, the risk management of the critical use of reinsurance is not regulated. New regulations should include explicit risk management requirements when using reinsurance. Also, an internal reinsurance supervision guideline should be developed, one that includes defining the corresponding responsibilities of the supervisors. This work will require TA.

34. The first pillar of the pension system is under stress and requires urgent parametric changes to achieve sustainability. Recent actuarial reports of the RIVM show that the reserve is projected to start being deployed around 2023, and exhausted around 2030. The dialogue to address the reserve gaps in the RIVM has started. The latest actuarial report of the FPJ shows a $10 billion reserve gap. Two proposed legal reforms to this pension plan are under parliamentary discussions. This will mitigate the financial gap but not resolve the sustainability of the scheme. The RCC shows actuarial stability but indexation of the benefits is below inflation. The reduction in the purchase power of the benefits is a technical parameter that allowed this pension plan to maintain actuarial stability.

35. The second pillar, which has surpassed the first pillar in terms of assets under management, has inefficiencies that are hindering further needed growth. Main inefficiencies include the mark-to-market valuation of assets in an illiquid market, concentration risk and short duration in the pension fund investment portfolios, a costly freedom of transfer between pension administrator that has questionable value for the participants, and collection costs that have not been revised since 2001.

36. SUPEN's regulatory and supervisory powers are challenged in court and the regulation of the pension sector for the first pillar is prone to diverging interpretations. SUPEN does not regulate the RIVM, and SUPEN's supervision powers of the RIVM are limited. The RIVM is administered by the Caja Costarricense del Seguro Social (CCSS), an autonomous entity that was constitutionally entrusted with the administration and governance of social insurance. The CCSS itself is not supervised. SUPEN's powers to regulate and supervise the FPJ are under judicial dispute. In response to a SUPEN inquiry, the Office of the Attorney General acknowledged SUPEN's powers to regulate and supervise the FPJ; however, this pronouncement is in dispute. The regulation and supervision of the RCC is carried out by SUPEN with due regard to its organic law, which establishes the framework for the governance and operations of investment of the resources of the RCC fund, and which supersedes regulations issued by CONASSIF.

Main Recommendations

37. The needed parametric reforms to secure sustainability of the first pillar should not be further delayed, and the second pillar should be strengthened. These necessary changes should be implemented, guided by equity principles affecting the different stakeholders and generations. The role of the second pillar in complementing the retirement income provided by the first pillar is particularly important in light of the challenges that the first pillar is facing. In addition, critical gaps in the regulation and supervision of the first pillar pension plans should be closed. The authorities should introduce held-to-maturity valuation for some of the assets that are held to maturity in a pension operator, prior prudential analysis of accounting, financial, and economic criteria and principles. The authorities should also consider revising the transfer right frequency and the process of the transfers between pension operators.

38. There are several key measures to strengthen the regulatory environment for insurance. These include: (1) drafting and implementing regulations on the use of reinsurance; (2) assessing the sufficiency of the technical provision of the insurance sector for selected lines of business, including life; (3) implementing the envisioned market conduct and intermediaries' regulation and supervision; and (4) including in regulation fit-and-proper requirements (in this regard, SUGEF's proposed changes to the law addressing this issue should include the whole regulated financial sector).

39. There are several other measures to strengthen the supervisory framework for insurance and pensions. These include: (1) consolidating the newly introduced RBS approach and aligning the supervisory structure and resources for optimal delivery under this new framework; (2) undertaking legislative changes that provide proper legal protection for the supervisor and staff in line with international best practices so as to help ensure an effective RBS; (3) considering quantitative metrics linked to the different levels of risk and a set of prompt corrective actions (by SUGESE); and (4) developing onsite risk-based inspections. In addition, SUPEN can reinforce its onsite work with audit firms to supervise the correct allocation of the contributions and the confirmation of the custodian accounts. SUGESE and SUPEN would enhance the forward-looking aspect of the supervision with the use of stress testing, systemic risk, and contagion risk analysis.

40. RBS needs to be supported by forward-looking tools and systemic risk analysis to assist its efforts in taking timely preventive actions. The use of market-wide stress testing and systemic risk analysis affecting the insurance sector is not currently carried out. While the contagion risk to the wider financial sector emanating from the insurance sector is negligible, given the size of the insurance sector, systemic risk affecting insurers is possible, though not now monitored. The mission recommends improving SUGESE and SUPEN capacities to elaborate stress tests for pensions and insurance companies (bottom-up and top-down).

C. Status of the Secondary Public Debt Market

Baseline Diagnostic

41. The securities market in Costa Rica is dominated by the public debt market. The volume on the primary market is very large, with the MoF and the BCCR being the main issuers. Outstanding public-debt issued securities totaled $21.7 billion, approximately, by October 2017, according to the MoF. The MoF issues debt to cover a fiscal deficit that defines its liquidity needs; issues by the BCCR are aimed at influencing the foreign exchange market. The equities market is small and there are other traded securities that are also not significant. The banks also issue non-serial short-term debt that is basically subscribed by the money market funds. According to the BNV, only approximately 5.3 percent of the total trading in the BNV in 2017 corresponds to private issuers' securities.

42. The design of the primary market has a significant effect on the subsequent development of the secondary market. It does not appear that a system for managing public debt issuance that focuses on transparency and the establishment of public debt benchmarks, as recommended in an IMF 2015 TA visit, has been achieved. Public debt is purchased on the primary market in auctions that do not operate as such, and in direct placements with, at times with little transparency. Some issues are placed directly without the terms being made public, and auctions frequently place securities only at the reference price. A significant proportion is subscribed by public entities to finance the MoF—over 60 percent of total outstanding public-debt securities as of October 2017—according to the BCCR public data. These entities—pension funds, insurance companies, the Costa Rican Social Security Fund, and public banks—maintain large volumes of public debt in their portfolios.

43. The volume of trading on the secondary market is very low, which is explained by specific characteristics of that market. It is difficult for operators to identify benchmarks; prices are not representative, as they are essentially fixed and do not show a spread that reflects the level of liquidity of the security. In addition, the level of transparency is inadequate, there is little appetite for trading on the part of the holders of the main portfolios, and trading systems are rigid (see paragraph 46) and do not include participants that promote liquidity, such as market makers. The fragmentation and frequency of issues in the primary market are serious obstacles for liquidity in the secondary market with reference benchmarks.

44. Trading prices on the secondary market are essentially fixed and do not reflect the level of liquidity or react to relevant information. Public debt securities should be valued by regulated entities that purchase them at the market price. Given the lack of prices created by the current functioning of the market, the regulations call for the use of valuations provided by price vendors. In practice, these valuations act as a fixed price at which the few operations on the secondary market are executed, thus further hampering the possibility of finding a real market price. These valuations incorporate the impact of some few transactions that are hardly representative and do not reflect the credit quality of the issuer.

45. The valuation mechanism is a strong disincentive to holders of public debt portfolios to operate on the secondary market. Major holders of public debt securities must value their portfolios at market price. This price is provided by price vendors, and price vendors' techniques imply that a transaction price may force the entity to change the valuation of the entire curve of similar securities in their portfolio.

46. Trading rules on the secondary market, which require routing all transactions through the BNV and with the intermediation of a securities broker (puestos de bolsa), also hamper the development of the secondary market. In addition, the role of the market maker does not now exist. These trading rules in fixed-income securities (commonly referred to as the "principle of concentration"), with no entities that offer prices and with limitations on transactions between institutional investors at agreed-upon terms, significantly and unnecessarily limit the operating capacity of market operators. Poor liquidity on the secondary market renders the large portfolios of financial institutions and social security entities illiquid, creating for them a potential liquidity risk.

47. Post-trading arrangements are adequate in the current circumstances, given the limited volume and small number of transactions. Nevertheless, improvements are needed, and can be resolved by introducing incident resolution measures, in the event of an increase in the volume and number of transactions on the market.

Main Recommendations

48. Taking the measures needed to promote a transparent and liquid secondary market requires a strong commitment and coordinated work among all stakeholders involved. These stakeholders include regulators, authorities, supervisors, and the various industry operators. Recommendations to this effect are made with a view to achieving deeper issuances, reference prices that operate as benchmarks, greater transparency, accurate pricing, more active operators, and expansion of the investment base to promote, inter alia, the opening of the market to foreign investors.

49. Align primary market practices with liquidity needs of the secondary market. The BCCR and MoF are encouraged to limit the number of series and frequency of placements so that they can serve as a benchmark for operators and help to promote trading in secondary markets. Implementing this and other recommendations will certainly require prioritizing them to the authorities and coordinating their implementation, involving all relevant parties.

50. Revise current valuation mechanisms and price formation processes. The mission recommended a comprehensive revision of the current valuation and price formation mechanisms, including achieving a more intrusive supervision over price vendors by SUGEVAL, and a revision of public debt asset valuation for certain institutional investors. The public debt asset valuation system, based on price vendors, has resulted in an almost fixed price for secondary market transactions. Where there are variations in prices, these do not reflect issuer credit quality nor asset liquidity. Additionally, a strong disincentive exists for large portfolio holders to trading in secondary markets due to the potential adverse effect of transactions over the whole portfolio valuation. The mission also recommended increasing transparency by establishing a price repository where all market operators have access to every public debt transaction in primary and secondary markets.

51. Implement specific market trading mechanisms for fixed-income securities. The way trading rules in public debt are currently applied, limiting the possibility for institutional investors to execute transactions in agreed-upon terms needs revision, and specific trading systems for fixed-income need to be implemented. The mission strongly recommended increasing direct market access for institutional investors and banks with client portfolios, introducing the role of market makers, broadening the base of potential investors, and avoiding regulatory barriers to access for foreign investors.

52. Improve post-trading settlement failures management. Post-trading operations for dealing with settlement fails in cash and securities legs need a comprehensive revision, by establishing specific mechanisms to deal with cash and securities shortages. These mechanisms should be operated in the post-trading environment instead of in the trading environment, as it is today. For that purpose, it is recommended that a clearing and settlement entity separated from the BNV be created, as foreseen by the law. Currently, the payment system settles cash from operations within different markets in a one single process. Having clearings and settlements function separately for each market would allow a better identification and management of settlement failures and allow a better operation of finality in cash and securities settlements, giving additional security to participating entities.

D. Monitoring of Financial Stability and Macroprudential Policy[6]

Baseline Diagnostic

53. The Financial Stability Department (FSD) of the BCCR and SUGEF has acted proactively to build a set of tools to be used for macroprudential policy.[7] A broad range of tools addresses the main risks financial institutions in Costa Rica are facing. The mission discussed enhancements to these macroprudential tools.

54. However, information sharing between SUGEF and BCCR is not as smooth and comprehensive as it should be. SUGEF's interpretation of law 7558, Ley Orgánica del Banco

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[6] The following IMF papers complement this section's policy advice: "Key Aspects of Macroprudential Policy," IMF Policy Paper, 2013; "Implementing Macroprudential Policy—Selected Legal Issues," IMF Policy Paper, 2013; "Staff Guidance Note on Macroprudential Policy," IMF Policy Paper, 2014; and "Staff Guidance Note on Macroprudential Policy—Detailed Guidance on Instruments," IMF Policy Paper, 2014.

[7] FSD has developed tools such as stress test models to address credit, market, liquidity and contagion risks, systemically important institutions identification (not only deposit takers but also money market funds and insurance companies), financial stability map, CAMELS-like model, financial stress index, credit-to-GDP gap, and step-in risk measures, among others. For its part, SUGEF has developed bottom-up stress test and D-SIBs identification models. SUGEF has also developed prudential tools that limit systemic risk, such as specific, generic, and dynamic provisions, Basel III liquidity coverage ratio, loan-to-value (LTV) and debt-service-to-income (DSTI) ratios for provisions to unhedged borrowers, concentration limits, individual credit growth limits, and LTV as an input to risk weights to charge capital and DSTI as an input to calibrate provisions.

Central de Costa Rica, limits SUGEF's exchange of information with the BCCR. Article 40 specifies that any information, report, and assessment held by any public entity must be provided to the BCCR upon request. Article 132 forbids SUGEF from disseminating information about supervised entities; one exception to Article 132 is for information requested by the agreement of at least five members of the Board of the BCCR, as far as such information is deemed necessary for the discharge of legally prescribed duties. SUGEF's interpretation is that the agreement should be specific, whereas the BCCR understands the agreement could also be generic.

55. Insufficient coordination between SUGEF and the FSD may lead to double work and confusion. The excellent and fully qualified staff from both the FSD and SUGEF can execute good assessments in their fields. However, at times, their work overlaps without sufficient communication or awareness of the other party's achievements and results.

56. The recently established Financial Stability Committee (FSC) is in its infancy. It has been in place since August 2016 for the coordination of macroprudential policy. It comprises the president of the BCCR, the president of CONASSIF, and the Minister of Finance. The FSC was formally established by an agreement among its members. It has only soft powers, which limits its ability to take effective actions that deliver financial stability through systemic risk management and macroprudential policy implementation. The FSC has not yet established communications policies with the general public. Meeting minutes are its only record and bring only general information on the issues discussed. SUGEF has been transparent in its policy regulations, including efforts to address countercyclical issues, and the FSD makes presentations on the content of the Financial Stability Report for systemic institutions and banks associations.

57. The use of macroeconomic stress test models is broadly in line with common practices and helps the authorities identify weaknesses in the financial sector. Stress test models cover a broad range of risks. However, there currently is no remedial action taken if a bank fails. Since 2015, IMF-led TA missions have helped develop and strengthen stress testing models of market, liquidity, and credit risks, as well as contagion risk tools.

Main Recommendations

58. The FSD and SUGEF are encouraged to improve their coordination and information sharing while minimizing overlaps. A responsibility matrix, mainly among the FSD, SUGEF, and CONASSIF should be established specifying "who does what," where responsibility does not mean exclusivity, but rather leadership in coordination. Other authorities could be also included in the matrix. The FSC could act as a common leader in monitoring financial stability. When the legal interpretation of Organic Law of the BCCR (Law 7558) hinders information sharing between the BCCR and SUGEF, the legal opinion of the Attorney General's Office should be sought. It is the well-established doctrine of the IMF that authorities involved in macroprudential policies should be under a legal obligation—and not simply possess the legal authority—to share pertinent information with other relevant authorities.

59. The authorities are advised to strengthen the effectiveness of the newly created FSC. The FSC could be empowered by turning its current agreement into law or enacting regulation.

Subsequently, the authorities should augment its current advisory role with the authority to stipulate: "comply or explain." Publication of a policy strategy, record of meetings, and periodic reports (for example, financial stability reports) could be among the FSC's communications tools.

60. The stress test framework should be strengthened with the improvement of sensitivity analysis. Current scenario analysis can be complemented with a single factor sensitivity analysis so that the outcomes are not limited to a single scenario but rather cover a range of them. Enhanced communication and information sharing between the FSD and SUGEF is encouraged to develop and run stress tests. In case results show that a bank is taking excessive risk, SUGEF can also use these results to challenge risk management and capital adequacy.

61. The following measures will improve the use of macroprudential tools. The authorities would benefit from a plan to build a countercyclical capital buffer as part of the macroprudential policy in order to help the banking sector accumulate capital in good times and keep the flow of credit to the real sector in bad times. The mission recommends that this policy be implemented gradually and take into consideration the current accumulation phase of the recently implemented dynamic provisions.[8] Finally, the detailed measurement of capital flows, which currently is deficient, would help in the assessment of systemic risk.

E. Financial Stability Issues under Dollarization[9]

Baseline Diagnostic

62. Dollarization in Costa Rica generates two potential sources of systemic risk: liquidity and solvency risk. Liquidity risk relates to BCCR's limited capacity to fulfill its function as lender of last resort in foreign currency. The liquidity risk to Costa Rica's financial system created by dollarization is moderate, but could increase in the event of significant capital outflows or a reversal of wholesale funding to banks, and particularly if the current financial dollarization levels are not reduced while the financial system keeps expanding.[10] Solvency risk relates to the significant increase in nonperforming loans if an abrupt depreciation in the colón reduces the creditworthiness of clients who do not earn revenues in dollars, take dollar loans, and lack the means to hedge against this risk. While financial dollarization in Costa Rica is not the highest in the region, credit concentration on dollar loans to non-dollar earners enhances the

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[8] See Acuerdo SUGEF 19-16, Regulation for the determination and registration of countercyclical estimates.

[9] Dollarization has remained in Costa Rica at around 45 percent of credit and deposits. Financial dollarization refers to the use of another currency by the financial system, usually the dollar, together with the domestic currency, in the financial intermediation process. This includes attracting deposits and extending loans in dollars. Financial dollarization differs from transaction dollarization (the use of the dollar in transactions) and real dollarization (the use of the dollar as a unit of account).

[10] This risk scenario is more likely when fiscal and current account deficits are widening.

potential solvency risks to the financial system.[11] The lack of depth of the foreign exchange market and the elevated risk represented by dollarization of credit in case a depreciation of the colón were to lead the BCCR to intervene actively in the exchange market, thereby limiting the perceived risk of borrowing in dollars.

63. The BCCR is facing four challenges common to partially dollarized economies:

- **Allowing greater exchange-rate volatility in a context of high levels of financial dollarization.** Greater exchange-rate volatility helps reduce dollarization; however, excessive volatility can exacerbate systemic risk.
- **Maintaining an appropriate level of international liquidity** in the context of a 15 percent limit on dollar reserve requirements and a widening fiscal deficit.[12]
- **Increasing financial institutions' awareness of the risk they face under high dollarization.** The low cost of dollar loans reflects banks' misperceptions concerning the creditworthiness of unhedged borrowers. Dollarization is persistent due to banks' low exchange-rate risk perception, as well as to structural factors limiting the capacity to obtain financing in domestic currency from private banks (see footnote 3 for the two major structural factors).
- **Harmonizing the regulatory measures adopted by SUGEF with monetary policy actions geared toward reducing the risks of dollarization.** No evaluation has yet been conducted of the impact of SUGEF regulations to disincentivize non-dollar earners to borrow in dollars. Therefore, it is difficult to determine whether the current calibration of monetary policy instruments, including the intensity of foreign exchange market interventions, is appropriate.

Main Recommendations

64. A number of potential areas of immediate action have been identified that can help resolve monetary policy dilemmas and reduce the risks to financial stability:

- **Allow greater exchange-rate volatility.** A single objective should be adopted for foreign exchange market interventions: to reduce excessive exchange-rate volatility generated by market pressures that are not correlated to trends in fundamental exchange-rate determinants and do entail a threat for financial stability. Temporary upward and downward exchange-rate movements should be tolerated. However, given the relative lack of depth of the Costa Rican

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[11] Dollarization in Costa Rica is close to 40 percent, and highly concentrated in private banks and financial companies, where dollarization reaches 78 and 75 percent, respectively. In addition, 70 percent of dollar-denominated loans of private banks are allocated to non-dollar earners, equivalent to 55 percent of private banks' total credit. The lack of a well-developed foreign exchange hedge market reduces the possibilities for non-dollar earners to hedge foreign exchange risks, increasing the solvency risks of dollarization. Dollarization is high in less tradable sectors and, therefore, less likely to generate dollar incomes. Solvency risk of dollarization is also high in the household sector, since dollar loans to non-dollar-earners' households is equivalent to 55 percent of total credit in dollars provided by the financial system.

[12] The Organic Law of the BCCR (Law 7558) establishes a maximum legal reserve requirement ratio of 15 percent, which can be fixed higher for a maximum of six months. This legal restriction limits the BCCR's ability to use dollar reserve requirements more actively, both for building international reserves and reducing dollarization.

foreign exchange market, it is important to estimate the level of depreciation of the colón required to trigger a balance sheet effect so as to establish the relevant benchmark for the increased exchange-rate volatility.

- **Reduce the reserve requirement rate in domestic currency (15 percent currently) to levels closer to banks' operative requirements.** This would contribute to increasing deposit rates and reducing loan rates in local currency, thereby favoring both deposit and credit de-dollarization.
- **Modify the current Basel III liquidity coverage ratio in order to strengthen the international liquidity position of the financial system.** For example, the weights of banks' liabilities denominated in foreign currency can be gradually increased, considering that they represent a greater systemic risk for the banking system.
- **Assess the impact of macroprudential measures already adopted to appropriately calibrate them and ensure that they encourage a gradual but long-term decrease in financial dollarization.** At this date, SUGEF has adopted a number of prudential measures in collaboration with the BCCR to reduce credit dollarization. In August 2013, the credit risk weight was increased for borrowers with high exchange risk, and separate liquidity requirements were established by currency.
- **Study the option of adding new domestic- and foreign-currency-denominated liquidity injection instruments at different terms.** In partially dollarized economies, significant changes in residents' portfolios can affect banks' liquidity needs at different terms in both domestic and foreign currency, and pressure interest rates upward, which could increase the BCCR's need for liquidity instruments at appropriate terms.
- **Analyze the option of introducing greater flexibility in the current regulations that impose a limit on the BCCR's use of reserves requirements.** International reserves in foreign currency enable the BCCR to reduce the liquidity risk generated by dollarization while also using reserves requirements on a cyclical basis to offset the impact of international interest rate fluctuations on incentives to borrow in dollars.[13]

F. Deposit Insurance, Bank Resolution, and Crisis Management

65. Costa Rica needs to improve its financial safety net (1) by providing an effective lender of last resort process; (2) by implementing a deposit insurance fund for all banks; (3) by developing effective bank resolution mechanisms; and (4) by establishing crisis management protocols. In addition, effective bank supervision, as discussed in Section II.A, needs to include enforcement measures and allowances for early intervention before a bank's

[13] In periods of larger capital inflows, higher reserve requirements in foreign currency allows domestic banks to accumulate larger levels of international liquidity that can be used to limit the impact of capital flow reversals. In addition, higher reserve requirements in foreign currency increase the cost of financial intermediation in dollars, which reduces the incentives for dollarization during periods of low international interest rates. For empirical evidence of the effectiveness of the cyclical use of reserve requirements in foreign currency see Armas, A., Castillo, P.G., y Vega, M.A.: "Inflation Targeting and Quantitative Tightening: Effects of Reserve Requirements," in *Economia*, 15 (1), 2014, Brookings Institute Press, pp. 133–175.

capital falls to a low level. Illiquid but solvent banks do not have access to ELA at the BCCR, which may exacerbate banks' solvency concerns. Crisis management decisions would be on an ad hoc basis, given that there are no formal protocols in place. State-owned banks enjoy a government blanket guarantee for depositors while other deposit-taking institutions have no protection. A draft law for the establishment of a deposit insurance fund is in the process of approval. The law would have benefited from following the steps of a bank resolution based on IADI Core Principles and Key Attributes for Effective Resolution of Financial Institutions.

Deposit Insurance—Baseline Diagnostic and Main Recommendations

66. The BCCR has drafted a Law on the Deposit Guarantee Fund and Bank Resolution (LDGF) for the establishment of a fund as well as for developing the bank resolution process. The LDGF is a positive step forward, but there are areas within the draft law that could be improved. Many of the traditional roles of the board of the Deposit Guarantee Fund (DGF) appear to be within CONASSIF. The role of calculating insured deposits is in SUGEF, which is inconsistent with international best practices for deposit insurance. Based on the roles of CONASSIF and SUGEF, IADI's Core Principle on governance and operational autonomy is not met under the draft law.

67. Amendments to the LDGF or implementation regulations should clearly articulate DGF's operations. The DGF should only be used to support payment of insured deposits and should not be used to capitalize banks. Proscription of payments to depositors who are involved in money laundering and criminal activities, and those of service providers who misrepresented the financial condition of the bank, should be implemented. Insured deposits of depositors with past due loans should be offset. The DGF will need to determine whether the offset would equal the past due amount or the full amount of the deposit. The DGF should consider the payment history of the borrower in making the decision on the amount of the offset. Implementation regulations should be issued to provide legal certainty as to how the DGF's organization and governance operate during its initial stages.

68. The mission advised that the DGF be housed in the BCCR with its own legal personality, reporting to the Board of the BCCR. The size of the Costa Rican banking sector and the DGF's paybox mandate justifies this structure. The DGF's primary responsibilities are to collect premiums, invest the assets of the fund, educate depositors, and pay insured deposits as directed by CONASSIF during the resolution process. SUGEF provides the DGF with the information required for payment of insured deposits. Operational autonomy will be difficult in the environment created by the draft law. Agreements for the DGF's operating expenses can be implemented, taking advantage of the BCCR's resources while maintaining adequate fire walls. Creating an independent organization is discouraged, as operation costs would affect the DGF's ability to build a robust fund in a timely manner. Member institutions also support the positioning of the DGF within the BCCR instead of as an independent agency. Perceived conflicts of interest for the DGF within the BCCR are not relevant.

69. The authorities could usefully consider the social and economic benefits from an eventual rollback of the blanket guarantee for state-owned banks. Blanket guarantees for depositors at state-owned banks create competitive advantages for these banks. In addition, the blanket guarantee results in large contingent liabilities for the government in the event of a bank failure. Implementation of an explicit guarantee scheme for all deposit-taking institutions will move toward leveling the playing field. Additionally, the financial burden of a banking crisis will then be shared within the industry.

70. The DGF, SUGEF, and CONASSIF staff would benefit from training in bank resolution and intervention. Training on best practices for resolution and intervention for banks, including the use of the Purchase and Assumption methodology, will better prepare staff for improving the design and drafting of operating policies so as to avoid suspending bank operations and to ensure prompt payment to depositors.

Bank Resolution—Baseline Diagnostic and Main Recommendations

71. BCCR has been working on an effective bank resolution framework for several years. These efforts, also supported by IMF TA, have slowed, and the authorities are hopeful that the legislative process required to move forward will be fruitful in the short to medium term. The draft LDGF is the main outcome of these efforts and should result in more effective bank resolution. It establishes CONASSIF as the resolution authority with the ability to implement a variety of options that are not subject to court approval. The LDGF provides for a special bank resolution regime and for depositor preference for the DGF, providing the DFG with a favorable legal framework to meet its mandate.

72. The government should have the legal power to provide financial support to ailing banks, under strict conditions. These conditions should include, at a minimum, that shareholders take first loss, change intervention in management, limits on executive compensation, limits on dividend payments, and that all actions are taken according to an exit strategy. The mission recommends that CONASSIF uses purchase and acquisition resolution transactions (P&A) to avoid suspending bank operations and delaying payment of insured deposits. Through planning, early intervention, and use of P&A, CONASSIF should be able to meet IADI's core principle on prompt payment to depositors. The mission also recommends prohibiting the use of the DGF for providing bank capital. Finally, CONASSIF and SUGEF could require systemic banks to prepare recovery and resolution plans.

Crisis Management—Baseline Diagnostic and Main Recommendations

73. There have been limited efforts on planning for a financial crisis. There is no emergency liquidity support for illiquid but solvent banks. In addition, there is no formal process for the gathering and reviewing of information needed to make informed decisions in a crisis environment. An ad hoc approach to the decision-making process is not appropriate for managing a crisis.

74. BCCR needs to implement an effective ELA. The banking law provides the BCCR with the legal ability to provide ELA. However, if the modalities of such assistance are not clear in the laws and policies, the BCCR's broad powers to provide liquidity support could potentially open the door to undue influence that might result in the provision of solvency support instead emergency liquidity. The BCCR is working on ELA and should move promptly to implement. Challenges related to what type of assets to accept as collateral, valuation of pledged assets, and determination of liquidity versus solvency should be addressed in policy development.

75. There is a need to establish a formal crisis management protocol that assigns roles and responsibilities to the key stakeholders. Obtaining the required information in a prompt and efficient manner is key to effective decision making in a crisis. CONASSIF is the intergovernmental coordination committee responsible for preparing and coordinating actions during a financial crisis. The decision-making process needs to be institutionalized. Development of working groups that will be responsible for gathering the required information and drafting a national contingency plan should begin immediately.

G. Financial Deepening and Inclusion

Baseline Diagnostic

76. Costa Rica has made significant efforts to expand banking services for the population. Indicators point to a high level of financial inclusion for individuals. Nearly two-thirds of adults have an account in a financial institution,[14] which is above the one-half average for Latin America and the Caribbean. Costa Rica also exhibits ratios higher than those for the same region in respect of adults who have taken out a loan (almost 13 percent), who have savings in a financial institution (24 percent), and who possess a debit card (54 percent). A low percentage of adults (14.5 percent) have credit cards, while a significant percentage of the adult population saves through informal mechanisms or outside a financial institution.[15]

77. Nevertheless, the efforts undertaken have lacked coordination and a common objective of increasing financial inclusion. Costa Rica has no National Strategy for Financial Inclusion (NSFI) and no national coordinating body to head, implement, and monitor such a strategy. The Office of the Vice President assigned a leadership role on financial inclusion-related matters to the BCCR, which has yet to be developed in practice. The BCCR has commissioned a consulting firm to perform a diagnostic of the status of financial inclusion, which would also provide a training component. SUGEF is a member of the Alliance for Financial Inclusion (AFI) and the Chief of CONASSIF is currently a member of the AFI's Board, but participation is not coordinated with the BCCR or the other superintendencies. There is no sound data infrastructure, with supply and demand data, to monitor the status of financial inclusion and pursue evidence-based policies.

78. Costa Rica is implementing an ambitious plan to upgrade retail payments and is strongly encouraging the use of electronic means of payment. One challenge it still faces is in reducing the cost of certain transactions to encourage their greater use. Banking agents have only

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[14] Global Findex 2014, World Bank Global Financial Inclusion database.

[15] As indicated by the difference between the percentage of adults who state that they save (54 percent) and the percentage who say they do so in a financial institution (24 percent).

just started to make an appearance in Costa Rica, and other innovations, such as e-money, are not significant in the country.

79. Financial inclusion in the regulated sector has been severely constrained by competition from the non-regulated sector, particularly with respect to consumer loans. Some consumer client segments are showing signs of over-indebtedness, although the lack of aggregate information makes it difficult to know how widespread this is in the financial system. This may have unwanted consequences for financial inclusion and financial stability, due to existing interconnections between the regulated and non-regulated sectors.

80. Costa Rica still faces challenges to achieving greater financial inclusion of firms of varying sizes. Lending still relies excessively on the use of real estate collateral. A framework for secured transactions is in place, but its use is still incipient. The development banking system needs to expand within a context of sound risk-taking. The dollar resources that come with that system, thanks to private bank contributions, are not being directed to productive projects, because of their exposure to exchange-rate risk. Regulated institutions do not grant traditional microcredit, and prudential treatment of microcredit appears geared to small loans rather than micro.

81. The legal framework for financial consumer protection is fragmented, with considerable differences among the powers vested in the various superintendencies. There are no formal coordination mechanisms among the institutions involved in financial consumer protection. Regulations on transparency are not comprehensive and suffer from considerable shortcomings in the financial intermediation sector. There are cases of abuse, improper transactions, and lack of transparency, especially among non-regulated lenders competing in some segments with regulated institutions. Costa Rica currently has no National Strategy for Financial Education (NSFE) for setting objectives and outlining courses of action in this area.

Main Recommendations

82. A high-level institutional body is needed to lead and coordinate financial inclusion policies. The institutions responsible for financial inclusion should be represented in that structure, which should direct the development, approval, implementation, monitoring, and review of a NSFI, as well as the preparation of a NSFE.

83. The authorities need to continue their financial deepening strategy, with a view to lowering the costs of electronic transactions, thereby encouraging their greater use. Authorities need to move forward with the regulation of banking agents. The regulatory perimeter of SUGEF needs to be widened to include broad powers with respect to currently non-regulated institutions.

84. Regarding the provision of financing to firms, the regulations need to distinguish clearly between different types of microcredit. The use of secured transactions should be promoted, along with stricter rules for the valuation of real collateral. Dollar-denominated funds provided by private banks to the development banking system should be eliminated gradually, given that they are not meeting their purpose.

85. Reforms to the legal framework are needed to enhance financial consumer protection. Consumers would benefit from a flexible and expeditious administrative body empowered to hand down resolutions and indemnify, as opposed to the alternative of resorting to judicial proceedings. A new institutional structure is necessary for coordination among institutions. To promote market discipline, regulators and the industry should disclose comprehensive information about prices and conditions of financial products.

III. THE TECHNICAL ASSISTANCE ROADMAP

86. A defining component of the FSSR initiative is the agreed-upon proposal for the TA Roadmap. Based on the baseline diagnostic assessments summarized in Section II, the mission recommended action plans for financial sector reforms to be undertaken over the following three years. The FSSR initiative is intended to support these action plans with intensive and targeted follow-up TA in those areas where the mission, in consultation with the authorities, understands that the reforms will benefit from external assistance. These prioritized and sequenced TA activities constitute the FSSR TA Roadmap that is discussed in this section.

87. Table 2 summarizes the proposed TA Roadmap, which is further detailed in Annex III. TA activities are divided between those that can be carried out immediately and initiated and even concluded within six months, and those to be initiated in the medium term and concluded before the end of the three-year time horizon. Specific timeframes for the TA will be further determined at the time of preparing the Terms of Reference. Table 2 also separates those TA activities that need a previous action to be initiated, such as a legal reform. The Roadmap is not to be seen as the Terms of Reference of the TA but rather as a set of activities to achieve the desired strategic objective. In addition, TA activities are classified as high, medium-high, and medium priority depending on, if left unattended, the probability of affecting negatively the well-functioning of the financial system and the advancement of financial inclusion.

88. The authorities should assess the political viability of the TA activities before reaching agreement on the final Roadmap. The IMF has enjoyed a positive engagement with Costa Rican authorities regarding TA over the past two decades, and this mission has made recommendations to take this work forward. However, a key challenge remains to be addressed. Weak political support to undertake needed legislative reforms in a financial system dominated by state-owned institutions has been a common factor that did not allow some earlier recommendations to progress to implementation. A successful TA Roadmap should be predicated on the assessment of the political viability of the different TA activities and, based on this, a strong commitment by policymakers to coordinate and ensure their implementation.

Comments on the Proposed TA Roadmap According to the Areas of Diagnostic Review

89. To strengthen banking regulation and supervision, TA is primarily directed to support regulatory developments following the approval of current legislative projects. The mission's main recommendations refer to the need to push forward draft legislation or to finalize it (see Section II.A). Once draft law amendments on fitness and properness are in place, high-priority TA can review the design and content of the Register of Roles that can be complemented with a training program. Likewise, TA can assist in the analysis of the impacts of the BCBS's disclosure requirements on remuneration and the design of its progressive implementation. Once the draft law on consolidated supervision is passed, high-priority TA can support its regulatory powers, including those concerning capital adequacy on a consolidated basis. Meanwhile, high-priority TA can start immediately to support the preparation of regulations still missing for the RBS approach and to complete the design of the risk matrix. This could also include the analysis of macroprudential inputs if adequate progress is achieved in monitoring financial stability and macroprudential policies (see Section II.D). In the medium term, TA can analyze the impact of Basel II/III standards and help implementation planning, depending on authorities' priorities and readiness.

90. The development of the prudential regulation and supervision of the insurance and the pension sectors will benefit from external assistance. High-priority TA can be provided to support SUGESE and SUPEN in their recent moves to a stronger risk-based approach, and to develop related regulations. Medium-high-priority TA can also assist SUPEN in developing supervision protocols under its new regulations, including over capital. The use of reinsurance is critical for sound competition and risk diversification beyond Costa Rica's borders. New regulations should include explicit risk management requirements when using reinsurance, and an internal reinsurance supervision and authority guidelines should be developed together with the corresponding capacity building for the supervisors. This work will require high-priority TA in the medium term. The envisioned market conduct supervisory approach will have to be separated from the prudential supervisors. Medium-priority accompanying TA in the implementation phase is recommended.

91. Previous TA helped the authorities build a comprehensive set of tools to monitor financial stability; however, further developments will benefit from TA. TA in 2012 helped the authorities design a macroprudential policy framework and associated instruments. Later TA, since 2015, helped develop and strengthen stress testing models of market, liquidity, and credit risks, as well as contagion risk tools. It also assisted with additional macroprudential tools and the institutional framework. Future high-priority TA will be helpful for assisting in the development of a responsibility matrix and to articulate a roadmap for the preparation of new systemic risk indicators. Medium-priority TA can enhance forward-looking analysis with the use of market-wide stress testing, systemic risk, and contagion risk analysis, including insurance and pensions. It can also complete information on cross-sectoral financial relationships (BSA Matrix) to make comprehensive assessments of economic vulnerabilities and to take proper corrective measures at the micro- and macroprudential levels.

92. Establishing a DGF and coordinating committee for financial crises will require TA to support the development of operational policies and procedures. Given the lack of practical experience with these matters in Costa Rica, transfer of knowledge from skilled practitioners should improve operations. TA should consist of both consultancy missions and workshops offering practical exercises. Suggested TA includes development of a project plan to establish the DGF, development of policies and operating procedures for the DGF, and development of staffing plans based on the organizational structure of the DGF. It also includes training on best practices for bank intervention and resolution, including the use of the Purchase and Assumption methodology, and bank resolution and crisis management simulation workshops. Medium-high-priority TA can also assist in developing operating policies and in the establishment of an intergovernmental coordinating committee responsible for preparing for and coordinating actions during a financial crisis, and to develop a national contingency plan.

93. In addition, high-priority TA, to be carried out immediately, can support the implementation of ELA, with focus on non-liquid collateral valuation methodologies.

94. TA to support financial stability measures under dollarization should be geared toward strengthening capacities to measure the systemic risk associated with dollarization. This can include TA missions to develop capacities in: (1) measuring exchange credit risk in the banking system; (2) evaluating systemic liquidity risk in foreign currency; and (3) developing macroeconomic models that consider the effects of exchange credit risk. The proposed TA recommended by previous missions would also be desirable: in particular, measures aimed at prudentially managing the exchange rate risk, given the structural economic conditions, and the development of a strategy for communicating monetary policy objectives and operations.

95. TA to create a transparent and liquid secondary public debt market should be supported by a strong political commitment. Improving the securities market was already a matter of public interest in 2012,[16] and the relevant issues are well known. That said, once political commitment is in place to take the necessary actions, the authorities will be able to benefit from TA on technical matters. In addition, high-priority TA can be carried out immediately on the complex issue of conducting a review of the harmful effects of the current public debt price-setting mechanism, not only in terms of the lack of liquidity, but also the impact on portfolio valuations and the disincentives to the development of the secondary market. The public debt market in Costa Rica was analyzed by an IMF TA mission in 2015 that covered the entire management of the public debt, and by another IMF mission in 2013 that included an analysis of the securities settlement systems. They identified some areas for improvement and made some recommendations on the operation of the primary and secondary debt markets and their post-trading arrangements. Most of their recommendations have not yet been addressed.

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[16] In 2012, the National Council for the Development of the Securities Markets prepared a "roadmap" with a broad consensus on the "urgent need" to create conditions "to provide Costa Rica with a securities market that contributes significantly to growth, job creation, competitiveness and the well-being of the Costa Rican people" http://www.bccr.fi.cr/publicaciones/consejomercadodevalores/Ruta_Estrategica_aprobada_por_CN_y_II_Vicepresidencia_Republica.pdf (original in Spanish).

96. **TA to advance the agenda on financial deepening and inclusion is recommended in order to strengthen weak coordination and leadership.** High-priority areas where the authorities can benefit from TA include the design of a NSFI, as well as an NSFE, in the form of both a diagnostic assessment and a roadmap for identifying objectives and components and then implementing them. Support to design the data infrastructure for financial inclusion, with supply and demand data, would also be useful. The TA could also help with the review of the current legal framework and recommend improvements with respect to powers vested in SUGEF in areas relating to consumer protection and its regulatory perimeter.

Table 2. Technical Assistance Priorities and Timeline

Strategic Objectives	**Technical Assistance Activities**		
	Immediate	Medium Term	Conditioned
Strengthening financial regulation and supervision	**#1** SUGEF RBS **#2** SUGESE RBS **#3** SUPEN RBS	**#4** Reinsurance development **#7** Basel standards for compensation **#8** Insurance pensions markets developments	**#5** SUGEF Consolidated Supervision (1) **#6** Fitness and properness (2)
Strengthening financial safety nets	**#9** Enhance ELA at the BCCR	**#10** Capacity building	**#11** Crisis management framework (3) **#12** Implementing DGF, including P&A (3)
Strengthening the monitoring of financial stability	**#13** Development of a responsibility matrix	**#14** Stress testing including insurance and pensions **#15** STA's BSA Assessments	---
Mitigating risks related to high dollarization	**#16** Design measures and enhance analytical tools	**#17** Assess and recalibrate macroprudencial measures	---
Fostering secondary markets	**#18** Price formation	---	**#19** Modernize trading (4) **#20** Resilience of post trading (4)
Advancing the national agenda for financial deepening and inclusion	---	**#22** Data collection **#23** SUGEF regulatory perimeter **#24** Consumer protection	**#21** Advance NSFI and NSFE (5)

Priority (impact on financial stability if left unaddressed): **HIGH**, **MEDIUM-HIGH**, **MEDIUM**

Notes: #N refers to TA projects as numbered and further detailed in Annex III. Conditioned TA: (1) passing of the law on consolidated supervision; (2) passing the legal amendments to fitness and properness; (3) passing the law on deposit insurance and bank resolution; (4) political commitment to act upon; (5) concluding the external diagnosis commissioned by the BCCR.

Annex I. Costa Rica: Areas of Diagnostic for the Financial Sector Stability Review

Mission Members by Areas of MCM Expertise

Banking Supervision and Regulation, *Jose María Lamamié de Clairac*

Analyzed the serious weaknesses identified in the general framework for supervision in Costa Rica. Many of them already identified in 2007 FSAP (if not in 2001 FSAP). The most critical are the absence of a legal framework for consolidated supervision, the limited adequacy and effectiveness of corrective actions, and an incomplete and barely dissuasive sanctioning regime.

Insurance and Pension Sectors, *Rodolfo Wehrhahn*

Analyzed the insurance and pension sectors to identify the main vulnerabilities in the regulation and supervision that present important sectoral risks that could materialize within the next two to three years. This area of work provided detailed discussion of the authorities' ability to supervise insurance and pensions sectors, and key areas for improvement.

Situation of the Secondary Market of Public Debt, *Ignacio Santillán*

Analyzed the vulnerabilities in the public debt market, where there is a significant lack of liquidity in secondary markets. A remarkable misalignment of primary market practices with secondary markets liquidity needs, a deficient price formation process, and a rigid trading environment are behind this. The diagnostic review made recommendations on these three topics as well as on other concurrent issues.

Monitoring of Financial Stability, *André Caccavo*

Discussed the newly created FSC and its challenges to operate without effective powers to deliver financial stability and manage systemic risk in an environment with no clear separation between microprudential supervision and macroprudential monitoring.

Financial Stability and Monetary Policy Challenges under Dollarization, *Paul Castillo*

Discussed the dollarization of credit and deposits in Costa Rica, which has remained high, increasing solvency and liquidity risks for the financial system. This area of work analyzed current monetary policy and regulatory framework enhancements with the more coordinated and targeted actions in order to reap the benefits of a low inflation environment and promote a faster reduction in dollarization. In particular, macroprudential and monetary policy instruments, including foreign exchange intervention, should be properly calibrated to achieve these objectives.

Deposit Insurance, Bank Resolution, and Crisis Management, *James Hambric*

Reviewed the law and plans to establish a deposit guarantee fund with recommendations on improvements to governance and operations. Implementation of purchase and assumption resolution transactions that avoid suspending bank operations to facilitate prompt payment of deposits. Implementation of an emergency liquidity facility at BCCR as part of the financial safety net. Establishment of a formal crisis management protocol that assigns roles and responsibilities to the key stakeholders to ensure sound decision making in a crisis environment.

Financial Deepening and Inclusion, *Cristina Pailhé*

Reviewed the institutional framework supporting financial inclusion in Costa Rica, including the need for a NSFI and a national coordination mechanism. Recommendations were provided for the development of a robust financial inclusion data infrastructure and to address challenges for financial inclusion coming from the shadow banking sector. A review of existing providers and products was conducted, and the need of a common, harmonized framework for consumer protection in the regulated financial sector was identified.

Annex II. Costa Rica: Financial Soundness Indicators and the Balance Sheet Approach[17]

Costa Rica disseminates the 12 core FSIs and one of the 28 FSIs encouraged by the IMF. SUGEF is the authority responsible for compiling the FSIs, and for that purpose, it uses the IMF's *Financial Soundness Indicators Compilation Guide* and also takes advantage of assistance and training provided by STA. The 13 FSIs compiled by SUGEF correspond exclusively to deposit takers (DTs). See Table 1 below.

Table 01 : Costa Rica Financial Soundness Indicators for Deposit Takers

Percent unless stated otherwise

	FSI	Consolidation Basis	2015M12	2016M12	2017M06
1	Regulatory Capital to Risk-Weighted Assets	DC	16.2	16.4	16.1
2	Regulatory Tier 1 Capital to Risk-Weighted Assets	DC	12.6	12.2	12.5
3	Non-performing Loans Net of Provisions to Capital	DC	-2.0	-4.1	-5.1
4	Non-performing Loans to Total Gross Loans	DC	1.7	1.6	1.7
5	Sectoral Distribution of Total Loans: Residents	DC	99.4	99.8	99.8
	Sectoral Distribution of Total Loans: Deposit-takers	DC	5.9	5.5	5.3
	Sectoral Distribution of Total Loans: Central bank	DC	...	...	...
	Sectoral Distribution of Total Loans: Other financial corporations	DC	...	...	...
	Sectoral Distribution of Total Loans: General government	DC	9.9	9.9	10.4
	Sectoral Distribution of Total Loans: Nonfinancial corporations	DC	33.7	34.4	34.1
	Sectoral Distribution of Total Loans: Other domestic sectors	DC	49.8	50.0	50.0
	Sectoral Distribution of Total Loans: Nonresidents	DC	0.2	0.2	0.2
6	Return on Assets	DC	1.0	0.9	0.7
7	Return on Equity	DC	7.3	6.3	5.2
8	Interest Margin to Gross Income	DC	60.2	55.6	53.8
9	Non-interest Expenses to Gross Income	DC	66.4	64.4	63.0
10	Liquid Assets to Total Assets (Liquid Asset Ratio)	DC	28.6	27.8	28.3
11	Liquid Assets to Short Term Liabilities	DC	130.3	132.4	132.5
12	Net Open Position in Foreign Exchange to Capital	DC	22.4	24.0	23.9
13	Capital to Assets (encouraged FSI)	DC	9.7	9.4	9.5

(-) Indicates that a figure is zero / (...) Indicates a lack of statistical data that can be reported or calculated from underlying observations

Source: Central Bank of Costa Rica and IMF, Financial Soundness Indicators / DC: Domestic consolidation basis

The scope of the FSIs for DTs in terms of the coverage of entities is appropriate. The FSIs compiled by SUGEF include the following DTs: state-owned commercial banks (40.5 percent of the total assets of DTs), banks created by special laws (10.8 percent), private banks (30.8 percent), nonbank financial corporations (1.1 percent), savings and loan cooperatives supervised by SUGEF (9.9 percent), mutual savings and loans (3.9 percent), and one savings and loan institution (3.4 percent).

The Costa Rican authorities have information that enables them to compile at least 10 additional FSIs encouraged by the IMF. Based on information from SUGEF and the BCCR, sources of information are now available for compiling additional FSIs, to complement those already disseminated within Costa Rican authorities: information related to the DTs, Other Financial Corporations, and Households and Real Estate Markets sectors (see Table 2). With respect to the other encouraged FSIs not listed in the table, the authorities state that information for constructing them is either not available or has a significant lag.

[17] Annex 2 was prepared by Martín Auqui, STA Expert.

Recommendation 1: *The Costa Rican authorities should increase the number of FSIs compiled and disclosed on the IMF's website. To implement the increase, SUGEF and the BCCR must work in a coordinated manner (on the part related to the financial system and other sectors, respectively) to structure and validate the information required for compiling the additional FSIs.*

Table 02 : Costa Rica, Additional FSIs that could be compiled by SUGEG and BCCR

Deposit Takers	**Other Financial Corporations**
1 Large Exposures to Capital	7 Assets to Total Financial System Assets
2 Trading Income to Total Income	8 Assets to Gross Domestic Product (GDP)
3 Personnel Expenses to Non-interest Expenses	**Households**
4 Customer Deposits to Total (Non-interbank) Loans	9 Household Debt to GDP
5 Foreign-Currency-Denominated Loans to Total Loans	**Real Estate Markets**
6 Foreign-Currency-Denominated Liabilities to Total Liabilities	10 Residential Real Estate Loans to Total Loans

The information provided by Costa Rica in the metadata files does not include references to the relevant regulatory framework (and its modifications) for compiling FSIs. SUGEF uses Metadata Table 2, disclosed through the IMF's webpage, to report basic data on: (1) definitions; (2) consolidation bases; (3) types of intragroup adjustments; (4) regulatory framework; (5) standards for the valuation of financial assets and recognition of gains; and (6) standards for determining the exchange rate.

Recommendation 2: *The Costa Rican authorities should increase the information reported in the metadata files in order to foster better understanding of the regulations related to the compilation and analysis of FSIs. Thus, in the sections on "Definition Comments" and "Regulatory Framework Comments," we recommend including references and/or links to SUGEF's regulatory standards, establishing the concepts used to compile the FSIs for liquidity, provisions, and capital, inter alia. Further, in these sections or in the section on "Other Relevant Information," mention should be made of any amendments to the regulatory standards that have an attendant impact on the FSIs, as in the case of the new general provisioning requirements introduced in 2013 that resulted in a significant impact on loan loss provisions.*

Costa Rica has made progress in generating intersectoral financial position matrices, in keeping with the BSA promoted by the IMF. During the mission, the BCCR submitted information from the matrices, using the national accounts associated with the public sector and the sectoral balance sheets of financial institutions (DTs and other financial corporations) as sources of information (Table 3). Further, the BCCR noted that although they have sources of information on nonfinancial sector positions (albeit with some lag), capturing this information in the sectoral matrices would require about one month's work while, as a prerequisite for periodically generating the matrices, they would need to develop standardized forms and automate the data generation process to reduce operating costs and the risk of errors.

Table 03 : Costa Rica Matrix of Intersectoral Asset and Liability Positions
End of June 2017, In millions of Colones

	Issuer of liability											
	Central bank		Rest of public sector		Financial Sector		Nonfin. Private Sector*		Nonresidents*		TOTAL *	
Holder of liability	**Claims**	**Liabilities**	**Claims**	**Liabilities**	**Claims**	**Liabilities**	**Claims**	**Liabilities**	**Claims**	**Liabilities**	**Claims**	**Liabilities**
Central bank			**806,948**	**-**	**3,935,202**	**318,232**	**819,685**	**-**	**10,994**	**4,206,088**	**5,572,829**	**4,524,320**
In domestic currency			739,880	-	2,455,733	318,232	819,651	-	80	14,781	4,015,344	333,013
In foreign currency			67,068	-	1,479,468	-	34	-	10,914	4,191,307	1,557,484	4,191,307
Rest of public sector	**-**	**806,948**			**6,880,815**	**905,617**	**-**	**-**	**-**	**-**	**6,880,815**	**1,712,565**
In domestic currency	-	739,880			5,308,963	770,638	-	-	-	-	5,308,963	1,510,518
In foreign currency	-	67,068			1,571,852	134,979	-	-	-	-	1,571,852	202,047
Financial Sector	**318,232**	**3,935,202**	**905,617**	**6,880,815**			**26,232,256**	**20,034,744**	**3,894,144**	**1,874,312**	**31,350,248**	**32,725,073**
In domestic currency	318,232	2,455,733	770,638	5,308,963			18,458,342	12,137,015	73,258	60,907	19,620,469	19,962,618
In foreign currency	-	1,479,468	134,979	1,571,852			7,773,914	7,897,729	3,820,886	1,813,406	11,729,779	12,762,456
Nonfin. Private Sector*	**-**	**819,685**	**-**	**-**	**20,034,744**	**26,232,256**			**-**	**-**	**20,034,744**	**27,051,941**
In domestic currency	-	819,651	-	-	12,137,015	18,458,342			-	-	12,137,015	19,277,993
In foreign currency	-	34	-	-	7,897,729	7,773,914			-	-	7,897,729	7,773,948
Nonresidents *	**4,206,088**	**10,994**	**-**	**-**	**1,874,312**	**3,894,144**	**-**	**-**			**6,080,401**	**3,905,138**
In domestic currency	14,781	80	-	-	60,907	73,258	-	-			75,688	73,338
In foreign currency	4,191,307	10,914	-	-	1,813,406	3,820,886	-	-			6,004,713	3,831,800
TOTAL *	**4,524,320**	**5,572,829**	**1,712,565**	**6,880,815**	**32,725,073**	**31,350,248**	**27,051,941**	**20,034,744**	**3,905,138**	**6,080,401**	**69,919,037**	**69,919,037**
In domestic currency	333,013	4,015,344	1,510,518	5,308,963	19,962,618	19,620,469	19,277,993	12,137,015	73,338	75,688	41,157,479	41,157,479
In foreign currency	4,191,307	1,557,484	202,047	1,571,852	12,762,456	11,729,779	7,773,948	7,897,729	3,831,800	6,004,713	28,761,558	28,761,558

Source: BCCR - BSA Matrix (*) Not completed information (nonfinancial private sector and nonresidents positions only include reported information by central bank and financial sector)

Recommendation 3: *The BCCR, in coordination with CONASSIF and the FSC, should examine the feasibility of periodically preparing intersectoral matrices (complete information) using the BSA Matrix and incorporating the analysis of these matrices as an additional tool for monitoring financial stability and the Costa Rican economy in general. The results of this FSSR illustrate the importance of conducting this type of analysis, since it has identified several intersectoral financial relationships that could be sources of economic vulnerability, such as: (1) public sector financing needs that are met by depository corporations and other financial corporations; (2) currency mismatches that are initially faced by the financial system and are then transferred to the nonfinancial sector (by granting loans in dollars to agents that do not generate foreign currency); (3) households that constitute the principal creditors in the financial system (deposits, investments, and pension contributions); and (4) increasing indebtedness of some sectors of the economy.*

Annex III. Costa Rica: Detailed FSSR Technical Assistance Roadmap

#	Topical Area	Key Vulnerabilities PRIORITY	Strategic TA Objectives	Technical Assistance Activities	Responsible Authorities
Strengthening Financial Regulation and Supervision					
1	Banking supervision	**HIGH PRIORITY** Insufficient implementation of an effective approach to risk-based supervision	Effective prudential risk-based supervision	**IMMEDIATE** • 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.	SUGEF
2	Insurance supervision	**HIGH PRIORITY** Insufficient implementation of an effective approach to risk-based supervision.	Effective prudential risk-based supervision	**IMMEDIATE** • Define the risk appetite of the supervisor. • Building on the risk-based approach, provide capacity to supervisors and the market, including the courts. • Align the supervisory structure and resources for an optimal RBS. • Calibrate risks and capital aligned with the risk appetite definition. • Calibrate the early warning systems to the Costa Rican market conditions. • Create consistency in the risk classification. • Contribute to develop a limited set of prompt corrective actions. • Improve the risk-based onsite inspections framework. • Suggest and implement adjustments to the supervisory system.	SUGESE
3	Pension supervision	**HIGH PRIORITY** Insufficient implementation of an effective approach to risk-based supervision	Effective prudential risk-based supervision	**IMMEDIATE** • Define the risk appetite of the supervisor. • Provide capacity building on the risk-based approach. • Define risk-based minimum capital according to risk management, for second pillar managers. • Suggest and implement adjustments to the supervisory system.	SUPEN
NOTE: TA projects #1, #2, and #3 have to be conducted in a coordinated manner with the strategic objective of strengthening consistently the RBS approach across the supervision of the different sectors. Securities can also be considered in this consistent approach to RBS based on a sufficient definition of the supervisors' risk appetites.					
4	Insurance supervision	**HIGH PRIORITY** Improper use of reinsurance to hide insolvencies. Insufficient reinsurance protection	Resilient insurance sector	**MEDIUM -TERM** • Analyze the existing reinsurance contracts. • Provide capacity building on the supervision on the use reinsurance. • Develop a supervisory guide on the use of reinsurance. • Carry out the onsite inspections using the supervisory guide.	SUGESE

#	Topical Area	Key Vulnerabilities PRIORITY	Strategic TA Objectives	Technical Assistance Activities	Responsible Authorities
5	Banking regulation and supervision	**HIGH PRIORITY** Current organic law of the BCCR does not allow effective consolidated supervision.	Improved regulation and supervision	*Within six months after the draft law on consolidated supervision is approved* • 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.	SUGEF
6	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.	Improved regulation and supervision	*Within 12 months after the draft law amendments on fitness and properness are approved.* • 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.	SUGEF SUGEVAL SUGESE SUPEN
7	Banking regulation	Gaps with international standards provide room for unhealthy practices as well as for regulatory arbitrage, hence weakening the financial system's reliability.	Set out roadmaps for the progressive implementation of Basel II/III and of international standards on remunerations.	• 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.	SUGEF
8	Insurance and pension	• Sustainability of the mandatory insurance • Entry barriers for the private sector too high, thus hindering sound competition.	Resilient insurance sector Pension competition	• Carry out an actuarial assessment of the reserves of the two existing mandatory products. • Suggest changes to the products and to the operating process, including the distribution, claims assessment, and benefit payments. • Create data structure to measure costs by product and a model to estimate the administrative fee for pension managers, II Pillar. • Promote pension competition and analyze entry barriers. • Provide support with drafting the regulations for a modern market conduct regulation and supervision.	SUGESE SUPEN

#	Topical Area	Key Vulnerabilities PRIORITY	Strategic TA Objectives	Technical Assistance Activities	Responsible Authorities
Strengthening Financial Safety Nets					
9	Crisis management	**HIGH PRIORITY** Ineffective emergency liquidity facility at BCCR	Implementation of an emergency liquidity facility limited to solvent institutions	**IMMEDIATE** • 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.	BCCR, SUGEF, FSC
10	Deposit insurance, crisis management and bank resolution	**HIGH PRIORITY** Lack of practical experience in Costa Rica	Capacity building	**MEDIUM-TERM** • 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.	DGF, SUGEF, BCCR, CONASSIF
11	Crisis management	Lack of a well-articulated crisis management arrangement	Establish a framework for crisis management.	*Within three months of the approval of the draft deposit insurance and bank resolution law:* • 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.	FSC
12	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. Implement P&A resolution transactions to avoid suspending bank operations and delaying payment of insured deposits.	*Within 3 months of the approval of the draft deposit insurance and bank resolution law:* • 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. • Develop resolution planning and practices to ensure prompt payment to insured depositors.	DGF, SUGEF, BCCR, CONASSIF

#	Topical Area	Key Vulnerabilities PRIORITY	Strategic TA Objectives	Technical Assistance Activities	Responsible Authorities
Strengthening the Monitoring of Financial Stability					
13	Financial Stability	**HIGH PRIORITY** Lack of clarity on the responsibilities of each participant in the financial stability	To have a responsibilities matrix between macroprudential, microprudential, fiscal, and monetary issues	**IMMEDIATE** • 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.	BCCR, MoF, CONASSIF
14	Financial Stability	Leave out insurance and pension in the stress analysis	To improve capacities to elaborate stress test for pension and insurance (bottom-up and top-down)	• 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.	BCCR, SUGESE, SUPEN
15	Balance Sheet Approach (BSA) Assessments	Current cross-sectoral financial relationships	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.	• 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.).	BCCR, SUGEF, CONASSIF
Mitigating Risks Related to High Dollarization					
16	Stability issues under dollarization	**HIGH PRIORITY** High degree of dollar credit granted to non-generators of dollars (households and non-tradable firms)	Reduce significantly the amount of credit to non-generators of dollars.	**IMMEDIATE** • 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.	BCCR, SUGEF, CONASSIF

#	Topical Area	Key Vulnerabilities PRIORITY	Strategic TA Objectives	Technical Assistance Activities	Responsible Authorities
17	Stability issues under dollarization	Stress on banking sector with regulation on de-dollarization	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	• 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.	BCCR, SUGEF, CONASSIF
Fostering Secondary Markets					
18	Securities	**HIGH PRIORITY** Non-reliable price formation process in public debt secondary markets	Overcoming the current rigid valuation system in Public Debt	**IMMEDIATE** • Provide training on securities valuation techniques in the area of supervision as well as evaluation of alternative valuation methods. • Provide assistance on the evaluation of potential measures to reduce current investors' and markets' dependence upon non-market formed prices and values.	SUGEVAL
19	Securities	**HIGH PRIORITY** Lack of specific trading systems for fixed-income securities	Developing a modern and effective trading system for fixed-income securities, including potential measures to increase liquidity, such as market makers	MEDIUM-TERM • Analyze different fixed-income trading venue models to find the most appropriate for the Costa Rican market. • Provide advice and support in the actual implementation of the trading system, the pricing formation process, and the transparency regime. • Provide recommendations to make the trading system attractive to institutional investors' needs.	SUGEVAL
20	Securities	Lack of robust system to deal with settlement failures in post trading	Increasing the resilience of the post-trading system when dealing with settlement failures	• Undertake analysis, preparation, and implementation measures to deal with cash and securities failures in settlement, placing them in a post-trading environment. • Review the effectiveness of the finality rule.	SUGEVAL, BCCR

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Advancing the National Agenda for financial deepening and inclusion					
21	Financial deepening and inclusion	**HIGH PRIORITY** Lack of coordination and leadership regarding financial inclusion	Advancing the national agenda for financial deepening and inclusion	**MEDIUM-TERM** • Design a roadmap for the NSFI and for the NSFE, identifying main steps to be taken. • Help with diagnosis and identify key topics to be included in the NSFI and in the NSFE.	BCCR, CONASSIF, SUGEF, SUGESE, SUGEVAL, SUPEN
22	Financial deepening and inclusion	Weak data structure for financial inclusion	Advancing the national agenda for financial deepening and inclusion	• 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.	BCCR, CONASSIF, SUGEF, SUGESE, SUGEVAL, SUPEN
23	Financial deepening and inclusion	Weak legal powers to supervise the shadow banking sector	Strengthening the regulatory environment	• Propose amendments to the law to enhance SUGEF's ability to include institutions under the regulatory perimeter, with a proportionate approach.	SUGEF
24	Financial deepening and inclusion	Weak legal powers for financial consumer protection	Strengthening the regulatory environment	• 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.	SUGEF, SUGESE, SUGEVAL, SUPEN, BCCR, MEIC