Tunneling when Regulation is Lax: The Colombian Banking Crisis of the 1980s

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Tunneling when Regulation is Lax: The Colombian Banking Crisis of the 1980s[1]

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Abstract

We study the resilience of banks to macroeconomic slowdowns in a context of lax microprudential regulations: Colombia during the Latin American debt crisis of the 1980s. We find that numerous banks underperformed during the crisis, as their shareholders and board members tunneled resources through related lending, loan concentration, and accounting fraud. These practices were enabled by power concentration within banks, lax regulation, and the expectation of bailouts. We provide evidence for this tunneling mechanism by comparing the local banks and business groups that failed during the crisis, the local banks and business groups that survived the crisis, and the former foreign banks—all of which survived the crisis. The regulatory changes enacted during the crisis also lend support to our proposed mechanism.

Keywords: Banking, Financial Regulation, Debt Crisis, Tunneling, Related Lending.

JEL: N26, G01, G21, G28, G30, E44

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1. Introduction

The bankruptcy of FTX, the third largest cryptocurrency exchange by volume, featured multiple characteristics of unregulated financial markets: power concentration, lack of transparency, related lending, fraud, and, eventually, a run.[5,6] The growth of unregulated financial markets highlights the need for a better understanding of their shortcomings, their mechanisms of self-regulation, and their role as propagators of macroeconomic turmoil. Such understanding requires detailed information about market intermediaries over long periods of time, but this information is often difficult to obtain in unregulated markets. In this paper, we study a banking sector with lax regulations against tunneling — "the transfer of assets and profits out of firms for the benefit of their controlling shareholders" (Johnson, La Porta, Lopez-de-Silanes, and Shleifer, 2000). We show that tunneling led to a banking crisis in Colombia during the 1980s.

The Colombian banking crisis of the 1980s entailed the liquidation or nationalization of six banks, the rescue of two banks through rediscounted loans, and the relief of two financial groups through stock acquisitions. The crisis began in 1981 and exploded in 1983 with the government's takeover of the largest bank. By 1985, non-performing loans in the banking system amounted to 17% of assets. Consequently, the banking system's return on assets fell from 1% in 1980 to -5% in 1985. By the end of the crisis, the Colombian government had spent between 3% and 6% of GDP on bailouts (Urrutia, Caballero-Argáez, and Lizarazo, 2006, p. 120; Klingebiel and Honohan, 2003). The crisis motivated new restrictions to related lending, increased penalties for tunneling, a new deposit insurance system, and new procedures for seizing and administering banks in distress.

We show that unsound practices by local private banks worsened the crisis: loan concentration, accounting fraud, and related lending for company acquisitions. These practices were used to tunnel resources from depositors to controlling shareholders, especially when the latter were business groups with concentrated ownership. The expectation of bailouts—tunneling from taxpayers to controlling shareholders—also induced risky behavior. Our evidence for these mechanisms results from the comparison of three sets: banks and business groups that failed

[5] Related loans are made to bank shareholders, their associates and families, and the firms they control (La-Porta, Lopez-de-Silanes, and Zamarripa, 2003).

[6] FTX Tapped into Customer Accounts to Fund Risky Bets, Setting Up Its Downfall (2022, November 11). *The Wall Street Journal.*

Downfall of FTX's Bankman-Fried sends shockwaves through the crypto world (2022, November 14). *NPR.*

during the crisis, banks and business groups that survived the crisis, and former foreign banks. We implement qualitative and quantitative comparisons, including an econometric event study that shows that foreign banks on average performed better than local banks. Overall, differences in ownership and bailout expectations explain the differences in tunneling behavior, loan portfolio quality, and performance. The regulatory changes implemented by the Colombian government in response to the crisis are also consistent with the role of power concentration, bailout expectations, related lending, loan concentration, and accounting fraud in the banking crisis.

Three sources support our analysis. First, the balance sheets of every private bank in the Colombian market from 1965 to 1990.[7] We use these balance sheets to compare the banks' performance during the crisis. Second, annual reports published by the banks during the crisis. These reports provide information on the board composition, conduct, and performance of each bank. Third, multiple qualitative sources: (i) laws and decrees with their explanatory memoranda, (ii) rulings by courts and regulators, (ii) post-mortem reports by bank regulators, bank liquidators, government bureaus, and business associations, and (iii) newspaper articles. These qualitative sources are crucial for detecting tunneling and illegal behavior that, by their very nature, do not appear explicitly in balance sheets and bank reports.

Lending to shareholders, board members, and sister companies was an important mechanism used to tunnel resources from depositors, minority shareholders, and, eventually, taxpayers. Yet, related lending can be advantageous for banks and economies because it reduces informational asymmetries and transaction costs with borrowers (Hoshi, Kashyap, and Scharfstein, 1991; Rajan, 1992; Lamoreaux, 1994; Maurer and Haber, 2007). This positive effect tends to dominate in countries with legal controls on tunneling (Masulis, Pham, and Zein, 2011; Buchuk, Larrain, Muñoz, and Urzúa, 2014; Johnson, Boone, Breach, and Friedman, 2000; Cull, Haber, and Imai, 2011). In the absence of legal controls, strong institutions of corporate governance can still prevent tunneling, as in the Mexican banking system between 1888 and 1970, but not in the 1990s (Maurer and Haber, 2007; del Angel, 2016; La-Porta, Lopez-de-Silanes, and Zamarripa, 2003). Yet, corporate governance is an endogenous firm characteristic. We analyze tunneling at the level of banks and business groups, rather than countries: tunneling occurred at banks experiencing power concentration or bailout

[7] We digitized these balance sheets from the Banking Superintendency bulletins.

expectations. Overall, the effect of related lending in the Colombian context was negative: unpaid loans suggest misallocation.

Existing literature had already identified related lending and mismanagement as features of the Colombian crisis of the 1980s (Montenegro, 1983; Kalmanovitz and Tenjo, 1986; Misas, 1987; Urrutia, Caballero-Argáez, and Lizarazo, Desarrollo Financiero y Desarrollo Económico en Colombia, 2006, pp. 101-123; Ocampo J. A., 2015, pp. 86-88; Caballero-Argáez, 2019). However, this literature does not link related lending and mismanagement with tunneling, nor tunneling with ownership, as we do in this paper. Furthermore, the literature focuses on aggregate factors—such as export prices, capital flows, fiscal policy, and regulations—as explanations for the crisis.[8] We show that these aggregate factors had a disparate impact across banks, mainly because incentives and tunneling capabilities differed across banks.

More generally, scholars have long tried to explain why the debt crisis was milder in Colombia than in the rest of Latin America: there was no hyperinflation, public debt default, nor annual GDP contraction (Hernandez and Lopez, 2023). The literature has identified multiple advantages in Colombia relative to other countries: capital controls during the 1970s, international political support, lower net external debt, and reputational benefits from uninterrupted payments of sovereign debt (Ocampo J. A., 1986; Devlin, 1989, pp. 53, 101, 180; Garay, 1991, pp. 613-620; Ocampo J. A., 2014; Luzardo-Luna, 2019, pp. 110-111) (Caselli, Faralli, Manasse, and Panizza, 2021).

These advantages suggest that, without tunneling, the Colombian crisis would have been even milder: perhaps Colombia would have avoided a financial crisis altogether. While the foreign subsidiaries of important banks were currency mismatched—as shown by Avella and Caballero-Argáez (1986), Caballero-Argáez (1988), and Álvarez (2023)—such mismatch resulted from tunneling—as we show. More generally, we show that tunneling was the most important propagator of macroeconomic turmoil in the Colombian banking sector. Since the literature is not clear on whether tunneling was as important in other Latin American countries, our study suggests the need to further study tunneling as a means of crisis propagation during the 1980s.[9]

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[8] Hernandez and López (2023) summarize this literature.

[9] Mexican business groups borrowed from their own banks, which in turn borrowed recklessly from international banks in the run-up to the debt crisis (del Angel, 2016; Álvarez, 2015; 2017; 2018; Álvarez, 2021). It is doubtful

2. Banking before the Crisis

There were three types of banks in 1980, before the crisis began: (i) State banks focused on agriculture, housing, and retail banking, (ii) parastatal banks focused on coffee and cattle farming, and (iii) private banks, which accounted for 73% of the banking system's assets.[10,11] We classify private banks into local and mixed, which we define below.

Local banks, i.e., those controlled by Colombian nationals and companies, were heterogeneous in size, control, and retail focus (Table 1). Eleven banks were controlled by business groups and two banks had business groups as large shareholders. Governance within business groups was heterogeneous as well (Table *2*). *Grupo Empresarial Antioqueño* was a conglomerate of companies with reciprocal crossholdings and interlocked boards of directors in which decisions were reached by consensus. In contrast, a single person exercised control in five business groups.

Control within business groups occurred through crossholdings and interlocking directorates. Related lending became an important source of funding for business groups in the 1960s (Rodríguez-Satizabal, 2021). As a result, by 1975, 67% of the firms affiliated with business groups had common board members with financial institutions (Rodríguez-Satizabal, 2021).

Local private banks had been opening subsidiaries overseas since the 1970s, especially in the Caribbean and Panama (Avella and Caballero-Argáez, 1986, p. 33). Between 1971 and 1982, ten Colombian banks opened subsidiaries in Panama—the largest subsidiaries belonging to *Banco de Colombia*, a private bank, and *Banco Cafetero*, a parastatal bank (Caballero-Argaez,

that this mechanism amounts to tunneling: international banks were not being deceived, minority shareholders were protected by counterbalanced decision-making, and it is not clear whether majority shareholders expected to benefit from a bailout. Díaz-Alejandro (1985) briefly mentions that Chilean banks used Panamanian subsidiaries to circumvent legal limits to related lending and used false transactions to increase the value of loan collateral. Nevertheless, he does not discuss the relationship of these practices with tunneling, nor the role of tunneling in magnifying the crisis, as we do in this paper.

[10] Calculations omit *Caja de Crédito Agrario*, the public bank focused on agriculture, whose financial statements were not reported by the Banking Superintendency.

[11] There were other financial intermediaries in addition to banks: *corporaciones de ahorro y vivienda,* housing-focused institutions that lent money for building, developing, or acquiring housing; c*orporaciones financieras*, long-term lenders and venture capitalists funded primarily by the central bank; *compañías de financiamiento comercial,* short-term lenders (less than a year); and investment funds (Clavijo, 1984; Ocampo, 2015, pp. 46, 56, 57; Urrutia and Namen, 2012; Rodríguez-Satizabal, 2021). Banks accounted for 85% of the assets of the financial sector in 1975 (Ocampo, 2015)

1988). Subsidiaries allowed Colombian banks to obtain liquidity from international markets, avoid the Colombian capital-reserve requirements, and avoid Colombian regulations on foreign exchange transactions (Caballero-Argaez, 1988). In fact, the liabilities of the subsidiaries in Panama were often backed by their headquarters in Colombia, becoming a potential source of currency mismatch for Colombian banks (Avella and Caballero-Argáez, 1986; Álvarez, 2023). By 1982, most foreign debt by Colombian banks had been obtained through their subsidiaries in Panama (Avella and Caballero-Argáez, 1986, p. 35).

Table 1. Local Private Banks in 1980

	Share of assets (A; %)	**Share of branches (B; %)**	**Retail index (B/A)**	**Assets in foreign exchange (%)**	**Liabilities in foreign exchange (%)**	**Control***
Colombia	16	13	0.8	13	19	BG (C)
Bogotá	14	13	0.9	19	21	BG (L)
Comercio	8	7	0.8	4	8	Dispersed†
Comercial Antioqueño	6	6	1.0	14	14	BG (L)
Industrial Colombiano	4	4	1.1	16	17	BG (C)
Occidente	4	4	1.1	9	8	BG (C)
Estado	3	2	0.7	9	10	BG (C)
Santander	3	2	0.6	9	12	BG (C)
Caldas	2	1	0.7	22	23	BG (C)
Nacional	2	1	0.8	16	18	BG (C)
Tequendama	1	1	0.5	40	45	BG (C) ‡
Colpatria	1	1	0.9	11	13	BG (C)
Caja Social de Ahorros	1	3	2.7	0	0	BG (C)
Trabajadores	1	1	1.2	11	12	BG (C)
Crédito y Desarrollo	1	0	0.5	14	12	P (C) ♠
TOTAL	66	60	0.9	14	16	

*BG= Business group, P=Single person, C= Controlling shareholder; L=Large, but not controlling shareholder.
† Chase Manhattan Bank of New York owned a 34% stake and had one director on the board. The other six directors were shareholders of three investment companies that owned 36% of the bank.
‡ A Colombo-Venezuelan business group, led by a Colombian family, controlled the bank. Nine of the ten bank branches were in Colombia.
♠ An individual person owned 90% of the bank.
Sources: Assets: balance sheets, branches: DANE (1981, p. 193), control: Herrera (1983), Table 2, and Appendix.

Table 2. Private business groups that owned banks*

Group	Banks[¶]	Core industry	Control[†]
Grupo Empresarial Antioqueño [‡]	• Comercial Antioqueño (**L** until 1981) • Industrial Colombiano (**C**)	Finance, insurance, manufacturing	Dispersed
Grancolombiano	• de Colombia (**C**) • Mercantil (**C** 1975-1978)	Finance	Unipersonal
Sarmiento	• Occidente (**C**) • Bogotá (**L** 1981-1983, **C** since 1988)	Finance, construction	Unipersonal
Bolivar	• Bogotá (**L**, until 1983)	Finance, Insurance, construction	Family
Santo Domingo	• Comercial Antioqueño (**C** since 1981) • Santander (**C**)	Finance, manufacturing, services	Unipersonal
Colombia	• Nacional (**C** since 1978)	Finance	Unipersonal
Mosquera	• del Estado (**C**, since 1978)	Finance	Unipersonal
Cali Cartel	• Trabajadores (**C**, until 1980)	Narcotics, retail	Family
Forero Fetecua	• Trabajadores (**C**, since 1980)	Finance, construction	Unipersonal
Tequendama	• Tequendama (**C**)	Finance, insurance	Colombo-Venezuelan joint-venture [♠]
Colpatria	• Colpatria (**C**)	Finance, insurance, construction	Family
Fundación Grupo Social	• Caja Social de Ahorros (**C**)	Finance, construction	Unipersonal under Jesuit supervision [§]
Restrepo	• Caldas (**L**)	Industry	Family

Arango	• Caldas (**L**)	Transport Industry	Family
Coffee Growers Federation	• Caldas (C)	Agriculture Services	Business Association

* A business group is a set of independent firms operating in multiple industries and bound together by persistent formal and informal ties (Khanna and Yafeh, 2007). Colombian Law defined business groups in 1995, after the crisis (Law 222 of 1995).
¶C= Controlling shareholder; L=Large, but not controlling shareholder.
† Dispersed: No single person, family, or company has control over the group. Unipersonal: A single person has control over the group. We focus on control rather than nominal ownership. For example, shares of *Santo Domingo* Group's companies were owned by multiple members of the Santo Domingo family, but Julio Mario Santo Domingo exercised control.
‡ Also known at the time as *Sindicato Antioqueño*. *Grupo Empresarial Antioqueño* evolved from increasing crossholdings, interlocking directorates, and joint foundations in Antioquia since 1920. Collective decision-making by 12 companies was formalized in 1978. No single person or company controlled the group, although there was a regional perspective on decision-making.
♠ See footnotes in Table 1.
§ The *Fundación Grupo Social* was founded by the Jesuit order and managed by Adán Londoño, SJ, a member who had "considerable influence in naming managers and making decisions" through his personal relationships with each manager (Dávila, Dávila, Grisales, and Schnarch, 2014, p. 8).
Sources: Herrera (1983), Ogliastri (1990), Rodríguez (1993), Álvarez (2003), Acosta and Londoño (2003), Londoño (2004), Rodríguez y Duque (2008), Reyes (2012), Dávila, Dávila, Grisales, and Schnarch (2014, pp. 1-9, 73-84, 175), Rodríguez-Satizabal (2014), Rodríguez-Satizabal (2020), Banking Superintendency's Memorandum 102 of 1983, and primary sources cited in the Appendix.

Foreign investors had a minority stake in two banks that we classify as local. *Banco del Comercio* had Colombian origins; its Colombian shareholders occupied six out of seven positions on the board—Chase owned 34% of the bank and had a single representative on the board. [12] *Banco Tequendama* was owned by Colombian and Venezuelan investors—Colombians owned a 52% stake.[13] The bank's headquarters as well as nine of its ten branches were in Colombia.[14]

Foreign-owned banks had operated in Colombia since the early 20th century when a boom in coffee exports increased the demand for credit by coffee growers and distributors (Table 3). There were seven foreign-owned banks in 1975, accounting for 7% of assets, 8% of equity, 7% of loans, 8% of deposits, and 4% of the branches in the bank system.

[12] Herrera (1983) and Annual Reports.
[13] Herrera (1983). Also: Recupérase el hemisferio. (1976, May 30). *El Miami Herald.* Venezuelan participation remained the same in 1980 (CEPAL, 1986).
[14] *Banco Tequendama*, Annual Report, 1979.

In 1975, banking policy swung towards nationalism. The government's intent was not to nationalize banking, but to ensure that Colombian nationals were in control of the banks.[15] The government created a commission to negotiate with foreign-owned banks their transformation into 'national companies,' leveraging its bargaining power on licenses that foreign-owned banks needed to operate in Colombia (López Michelsen, 1976, pp. xvi-xvii).[16] Negotiations concluded when six of the seven foreign-owned banks agreed to transform into mixed companies, where Colombian shareholders would own at least 51% of each bank, by 1978 (López Michelsen, 1976, pp. xvi-xviii). Since no agreement was reached with the City Bank of New York, the government presented a bill to Congress to force ownership change: Law 55 was enacted in 1975.

Table 3. Mixed (previously foreign) banks in 1980

Name since 1975	**Former owner**	**Year of arrival**	**Share of assets (%)**	**Retail Index***	**Share of assets in foreign exchange**	**Share of liabilities in foreign exchange**
Internacional	City Bank	1916	1.1	0.7	4	4
Sudameris	Sudameris	1920	1.4	1.1	22	25
Mercantil (Franco Colombiano)	Banque Nationale de Paris[17]	1955	0.7	0.5	21	24
Anglo Colombiano	Banco de Londres y Montreal (Lloyds)	1922	1.4	1.4	14	18
Colombo Americano	Bank of America	1968	0.4	0.6	23	33
Royal Colombiano	Royal Bank of Canada	1920	0.6	1.2	11	8
Real	Real do Brasil	1975	0.4	0.6	16	15
TOTAL			7.4	0.8	16	18

Sources: assets and liabilities: balance sheets; branches: DANE (1981, p. 193); arrival: Granados (2019a) and Bonin (2005, p. 197).

[15] Ponencia del primer debate, ley 75 de 1975. In ANIF (1976, pág. 71)
[16] Decree 295 of June 1975.
[17] Opened as a branch that later became a subsidiary of *Banque nationale pour le commerce et l'industrie* (Bonin, 2005, p. 197)

Law 55 forbade new foreign, non-Andean investments in the financial sector. The law also compelled financial intermediaries to transform into mixed companies—i.e., 51% Colombian ownership—by 1976. Foreigners from Andean countries, such a Venezuela, were exempted. Hence, we define a bank as *mixed* if non-Andean entities owned more than 50% of the bank in 1975. The transformation from foreign to mixed banks was known at the time as the "Colombianization" of banks.

In six out of seven banks, Colombianization occurred through the sale of stocks from foreign banks to Colombian nationals. Crucially, the stocks were not sold to other banks or financial groups. Rather, the banks were sold to individuals and companies linked to the real sector (Herrera, 1983). In fact, foreign banks remained the largest shareholders, even though their stake was less than 49% (Herrera, 1983). The only exception to this ownership structure was *Banco Franco Colombiano*, renamed as *Banco Mercantil* in 1978. *Banque Nationale de Paris* and its subsidiaries owned 80% of the bank in 1975.[18] Their participation fell to 52% in that year, after the *Grancolombiano* financial group acquired 48% of the shares. Ownership remained split until 1978, when an industrialist acquired a 55% stake that grew to 91% in 1983.[19] *Banco Provincial*, a Venezuelan bank partially owned by Credit Lyonnais, had a minoritarian 8% stake since 1979.[20]

Mixed banks focused primarily on the corporate market, as revealed by the retail index in Table 3, but their focus on corporate borrowers was similar to multiple local banks in Table 1.[21] Some mixed banks were involved in consumer banking, with retail indexes well above 1. For example, *Banco Royal Colombiano*, formerly Royal Bank of Canada, had a branch in *Corabastos*, the largest wholesale perishable food market in Bogotá.[22] Corporate customers were both local and foreign. *Banco Internacional*, formerly City Bank, described its market segment as follows: "Multinational and local corporations that need sophisticated banking

[18] Banking Superintendency's Memorandum 102 of 1983.

[19] Banking Superintendency's Internal Memorandum, August 6, 1981. Also, Banking Superintendency's Memorandum 102 of 1983, and Banking Superintendency's Derecho de Petición 2023089069-005-000, September 18, 2023.

[20] Banking Superintendency's Memorandum 102 of 1983. Also, Half-Yearly Report, *Banco Mercantil*, December 1979, Plessis (1994, p. 215) and Herrera (1983)

[21] We define the retail index for each bank as its share of branches divided by its share of assets in the banking system.

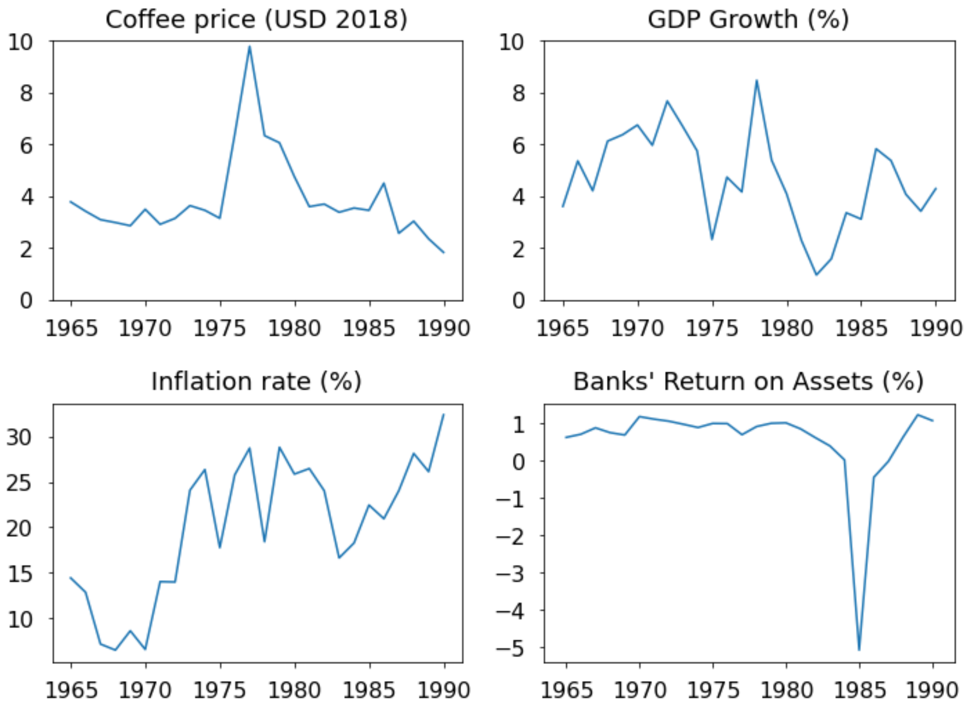
[22] *Half-Yearly report, Banco Royal Colombiano*, December 1980.

services, both international and local."[23] Foreign exchange inflows were more important for mixed banks than for local banks in general, as inflows through foreign banks were 33% of total inflows in 1975 —foreign banks only accounted for 7% of assets in that year (DNP, 1975).

3. The Banking Crisis of the 1980s

Colombia entered an economic boom in 1976 thanks to an increase in the price of coffee, the main Colombian export.[24] The increase in exports induced economic growth, foreign exchange inflows, and increases in foreign exchange reserves at the central bank (Figure 1). This economic boom reinforced the high inflation rate that Colombia had experienced throughout the 1970s (Figure 1). In contrast with these macroeconomic variations, the banks' return on assets did not experience major changes in the aggregate during the 1970s (Figure 1).

Figure 1. Macroeconomic indicators and ROA for the banking sector



Sources:
GDP: Banco de la República and DANE. Inflation: DANE.
Coffee Price: Federación Nacional de Cafeteros (2019), deflacted to USD of 2018 using US urban CPI from the Minneapolis Fed.
Return on Assets: Own calculations from balance sheets.

[23] *Annual Report, Banco Internacional*, 1980.

[24] Coffee accounted for 65% of exports in 1977, the year in which coffee reached a peak of 9.78 2018 dollars per pound.

Policymakers attempted to control inflation and exchange rate appreciation by raising the marginal reserve requirements on checking accounts to 100%, raising the average reserve requirements on other liabilities, imposing new controls to foreign indebtedness, and expanding the existing controls to interest rates (Garay, et al., 1998, p. 40; Ocampo J. A., 2015, pp. 70-80). These measures were in addition to previously existing regulations that increased lending costs, such as forced investments in central bank bonds that were a fixed share of bank loans (Caballero-Argaez, 1988).

These regulations reduced the profitability of borrowing and lending money through standard channels. Savers and borrowers responded by using the informal financial market, which thrived in consequence. Banks responded by finding new financial instruments and practices that would allow them to elude the new regulations, such as opening subsidiaries overseas (Ortega, 1979; Avella and Caballero-Argáez, 1986, pp. 33-35; Villegas, 1990, p. 14).

Two factors coincided in the early 1980s to reduce economic growth. First, the price of coffee fell 63% in real terms between 1977 and 1981 (Figure 1, above). Second, international interest rates increased in response to U.S. monetary policy and the debt defaults of other Latin American countries (Caballero-Argáez, 2019; Luzardo-Luna, 2019, p. 110). GDP growth in 1982 was a meager 1%—much lower than the 8% growth that the Colombian economy experienced in 1977. Low economic growth affected the ability of companies and households to serve their debts. Multiple banks faced financial difficulties. Return on assets for the banking system fell from 1% in 1980 to -5% in 1985 (Figure 1, above).

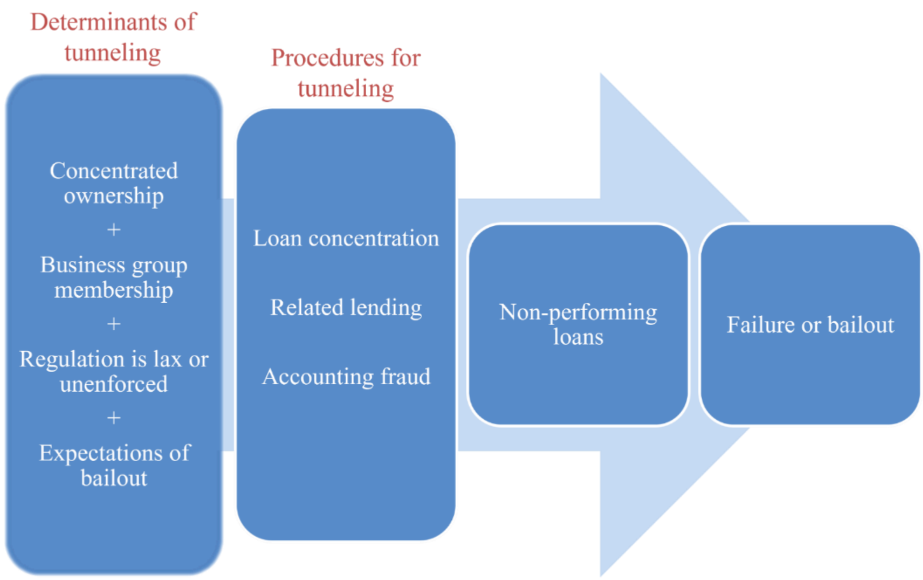
The first bank to fail was *Banco Nacional*, in 1981. The government seized the bank and forced its liquidation on grounds of insolvency.[25] The same year, the government bailed out and nationalized *Banco del Estado*.[26] Four more banks, including the largest, were bailed out and nationalized in 1986 and 1987.[27] By the end of the crisis in 1987, the government had nationalized 29% of the assets held by the banking system in 1980.

[25] Resolution 3259 of 1981
[26] Executive resolution 203 of 1982. See also: *Banco del Estado*, A Salvo Nacionalización (1995, October 14). *El Tiempo*.
[27] The nationalization process after 1985 was known as officialization. We explain the differences between pre-1985 nationalizations and post-1985 officializations below.

4. Mechanism

Figure 2 summarizes our proposed mechanism. Power concentration in banks and business groups, together with prudential regulations that are lax and unenforced, enable tunneling from depositors and taxpayers to bank owners. Such tunneling is more likely to occur if bank owners have reasonable expectations of a bailout, for example, due to their links with political power. Tunneling can occur through loan concentration on shareholders—related lending—and accounting fraud. When interest rates increase and economic activity decreases, these practices reduce loan portfolio quality, which eventually results in bank failures or bailouts.

Figure 2. Mechanism for tunneling



5. Evidence for the mechanism

We provide evidence of this mechanism by comparing three types of banks: banks and business groups that failed during the crisis, banks and business groups that survived the crisis, and mixed (previously foreign) banks. Table 4 presents indicators for four potential mediators of the crisis: retail focus, currency mismatch, government debt, and loan portfolio quality. We compare these variables across bank categories, leaving *Banco del Comercio* as a separate category because Chase, a foreign conglomerate, was a minority but large shareholder in the bank. The main difference across bank categories, by far, is the share of non-performing loans (Column 3).

Column 4 shows that exposure to government debt was not an issue by 1985: the ratio of non-performing public loans to assets was less than 0.8% for every bank. A single public institution, IDEMA, had been responsible for 13% of non-performing debt in 1984 (Palacios, 1985).[28] However, the government took out a foreign loan in 1985 in order to pay for IDEMA's debt with local and international banks (Palacios, 1985).

Table 4. Potential mediator variables of the crisis

	N	Non-performing loans (1985; %)	Non-performing public loans (1985; %)	Assets in foreign exchange (1980, %)	Liabilities in foreign exchange (1980, %)	Retail index† (1980)	ROA (1985; %)
Local Banks (failed)	5	58	0.4	14	19	0.8	-27
Local Banks (survived)	9	6	0.3	15	16	1.0	0
Comercio (failed)	1	17	0.5	4	8	0.8	-5
Mixed banks (all survived)	7	5	0.0	16	18	0.8	1
TOTAL*	22	17	0.3	14	17	0.9	-5

* Excluding public and parastatal banks.
† Share of branches / Share of assets
Data for 1985 does not include *Banco Nacional* and *Banco del Estado*, which failed in 1982.
Source: Own calculations from balance sheets.

Currency mismatch is larger for failing banks than for surviving banks (Columns 5 and 6). This difference comes mostly from Banco de Colombia, the largest bank in Colombia—the bank used its Panamanian subsidiary to tunnel resources towards its controlling business group by issuing loans that were not repaid, as we explain in section 5 and the Appendix. Retail focus is slightly larger for surviving local banks than for failing banks and mixed banks, which is consistent with failing banks lending to their shareholders, and mixed banks facilitating international trade (column 7).

[28] In 1983. Source: 'La Comisión Nacional de Valores y sus actuaciones frente al Grupo Grancolombiano'. *Comisión Nacional de Valores*, 1986, p. 208. IDEMA, a public institution, was a market intermediary in the agricultural sector.

Having established that non-performing loans were the primary driver of the banking crisis, we move to argue that tunneling was the main mechanism for non-performing loans. We start by showing that banking regulation evolved in response to the mechanism in Figure 2.

5.1. Regulatory Change

Prior to the crisis, tunneling regulations focused on loan concentration, related lending, bookkeeping, and foreign loans, as outlined in Table 5. Loans to employees and bank directors were limited to 25% of the bank's equity. Foreign loans had to be pre-approved by the central bank, which approved loans mainly to finance foreign trade (Avella and Caballero-Argáez, 1986, pp. 7, II.2). Directors, employees, and banks themselves faced fines for violating regulations. Additionally, the banking superintendent could, at their discretion, take control of banks that persisted in violating regulations.[29]

In practice, enforcement was discretionary and lax. The office of the Inspector General later discovered that lending, bookkeeping, and reserve requirement regulations were not properly enforced between 1978 and 1982.[30] As part of his defense, the banking superintendent argued that his intervention was discretionary.[31] For example, the superintendent allowed *Banco Nacional* to acquire bank stocks in the US against the advice of his subordinates and the norms that regulated such permission. Furthermore, the Superintendency's employees in charge of monitoring *Banco del Estado* had received loans from the same bank—a conflict of interest.[32]

Table 5. Regulations before the crisis

Regulation	Penalty
Unsecured loans to a single debtor cannot exceed 10% of equity. Secured loans to a single debtor cannot exceed 25% of the equity.	None*
Stocks from the bank cannot be used as collateral for loans by the bank	Fine

[29] After attempting to detect and fix irregularities, the superintendent must (conditionally) return control to the owners of the bank or liquidate the bank. Law 45 of 1923: arts. 48-50.
[30] Sentencia 1443 del Consejo de Estado, 1995.
[31] He argued that both his intervention and the timing of his intervention were discretionary. Sentencia 1443 del Consejo de Estado, 1995.
[32] Sentencia 1443 del Consejo de Estado, 1995.

The bank cannot make loans to acquire the bank itself unless the collateral is worth 125% of the loan amount.	Fine*
Employees and directors of the bank cannot borrow large loans unless there is written permission by more than half of the members of the board.	Fine*
Banks or their sister companies cannot use deposits for company acquisitions.	Fine*
Foreign funding can only be used for banking-related activities[†]. Foreign loans must be pre-approved by the central bank. Any foreign exchange associated with the loan must be sold to the central bank.	Fine*
Banks need permission from regulators to establish or buy agencies and subsidiaries overseas.	NA
It is forbidden to manipulate financial records.	Fine and jail time*

[†] In Spanish: "para los fines propios de su actividad." In the context of foreign exchange regulations, "banking purposes" was usually interpreted as financing foreign trade; nevertheless, the term was ambiguous and open to controversy at the time (Avella and Caballero-Argáez, 1986, p. II.2).
* If the violation is persistent, regulators can discretionally take control of the bank (Law 45 of 1923, art. 48). In addition, directors and executives are personally liable for losses incurred by third parties as a result of knowingly violating regulations (Law 57 of 1931, art. 5).
Sources: Law 45 of 1923, Law 57 of 1931, Decree 3233 of 1965, Decree 444 of 1967, Decree 2388 of 1976, Decree 410 of 1971, and Decree 100 of 1980. Cancino (1979) provides a detailed explanation of most of these regulations.

The government responded to early signs of the banking crisis by implementing stricter prudential regulations, which became even tougher as the crisis worsened (Table 6). Consistent with tunneling that occurs through related lending, the government imposed new restrictions on loan usage, loan concentration, and related lending. More significantly, breachers of financial regulations faced stricter penalties, including jail time.

Consistent with tunneling enabled by power concentration within banks, the government limited ownership concentration. Decree 3227 of 1982 mandated that by 1988 no shareholder could own more than 20% of a bank's shares. Shareholdings would be reduced through public offerings financed by a credit line from the central bank.[33] If the original shareholders transferred their stocks to a trust, the central bank would pay 80% of the stock prices in advance.

[33] Resolución 42 de 1983.

After the advance payment, the actual sale of stocks could take up to seven years.[34] In practice, the reduction in ownership concentration never occurred: the deadlines for reaching caps in ownership were postponed in 1984, 1985, and 1987, and the caps were eventually lifted in 1989.[35]

Consistent with tunneling being induced by bailout expectations, the government introduced new mechanisms to bail out depositors without bailing out bank owners. The main mechanism was the nationalization of failing banks. In 1982, the government began nationalizing banks in distress by injecting equity until it diluted the current shareholders' stake. After 1985, congress enacted a new nationalization process, named *officialization*, which guaranteed that shareholders lost their stake in the bank and, hence, did not benefit from the bailout. Congress also created FOGAFIN, an institution in charge of providing deposit insurance and administering the banks that had been nationalized by the government.

Table 6. Regulations implemented during the crisis.

Type	Changes (year)
Restrictions to lending	• Ban loans for the acquisition of banks (1981) • Further limits to related lending (1981, 1987) * • Limits to loan concentration (1981, 1987) • Further restrictions on who can be a financial intermediary (1982)
Increased penalties	• No access to central bank credit lines for six months (1981) • Jail time (1982) † • Intervention: regulator takes control of failing banks in a more expedited and less discretional manner (1982) ‡ • Nationalization (1982) § • Officialization (1986) ♠
Limits to ownership concentration	• Acquisition of more than 10% of a bank needs permission from the Banking Superintendency (1981) • By 1988 no shareholder can own more than 20% of the stocks of the bank (1982, 1983, 1984, 1985, 1987, 1989)

[34] Resolución 61 de 1983.
[35] Ley 74 de 1989, art. 21

Mechanisms for bailouts	• Nationalization (1982, 1985) [§] • Officialization (1986) [♠] • Bailout to depositors from the central bank (1982) • Deposit Insurance (1985)

* Since 1981, loans to shareholders who control more than 10% of the bank's stocks need the board's unanimous approval. These loans were wholly forbidden in 1987.

† For directors and employees responsible for using the public's deposits for acquiring companies, violating limits to related lending, or being financial intermediaries without a permit. Hernández (2000) explains these penalties in detail.

‡ Intervention: the regulator takes control, not the bank's ownership.

§ Nationalization: The government injects equity in the bank, diluting the current shareholders' stake. The nationalization process involved the government's takeover of the bank's administration and the suspension of dividend payments. In addition to diluting the existing shareholders' stake, the government was allowed to buy the bank from existing shareholders before injecting equity. Decree 2920 of 1982, chapter 2.

♠ Officialization: A nationalization process that reduces share prices to their nominal value, meaning that existing shareholders do not receive any financial gain from the infusion of capital. If the bank's cumulative losses exceed shareholders' equity, the share prices are reduced to one cent.

Sources: Decree 3604 of 1981, decrees 2216, 2527, 2920 and 3227 of 1982, resolutions 39, 42 and 47 of 1982, resolutions 42, 55, and 61 of 1983, law 117 of 1985, decree 35 of 1985, decrees 32 and 2476 of 1986, decrees 356, 415, and 365 of 1987, resolution 14 of 1988. All resolutions are from the central bank.

5.2. Banks that failed during the crisis

Bank failures were driven by non-performing loans (Table 7). Non-performing loans were higher than 18% of total loans for five of the six banks that failed during the crisis (column 4). The financial statements for the remaining bank, *Banco del Estado*, were never approved by regulators.

Table 7. Banks liquidated or bailed out during the crisis.

Bank	**Failure year**	**ROA in year before**	**Share of non-performing loans in year before**	**Share of assets in foreign exchange (1980)**	**Share of liabilities in foreign exchange (1980)**	**Retail index[†] (1980)**	**Market share of assets (1980)**
Nacional	1982	0%	3% (46%)	16%	18%	0.8	2%
Estado	1982	1%	5%	9%	10%	0.7	3%
Colombia	1986	-35%	68%	13%	19%	0.8	16%
Trabajadores	1986	-16%	44%	11%	12%	1.2	1%

Tequendama	1986	-41%	34%	40%	45%	0.5	1%
Comercio	1987	-7%	18%	4%	8%	0.8	8%

Every bank in this table committed accounting fraud, overreporting earnings and underreporting non-performing loans before regulators took control. Financial reports were particularly unreliable for *Banco Nacional* and *Banco del Estado* because their statements were not audited by regulators before 1982. *Banco Nacional* reported 3% of non-performing loans, even though the actual ratio was 46%. The financial statements by *Banco del Estado* were later rejected by regulators due to 'delays', 'irregularities', and 'failures.' See Appendix for details.
† Share of branches / Share of assets
Source: Own calculations from balance sheets and DANE (1981)

Currency mismatch was a smaller factor in bank failure than non-performing loans. 45% of the liabilities and 40% of the assets of *Banco Tequendama* were in foreign exchange because of the bank's Venezuelan branch. Non-performing loans, 34% of the loan portfolio in 1985, were a larger issue for the bank. Currency mismatch was important for *Banco de Colombia:* foreign exchange represented 19% of liabilities and 13% of assets in 1980. However, currency mismatch itself was a consequence of tunneling; when the crisis started, the bank used its subsidiary in Panama to bail out investment funds and companies managed by its business group. Later, the headquarters in Colombia had to bail out the subsidiary in Panama. As a result, the share of liabilities in foreign exchange at the headquarters increased to 51% in 1985. That same year, 64% of the bank's loan portfolio was non-performing.[36]

Non-performing loans resulted from practices that transferred assets and profits out of local banks for the benefit of their controlling shareholders, i.e., tunneling. Table 8 lists the practices committed by each bank and its owners, as described in the Appendix. The loan portfolio was concentrated on owners, board members, or their companies in every bank that failed.[37] Before the regulatory reforms of 1982, these loans were often used for company acquisitions. Eventually, insider loans went unpaid, inducing bank failure.

Before 1982, violating regulations on related lending was not a crime; bank owners and executives were sent to prison because of fraud, but only received fines for concentrating loans on shareholders. Accounting or identity fraud occurred at every failed bank, as we show in the Appendix. After 1982, "undue loan concentration" became a crime: owners and executives of *Banco de Colombia* were sentenced to prison for contravening regulations against related

[36] See Appendix for sources and a more detailed explanation.
[37] This practice was known as *autopréstamos* (self-lending).

lending, loan concentration, and using deposits for company acquisitions.[38] Bank owners at the remaining banks were not sent to prison on these charges: the owners of *Banco de los Trabajadores* were sent to prison for drug trafficking and election crimes, whereas the president of *Banco del Comercio* was fined, but not sent to prison, for approving larger and riskier loans than regulations allowed.

Power concentration was the main factor enabling tunneling at failed banks. As shown in Table 1 and Table *2*, as well as the Appendix, four of the six banks were controlled by a business group that was in turn controlled by a single person (*Nacional, Estado, Colombia,* and *Trabajadores*). *Banco Tequendama* was a joint venture of Colombian and Venezuelan families, with the Colombian family owning 52% of the bank.

Table 8. Tunneling practices by failing banks.

Bank	**Failure year**	**Loan concentration on owners**	**Owners' loans used for company acquisitions**	**Owners' loans not repaid**	**Accounting or identity fraud**	**Owner or president in prison (crime)**
Nacional	1982	X	X	X	X	Fraud*
Estado	1982	X	X	X	X	Fraud*
Colombia	1986	X	X	X	X	Undue loan concentration
Trabajadores	1986	X		X	X	Drug trafficking, Election crimes
Tequendama	1986	X		X	X	No
Comercio	1987	X		X	X	No

* Before 1982, violating regulations on related lending was only punished with fines rather than prison time.
Sources: Explanatory memorandum for Resolución 3259 de 1982, Banking Superintendency. Resolución 5387 de 1982. Resolución Ejecutiva 203 de 1982. Sentencia 1443 del Consejo de Estado, 1995. Decisión sobre recurso de casación. *Supreme Court*, *Sala Civil*, expediente 4370, 1995. La Comisión Nacional de Valores y sus actuaciones frente al Grupo Grancolombiano, Comisión Nacional de Valores, 1986. Supreme Court, Sala de

[38] The main crime was "undue concentration of loans." Decisión sobre recurso de casación. Delito: Concentración indebida de créditos. *Supreme Court, Sala de Casación Penal*, radicado 6114, MP: Jorge Carreño Luengas. 1992.
51 meses de cárcel a Michelsen (1990, September 27). *El Tiempo*.
Ayer, segunda condena en contra de Michelsen Uribe (1992, September 9). *El Tiempo*
Donadio (1984, págs. 20, 65)

Casación Penal, Decisión sobre recurso de casación. Delito: Concentración indebida de créditos. Radicado 6114, 1992. Letter DAB-0780 from the Banking Superintendency's first delegate to the FOGAFIN chair, 1986. Resolución 12 de 1986. Letter DAB-0570 from the Banking Superintendency's first delegate to the director de FOGAFIN, 1986. Informe de Labores. Banking Superintendency, 1987. Statement by the FOGAFIN chair during a House of Representatives debate, August 10-30, 1988, cited by Child and Arango (1988, p. 267). Banks' Annual Reports. Newspaper articles cited in the Appendix. Castrillón (1983, pp. 56, 61–63, 65), Donadio (1983, pp. 18–20, 33, 35, 39–79, 83, 128–129), Echavarría (1983, pp. 5–34, 245–270), Donadio (1984, pp. 20, 65), Lernoux (1984, pp. 138–139), Misas (1987), Caballero Argáez (1988), Ordóñez (1989, pp. 25–26, 154–155), Superintendencia de Sociedades (2012, p. 26) and Rodríguez Olarte (2013).

Banco del Comercio is a partial exception to this pattern, as power concentration was lower: 35% of the bank belonged to Chase Manhattan Bank and 36% belonged to three companies with five shareholders in common, including the representative of Chase Manhattan Bank. Nevertheless, the bank had been a local private bank for 19 years before Chase acquired its stake. Chase had to adapt to existing governance practices from the power position of a minority shareholder. For example, when a whistleblower denounced the loan concentration and corruption at *Banco del Comercio* in a U.S. court, the judge concluded that lending money to members of the board "might be something that Chase has to accept given the customs and practices [of Colombia] and the needs of doing business overseas."[39] Unlike the rogue trader at the Lugano Branch of Lloyds bank in 1974 studied by Schenk (2017), the single Chase representative was not an isolated case within *Banco del Comercio*; rather, he was colluding with the Colombian members of the board. In fact, all board directors, including the representative of Chase, were equity partners at companies that received loans from the bank.

Bailout expectations likely played a role in inducing tunneling at *Banco de Colombia*, *Banco del Comercio*, and *Banco Tequendama*. *Banco de Colombia*, with 16% of the assets in the system, was likely considered too big to fail. Furthermore, the bank had strong links with the government: the president of the bank was a cousin of the president of Colombia between 1974 and 1978, and the superintendent of companies was the son of an important director at *Grupo Grancolombiano* (Echavarría, 1983, pp. 245-270). Likely as a result, the government prevented regulators from informing the public of unsound transactions at the bank's business group, even though regulators had detected such practices since 1980 (Echavarría, 1983, pp. 5-34, 245-270). *Banco del Comercio* also had links with the government, as a former board director was a high-ranking government official. This relationship probably enabled a bailout attempt through toxic asset acquisitions in 1987, which failed due to pressure from Congress and the press.[40] *Banco*

[39] Autopréstamos en Banco del Comercio revela publicación en EE.UU. (1982, October 4). *El Tiempo*.
[40] See Appendix for details.

Tequendama was indirectly bailed out in 1984 through loans rediscounted by the central bank (Misas, 1987).

In contrast, bailout expectations were likely non-existent at *Banco Nacional*, *Banco del Estado*, and *Banco de los Trabajadores*. The owners of *Banco Nacional* and *Banco de los Trabajadores* were political and financial elite outsiders. The owner of *Banco del Estado* belonged to a regional elite but had been raised overseas and was not connected enough with the national elite. In fact, commentators at the time partially blamed the start of the crisis on management's inexperience at *Banco Nacional*, the first bank to fail (Montenegro, 1983).

5.3. Local banks that survived the crisis

Of 15 local private banks, nine survived (Table 9). Performance across surviving banks was heterogeneous in a manner consistent with our proposed mechanism: the best-performing banks (i) had fragmented shareholdings, (ii) belonged to independent owners, (iii) belonged to business groups with fragmented control, or (iv) belonged to business groups with cash cows larger than the bank (Table 9). In the latter case, business groups still tunneled resources, as in our mechanism, but the source of cash was not the bank but other companies in the group. Such is the case of the *Bolívar*, *Sarmiento*, and *Santo Domingo* groups, as discussed below.

Consider the largest surviving bank, *Banco de Bogotá*. Its ratio of non-performing loans was the highest among surviving banks in 1985—10%—but lower than average in 1979—1%. Consistent with the mechanism we have identified, shareholdings were dispersed in 1979: the largest shareholder, the *Bolívar* business group, had a stake of 15% (Eslava, 1985, p. 380).

Table 9. Local banks that survived.

Bank	Market share of assets (1980)	ROA (1985)	Share of non-performing loans (1985)	Control (Names are business groups)
Bogotá	14%	-1%	10%	Dispersed, led by Bolivar (until 1981) Bid: Bolivar vs. Sarmiento (1981-1983)

				Government (1983-1988) Sarmiento (since 1988)
Comercial Antioqueño	6%	2%	4%	Dispersed, led by Grupo Empresarial Antioqueño (until 1981) Santo Domingo (1981 onwards)
Industrial Colombiano	4%	1%	4%	Grupo Empresarial Antioqueño (until 1978) Grancolombiano (until 1983)
Occidente	4%	1%	2%	Sarmiento
Santander	3%	-1%	9%	Santo Domingo
Caldas	2%	-4%	8%	Coffee, Arango and Restrepo
Colpatria	1%	0%	9%	Colpatria
Caja Social de ahorros	1%	1%	1%	Fundación Grupo Social
Crédito y Desarrollo	1%	1%	1%	Independent person
Total	**35%**	**0%**	**6%**	

Source: Own calculations from balance sheets and Table 1.

Ownership concentration increased as two financial groups competed in the stock market to control the bank. The *Sarmiento* business group funded share acquisitions with surpluses from construction companies and cash from selling off other companies (Montenegro, 2009, p. 154). The *Bolívar* business group partially funded share acquisitions through a loan from its own cement company, which was already under financial stress and was a debtor to the bank.[41] The group also used an international loan for funding share acquisitions, even though regulators had approved the loan for a mining project (Misas, 1987). Between August and October of 1981,

[41] 'Crisis en Samper'. Semana, 1984/09/02. 'Como el ave fénix', Dinero, 1996/11

the share price of *Banco de Bogotá* increased from 50 pesos to 500 pesos because of the bid (Montenegro, 2009, p. 155). By then, the groups owned 74% of the bank, but none had obtained a controlling stake (Eslava, 1985, p. 381). Both groups were on the brink of a liquidity crisis.

In our proposed mechanism, such risky conduct is more likely if business groups can expect a bailout. Indeed, both business groups were eventually bailed out by the government, which tunneled resources from seigniorage towards the business groups. In particular, both groups entrusted their shares to *Banco Cafetero*, a parastatal bank (Eslava, 1985, p. 382; Montenegro, 2009, p. 160).[42] The central bank funded advance payments of 93 of 150 pesos per share, alleviating both business groups' liquidity problems (Eslava, 1985, p. 382). This procedure had been created in 1982 to decrease ownership concentration in the banking sector (Table 6). In the end, the procedure allowed further concentration: in 1988, after the financial crisis had ended and regulatory caps on ownership concentration had been postponed, the Sarmiento group acquired the stocks from the trust, taking control of *Banco de Bogotá* (Montenegro, 2009, p. 161).

The cement company that had funded *Bolívar's* share acquisitions suspended debt payments in 1984, with *Banco de Bogotá* receiving a controlling stake as payment in 1986.[43] In 1985 and 1986, the bank received loans from both business groups; the central bank rediscounted these loans, so the bank was indirectly bailed out as well (Montenegro, 2009, p. 160).

The best performer in Table 3, *Banco Comercial Antioqueño*, also illustrates our mechanism. Its good performance during the crisis is consistent with the bank's fragmented shareholdings until 1981.[44] In that year, the *Santo Domingo* group made a hostile takeover of the bank.[45] The group, controlled single-handedly by Julio Mario Santo Domingo, funded most of the takeover through two companies: *Colinsa*—a holding—and *Bavaria*—the core company of the group, a beer near-monopoly with cash surpluses from increasing profits and debt, including debt from companies under its control (Junguito, 1980, pp. IX.31 - X.36; Ogliastri, 1990, p. 34). The following year, the *Santo Domingo* group tried to sell the bank to the *Mosquera* group, owner of *Banco del Estado*. The sale occurred in two steps. First, *Bavaria* sold its stock to *Colinsa* at

[42] Decree 2420 of 1968
[43] 'Como el ave fénix', Dinero, 1996/11
[44] 'Santodomingo comes out on top'. Latin News Archive, 1981/12/11
[45] 'Santodomingo comes out on top'. Latin News Archive, 1981/12/11

170 pesos per share. Second, *Colinsa* sold its stock to *Mosquera* at 60 pesos, losing 110 pesos per share in a week.[46] Regulators reversed the sale after they nationalized *Banco del Estado* that same year, 1982.[47] Regulators and executives of the nationalized bank discovered that *Mosquera* had deposited 110 pesos per share into a Swiss bank—the same amount lost by *Colinsa*. Since such a transaction was against foreign exchange regulations, multiple executives from the *Mosquera* group were fined. Nevertheless, despite multiple testimonies linking the transaction to the *Santo Domingo* group, regulators ruled that there was insufficient evidence to link the transaction to Santo Domingo.[48] A ruling in the opposite sense would have implied that Santo Domingo had tunneled resources from *Colinsa*, to the detriment of taxpayers and minority shareholders.

Multiple journalists denounced at the time that regulators were subjected to undue pressures to prevent a ruling against Santo Domingo, with whom the government had strong links (Reyes, 2012, pp. 218-240, 248). Most notably, the government replaced the head regulator of the case on the day she called a press conference to announce her ruling, after two years of investigations.[49] Three days later, her replacement exonerated Santo Domingo.

An exception to our mechanism is *Caja Social de Ahorros*, which performed well during the crisis despite being controlled by a business group whose director had considerable influence over decision-making (Dávila, Dávila, Grisales, and Schnarch, 2014, pp. 1-9, 73-84). At the time, the Jesuit Order controlled *Fundación Grupo Social*, which in turn controlled *Caja Social de Ahorros*. The goal of *Fundación Grupo Social* was to promote the common good according to the principles of Catholic Social Doctrine, rather than prioritizing individual profits (Dávila, Dávila, Grisales, and Schnarch, 2014, pp. 1-9, 30-75).[50] Since our theoretical framework does

[46] 'El caso Santo Domingo', Semana, 1990/07/15.
'Así fue el negocio', Semana, 1990/07/15.
Reyes (2012, pp. 218-240)

[47] Formally, the transaction was rejected by the Banking Superintendency. However, this rejection occurred after payments had been made, so the payments had to be reversed. Source: Decisión sobre recurso de casación. *Supreme Court, Sala Civil*, expediente 4370, 1995.

[48] 'El caso Santo Domingo', Semana, 1990/07/15
Reyes (2012, pp. 218-240)

[49] Decreto 1208 de 1990
'El caso Santo Domingo', Semana, 1990/07/15.
Reyes (2012, pp. 218-240, 248)

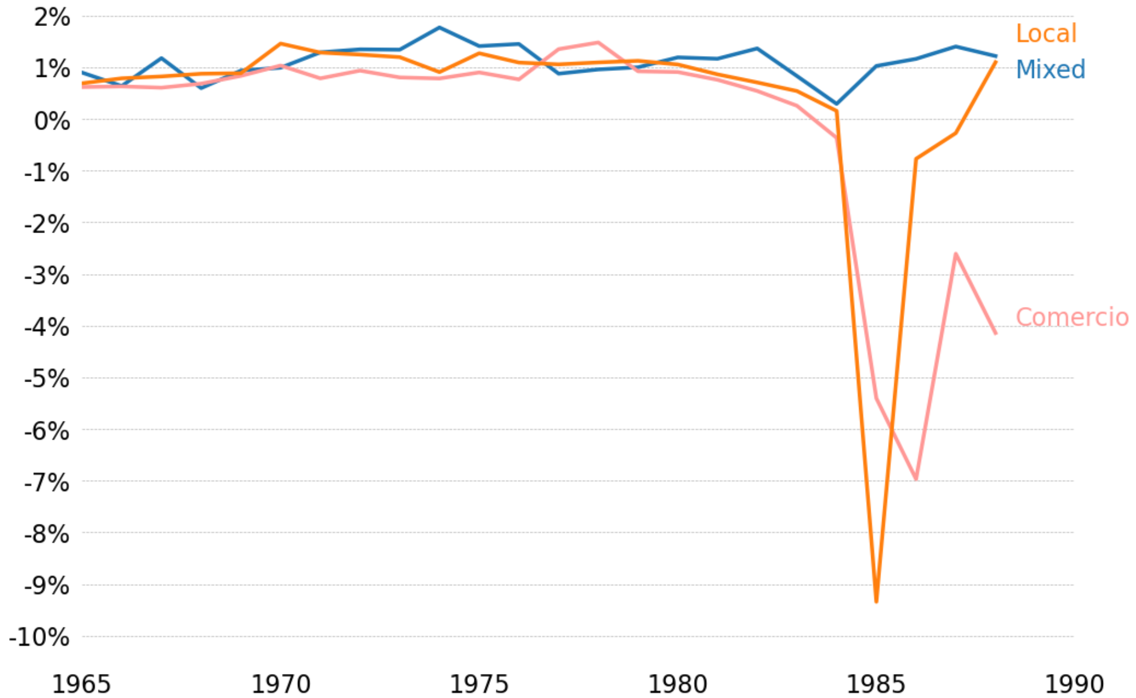
[50] According to its bylaws, the goal of *Fundación Grupo Social* was to improve the "living conditions of disadvantaged groups" by "promoting social change according to Christian principles by means of direct or indirect community services" (Bylaws, 1980, cited by Dávila, Dávila, Grisales, and Schnarch, 2014, p. 74).

not include corporate social responsibility as a motivation for businessmen and entrepreneurs, our framework does not apply to *Caja Social de Ahorros*.

5.4. Mixed (previously foreign) banks

No former foreign bank was liquidated or nationalized during the crisis, i.e., between 1982 and 1987. In this section, we compare the conduct and performance of mixed (previously foreign) banks and local private banks. Figure 3 shows the return on assets ratio (ROA) of mixed and local banks, with *Banco del Comercio* as a separate category. Before the crisis, in 1980, the ROA was nearly 1% for all bank categories. In the middle of the crisis, in 1985, the ROA was 1% for foreign-owned banks, -5% for *Banco del Comercio*, and -10% for local banks. As a share of equity, that year returns were 13% for foreign-owned banks, -57% for *Banco del Comercio*, and -125% for local banks. In other words, losses were greater than equity for *Banco del Comercio* and local private banks.

Figure 3. Return on Assets by Bank Type



*Net income/Assets. Comercio=Banco del Comercio
Source: Own calculations from balance sheets

We use a difference-in-differences strategy at the bank level to better quantify the differential performance of mixed banks during the crisis. A standard assumption of the difference-in-differences approach is that differences in performance would have remained constant had the crisis not occurred - the parallel trends' assumption. This assumption is always impossible to test formally, but Figure 3 suggests that the assumption holds: pre-existing trends do not explain the gap between local private banks and foreign-owned banks during the crisis. For our estimation, we use an event study specification at the bank-year level:

$$ROA_{it} = \eta_i + \gamma_t + \sum_{t \neq 1980} \beta_t Local_i \times \gamma_t + u_{it} \qquad (1)$$

where ROA_{it} is the return on assets bank i in year t, η_i is a fixed effect by bank, γ_t is a fixed effect by year, and $Local_i$ takes the value of 1 if the bank is local and zero if the bank was foreign before the Colombianization of banks in 1975. In our robustness tests, we also include *Banco del Comercio* as a separate category. The base category of our estimation consists of foreign-owned banks. Our base year is 1980 because the system's ROA began to decrease in 1981 (Figures *1* and *3*). Our difference-in-differences coefficient is β_t: the difference in performance between local banks and foreign-owned banks in that year, relative to their difference before the crisis.

Figure 4 shows our difference-in-differences estimates (β_t). On average, the ROA fell eight percentage points more for local banks than for foreign-owned banks in 1985. Figures 3 and 4 show that the crisis had the largest impact on balance sheets in 1985, once the Colombian government increased regulation and supervision, forcing banks to write off loans that had been non-performing since the start of the crisis. This result is surprising because the government liquidated *Banco Nacional* in 1982, nationalized *Banco del Estado* in 1982, and seized *Banco de Colombia* in 1983. Indeed, all three banks reported profits in 1981, whereas *Banco de Colombia* reported profits in 1982 and 1983. The lack of effects before 1985 in Figure 4 is further evidence of the accounting tricks and fake transactions that plagued the balance sheets of failing banks before the government interventions and regulatory changes in 1982 and 1983. For the remainder of this section, we focus on 1985.

Figure 4. Difference-in-Differences estimates. Return on Assets

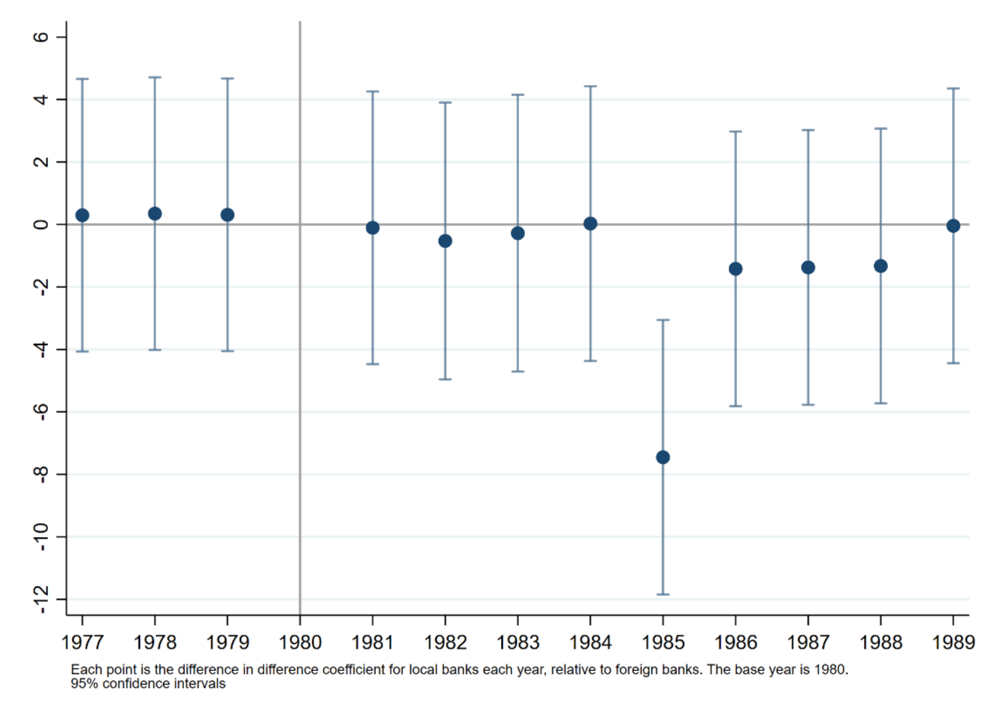


Table 10 presents robustness checks for the results in Figure 4. While we include separate coefficients for every year between 1981 and 1989 in the estimation, the table only shows the coefficients for 1985. Column 1 uses the same specification as Figure 4, but pooling 1977 – 1980 as a single pre-treatment period and excluding *Banco del Comercio* from the sample. Column 2 includes *Banco del Comercio* as a separate category. Column 3 uses market share by assets in 1980 to control for the smaller size of foreign-owned banks. Column 4 uses market share by branches in 1980 to control for retail focus. Column 5 uses our retail index—the ratio between branches' share and asset's share—as an alternative control for retail focus. Regardless of specifications, the differential effect of the crisis in local banks is still large and statistically significant: on average, the ROA fell seven percentage points more for local banks than for mixed banks in 1985. The better performance of mixed banks is not explained by differences in retail focus or market share.

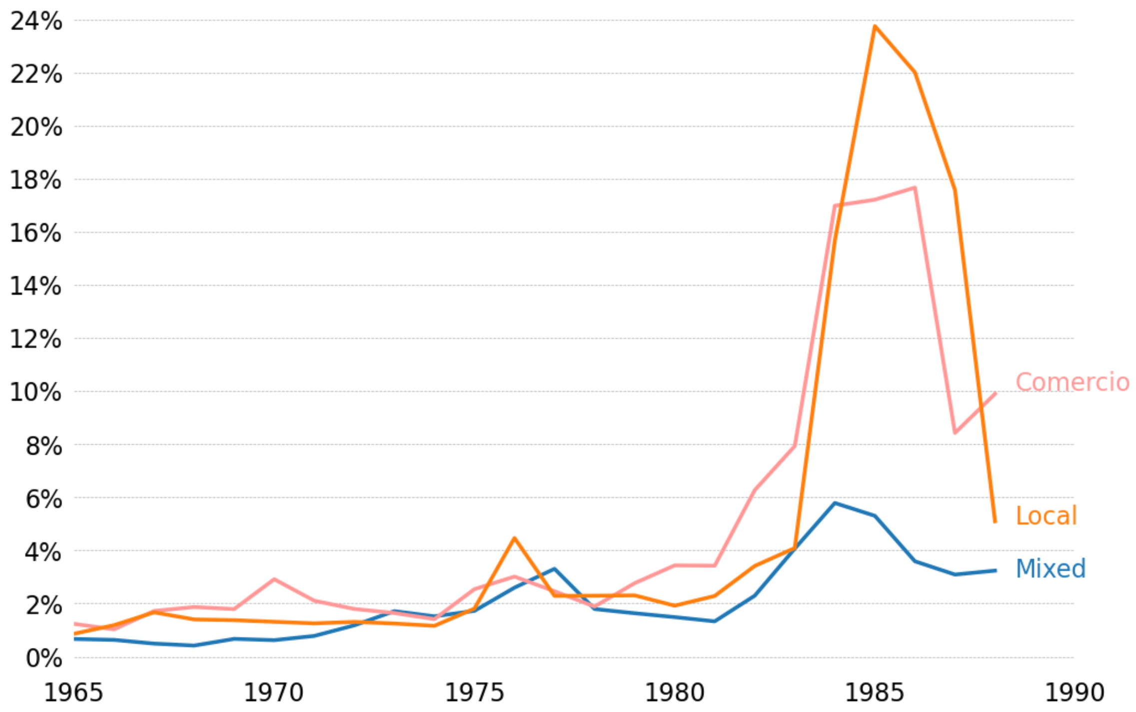
Table 10. Difference-in-differences estimation on return on assets.

	(1)	(2)	(3)	(4)	(5)
Local bank x d1985	-7.69***	-7.69***	-5.55***	-7.38***	-6.55***
	(1.75)	(1.74)	(1.86)	(1.74)	(1.87)
d1985	-0.73	-0.73	-0.03	0.32	-4.84**
	(1.41)	(1.40)	(1.41)	(1.30)	(2.03)
BanComercio x d1985		-5.84	-1.25	0.08	-1.73
		(3.96)	(4.21)	(3.89)	(4.17)
Assets Share in 1980 x d1985			-0.65***	-6.96***	-0.58***
			(0.21)	(1.01)	(0.21)
Branches Share in 1980 x d1985				7.27***	
				(1.14)	
Retail index in 1980 x d1985					5.59***
					(1.72)
Fixed effects by bank	Yes	Yes	Yes	Yes	Yes
Fixed effects by year	Yes	Yes	Yes	Yes	Yes
Fixed effects by year x Local bank	Yes	Yes	Yes	Yes	Yes
R^2	0.37	0.39	0.42	0.53	0.46
N	263	276	276	276	276

Notes: Standard errors in parentheses. The base category are foreign banks between 1977 and 1980. Retail index = Branches share / Assets share

The difference in performance between foreign-owned and local banks was driven by non-performing loans. Figure 5 shows the share of non-performing loans by bank category. In 1985, the share of non-performing loans was 5% for foreign-owned banks and 24% for local banks.

Figure 5. Share of non-performing loans



*Non-performing loans / Total loans. Comercio=Banco del Comercio. Last year is 1988 because accounting rules changed in 1989
Source: Own calculations from balance sheets.

We do not claim that foreign-owned banks are intrinsically virtuous relative to local banks. Indeed, the practices of Mosquera at *Banco del Estado* were likely a replica of similar practices in World Finance Corporation, where Mosquera had worked in the 1970s. Furthermore, the headquarters of foreign banks overlent to Latin American governments during the 1970s, partially because they expected their home governments or the IMF to bailout their borrowers in the event of a macroeconomic crisis (Devlin, 1989; Altamura and Zendejas, 2020). Instead, we propose four explanations for the lack of tunneling among foreign-owned banks in Colombia, relative to local banks.

First, foreign banks had transferred practices and technologies to their Colombian subsidiaries. *Banco Internacional* were still using Citibank's credit handbooks in 1981, six years after Colombianization. *Banco Mercantil* had a cooperation agreement with Credit Lyonnais that included "advice on banking techniques" and a program to "change the management of information systems within the bank" in 1979.[51] Insofar as these imported practices replaced discretion with rules, or facilitated the implementation of rules through better information, these practices may have reduced tunneling. This explanation is consistent with the literature's finding that foreign banks use design contracts and score credits to overcome their lack of familiarity with local institutions and firms (Dell 'Ariccia, Friedman, and Marquez, 1999; Stein, 2002; Sengupta, 2007; Beck, Ioannidou, and Schäfer, 2018). In fact, recent arrivals to the Colombian market performed poorly during the crisis (Table 11). The best performers had time to import banking practices, grow in the Colombian market, and build a diversified loan portfolio before *Colombianization* and the banking crisis kicked in.

Table 11. Performance of mixed banks during the crisis

Name since 1975	**Former owner**	**Year of arrival**	**Foreign ownership in 1982 (%)**	**Share of non-performing loans (1985)**	**ROA (%; 1985)**
Internacional	City Bank	1916	49	2	1.8
Sudameris	Sudameris	1920	39	2	1.2
Mercantil (Franco Colombiano)	Banque Nationale de Paris	1955	8	8	0.7
Anglo Colombiano	Banco de Londres y Montreal (Lloyds)	1922	49	3	1.7
Colombo Americano	Bank of America	1968	49	21	-4.0
Royal Colombiano	Royal Bank of Canada	1920	49	2	1.9
Real	Real do Brasil	1975	49	24	-1.2

Sources: assets and liabilities: balance sheets; arrival: Granados (2019a) and Bonin (2005, p. 197); ownership: Herrera (1983)

[51] Half-Yearly Report, *Banco Mercantil*, December 1979
Half-Yearly Report, *Banco Mercantil*, December 1980

Our second explanation is consistent with our proposed mechanism for the crisis: ownership was dispersed at mixed banks. After Colombianization, most foreign banks remained the largest shareholders, but their stake was less than 49% (Table 11). Hence, the largest shareholders had less decision-making power within foreign-owned banks than within the failed local banks.

The only mixed bank with concentrated ownership was *Banco Mercantil*, where a Colombian industrialist acquired a 55% stake in 1978 that grew to 92% in 1983.[52] The ratio of non-performing loans increased from 2% in 1979 to 10% in 1983. Facing financial difficulties himself, the industrialist was unable to inject capital to the bank. In response, the government waived the prohibition on foreign investments and acquisitions, under the condition that sale proceeds were used to pay for the industrialist's debts.[53] BCCI, an international bank, injected capital in exchange for equity, reaching a 44% stake in 1983.[54] In addition, the bank acquired the industrialist's stake in the bank by paying off his debts throughout 1984 and 1985. After acquiring the stocks of minoritarian stakeholders, BCCI reached a stake of 99.8% in 1985. [55] In 1988, the bank was indicted in Miami for money laundering for the Medellín Cartel.[56] In 1989, the Banking Superintendency fined the bank's management for violating banking and foreign exchange regulations.[57] Power concentration at *Banco Mercantil* is consistent with the bank's underperformance during the crisis, as well as the bank's connections with money laundering and the violation of regulations.

Third, mixed banks experienced lower gains from tunneling than local banks. Mixed banks were not part of local business groups that could use the public's deposits to fund company acquisitions within Colombia. Furthermore, due to capital controls, it would have been difficult to transfer the public's savings out of the country to acquire foreign companies. A similar mechanism explains the good performance of local housing-focused banking institutions during

[52] Banking Superintendency's Internal Memorandum, August 6, 1981. Also, Banking Superintendency's Memorandum 102 of 1983.
[53] 'Bcci Honed Bank-buying In South America'. The Washington Post, 1991/08/19
'BCCI transactions begin to unravel; Industrial Group Acquires Majority In Bogota Branch'. Latin American Weekly Report, LatinNews, 1991/08/29
'La gran lavandería'. Semana, 1991.
[54] Banking Superintendency's Internal Memorandum, September 15, 1992.
[55] Banking Superintendency's Internal Memorandum, September 15, 1992.
[56] 'BCCI Honed Bank-buying In South America'. The Washington Post, 1991/08/19
'Documents Link BCCI To Slain Medellin Cartel Leader'. The Washington Post, 1991/08/19
[57] Banking Superintendency's resolution 1318 of 1989.

the crisis.[58] Due to their regulations, these institutions could only make loans for building, developing, or acquiring housing.[59] Hence, they could not tunnel the resources of the public toward company acquisitions or towards sister companies not related to the construction sector. Therefore, these institutions performed much better than other financial institutions, including banks, during the crisis. In 1985, the share of non-performing loans for housing-focused institutions was lower than at the start of the crisis and 20 percentage points lower than for banks (Lora and Salazar, 1995).

Fourth, mixed banks were ex-ante less likely than local banks to receive a bailout in case of financial difficulties. A bailout from the foreign headquarters was unlikely, as foreign investment had been prohibited since 1975. The government only waved the foreign investment prohibition for *Banco Mercantil*, whose Colombian owner had a 92% shareholding in the bank and strong connections with the Colombian government.[60] For the remaining mixed banks, Colombian shareholders were a minority (Herrera, 1983).

6. Epilogue

Four of the five banks that had been nationalized throughout the 1980s were privatized during the 1990s: *Banco de los Trabajadores* and *Banco Tequendama* were sold to Venezuelan banks, whereas *Banco del Comercio* and *Banco de Colombia* were sold to Colombian financial groups (Ocampo J. A., 2015, p. 124). *Banco del Estado* was merged with another public bank that was later sold to a Colombian financial group in 2006.[61]

Restrictions on foreign investment in the banking sector were dropped in 1991. Law 9 of 1991 prohibited "discriminatory treatment against foreigners" and dropped the controls on foreign exchange flows that had been in place since 1967. Moreover, CONPES Resolution 40 of 1990 "authorized foreigners to invest in Colombian banks without any limit and dropped the restrictions that had forced foreign investors to share ownership of the banks with national

[58] In Spanish: *Corporaciones de Ahorro y Vivienda*
[59] Decree 678 of 1972
[60] 'BCCI Returns to Haunt Politician; Payments to Former Minister in Question: Other Links Hinted.' Latin American Weekly Report, LatinNews, 1991/11/14
[61] Final del Banestado (2000, June 30). *El Tiempo.*
Davivienda adquirió el Bancafé por 2 billones 207 mil millones de pesos (2006, October 11). *El Tiempo.*

investors" (Hommes, Montenegro, and Roda, 1994, pp. 56 and 65-66). Law 9 of 1991 effectively killed the policy of Colombianizing foreign-owned banks.

Five out of the seven Colombianized banks were reacquired by their former foreign owners (Barajas, Steiner, and Salazar, 2000). Other foreign banks entered the Colombian market throughout the 1990s and 2000s (Barajas, Steiner, and Salazar, 2000). Foreign ownership increased operational efficiency and competition in the banking sector during the financial liberalization period that bridged the crises of the 1980s and 1999 (Barajas, Steiner, and Salazar, 2000).

7. Conclusions

This paper studies the role of insider lending, loan concentration, and accounting fraud in the Colombian banking crisis of the 1980s. These practices allowed bank owners to tunnel resources from depositors, minority stakeholders, and eventually taxpayers. The effect of tunneling on bank performance was not salient while interest rates were low. When international interest rates rose and the price of coffee fell in the early 1980s, however, the effects of tunneling became evident: one bank was liquidated, and five banks were bailed out and nationalized by the government. Bank failure is mostly explained by non-performing loans that were highly concentrated on bank owners. By the end of the crisis, the government owned most of the banking system, as measured by assets.

A common denominator among failed banks was power concentration within banks and within business groups. Power concentration enabled tunneling. In addition, links with political power existed at half of the failed banks. Links with political power delayed government intervention and increased the ex-ante probability of a bailout. We provide evidence for these factors by comparing local failed banks with local surviving banks and former foreign banks. The evolution of regulation in response to the crisis is also consistent with our proposed mechanism.

Central to the banking crisis was the lax regulation on tunneling and related lending that applied in Colombia before 1982. Lax regulation still occurs in important financial markets of the 21st century, like cryptocurrency exchanges. Our results suggest the need for microprudential regulations that prevent accounting fraud, loan concentration, and the abuse of insider lending. These regulations are particularly important in preventing and alleviating banking crises.

Our results also suggest that the restrictions to foreign investment enacted in 1975 were detrimental to the Colombian banking system for two reasons: (i) they stalled the introduction of institutional practices that were successful during the crisis ahead and (ii) they obstructed the capitalization of the system after the crisis. In a context of lax regulations against tunneling and strong links between business groups, politicians, and regulators, the presence of foreign-owned banks in the local market has the potential to reduce systemic risk.

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Appendix. Failed banks: details and sources

Banco de Colombia

Colombia's largest bank, *Banco de Colombia*, was controlled by *Grupo Grancolombiano*, a business group controlling 168 companies, including five financial institutions.[62] *Grupo Grancolombiano* was in turn controlled by a holding, *Cingra*, which was controlled by a single person.

The bank's loan portfolio was concentrated on companies belonging to its own group: a lower bound of 16% at the Colombian headquarters and 25% at the Panama subsidiary in 1983.

[62] Our main source about *Banco de Colombia* is a regulator's report based on information gathered after the government seized the bank in 1983: 'La Comisión Nacional de Valores y sus actuaciones frente al Grupo Grancolombiano'. Comision Nacional de Valores, 1986, p. 199-276. Unreferenced statements about *Banco de Colombia* in this appendix are based on this report.

Furthermore, the companies of the group were heavily indebted to the bank: loans from the bank to the group amounted to 2.3 times the consolidated equity of the group. It was common for loans to fund company acquisitions, including the acquisition of shares of the bank itself by companies of the same business group. Debt service on these loans was a major source of losses for the real sector companies of the group. The group avoided regulatory constraints by interlocking ownership among dozens of companies, many created for the sole purpose of blurring property relations from the point of view of regulators.

In addition, the bank used its Panama subsidiary to borrow foreign exchange to bail out investment funds managed by its business group in Colombia (Caballero-Argaez, 1988), a practice that infringed foreign exchange regulations (Caballero-Argaez, 1988). Other companies of the group received large loans from the subsidiary: by 1983, half of the group's debt with the bank had been obtained through the subsidiary in Panama. When international conditions deteriorated and the Colombian peso depreciated, the subsidiary of *Banco de Colombia* in Panama had larger losses than the subsidiaries of other Colombian banks in Panama (Caballero-Argaez, 1988).

When international banks closed their credit lines to the Panama subsidiary in 1983, the subsidiary became illiquid. In response, the Colombian headquarters borrowed directly from international banks and deposited the money in the subsidiary, which allowed the subsidiary to service its liabilities (31% of the deposit) and extend further loans to the group's companies (69% of the deposit). 97% of this foreign debt was short-term, due in 1984. By 1985, 51% of the bank's liabilities were denominated in foreign exchange.

The financial statements of the bank's headquarters omitted the international loan from 1983. This omission was not an isolated case. In the official statements, non-performing assets amounted to 15% of total assets in 1983. As regulators discovered after the government took over in 1983, in reality, non-performing assets amounted to 42% of total assets. 50% of non-performing assets were due to companies in *Grupo Grancolombiano*.[63] By 1985, 70% of the group's debt with the bank was considered by regulators to be nonrecoverable.

[63] 25% was owed by IDEMA, a public institution whose debt was paid in full by the government in 1985.

The bank had strong links with the government: the president of the bank and the president of Colombia between 1974 and 1978 were cousins, and the superintendent of companies was the son of an important director at *Grupo Grancolombiano* (Echavarría, 1983, pp. 245-270). Regulators had detected unsound practices within *Grupo Grancolombiano* since 1980, but the government prevented regulators from informing the public (Echavarría, 1983, pp. 5-34, 245-270). Regulators waited until 1983, when liquidity problems became evident, to take control of the bank. In 1986, the government bailed out and nationalized the bank. In the 1990s, the president and main shareholder of the bank was sentenced to prison for contravening regulations against related lending, loan concentration, and the use of deposits for company acquisitions.[64]

Banco Nacional

The first bank to fail, *Banco Nacional*, was owned by *Grupo Colombia* since 1978 (Donadio, 1983, p. 46). *Grupo Colombia* controlled 60 financial and industrial firms (Donadio, 1983, p. 18). Three firms were at the core of the group: *Banco Nacional*, a bank, *Financiera Furatena*, a financial company, and *Correa Acevedo*, a company that had no legal permission to accept deposits from the public—but did so anyway. Thousands of depositors believed that they were depositing their money at *Financiera Furatena*, but their funds got funneled towards *Correa Acevedo* instead (Donadio, 1983, p. 19). Given that *Correa Acevedo* had no legal permission to accept deposits, it was not under the supervision of financial regulators. Hence, it took time for financial regulators to uncover *Correa Acevedo's* scheme of using depositors' money for company's acquisitions (Donadio, 1983, p. 19). It was not until 1981 that the high concentration of loans from *Banco Nacional* to *Correa Acevedo* alerted officials to audit the bank (Donadio, 1983, p. 20).

Between 1978 and 1982, *Banco Nacional* concentrated its loan portfolio on the owners and companies of *Grupo Colombia* (Donadio, 1983, pp. 39-64). In turn, the companies made loans to their owners and their families, who used the loans to acquire other companies (Donadio,

[64] The main crime was "undue concentration of loans." Decisión sobre recurso de casación. Delito: Concentración indebida de créditos. *Supreme Court, Sala de Casación Penal*, radicado 6114, MP: Jorge Carreño Luengas. 1992.
51 meses de cárcel a Michelsen (1990, September 27). *El Tiempo*.
Ayer, segunda condena en contra de Michelsen Uribe (1992, September 9). *El Tiempo*
Donadio (1984, págs. 20, 65)

1983, p. 50). In some cases, the owners pledged assets that did not exist as collateral for the loans received (Donadio, 1983, p. 35). It was complicated for financial regulators to discover these transactions because the loans were often made in the name of other people. Sometimes, the debtors were unaware of the loans taken out in their name–-an example of identity fraud (Donadio, 1983, p. 33).

In 1981, *Banco Nacional* began to face financial difficulties when the companies and owners of *Grupo Colombia* started to default on their debts. According to regulators' reports, financial difficulties were "mainly and almost exclusively" due to "loan concentration on companies belonging to the *Colombia* and *Correa Acevedo* groups, their main shareholders, and their families." [65] Furthermore, these loans were "highly and increasingly non-performing." Nevertheless, the bank continued lending money to the same companies and owners (Donadio, 1983, p. 56). Regulator audits in 1982 revealed that non-performing loans from the *Colombia* group alone represented at least 15% of total loans. Furthermore, non-performing loans across all borrowers were 46% of total loans in 1981—much higher than the 3% implied by the bank's official statements.[66]

When the fraud at *Financiera Furatena* was discovered in June 1982, the public initiated a bank run on *Banco Nacional* (Donadio, 1983, p. 39). The bank's run forced the nationalization and liquidation of the bank that same year.[67] The president of *Banco Nacional* was eventually sentenced to six years in prison for fraud.[68]

Banco del Estado

A regional bank founded in 1884, *Banco del Estado* had been private since 1958 (Castrillón, 1983, pp. 15, 45). By 1976, a coalition of shareholders, led by Jaime Mosquera, owned 40% of the bank (Castrillón, 1983, p. 56). Mosquera became president of the bank in 1978, the same year that the bank launched a public offering of new shares. Mosquera used a loan from the

[65] Explanatory memorandum for Resolución 3259 de 1982, Banking Superintendency.
[66] Own calculations from balance sheets and the explanatory memorandum for Resolución 3259 de 1982, Banking Superintendency.

[67] Resolución 3259 de 1982, Banking Superintendency
[68] Condena por crisis financiera de 1982 (1996, June 20). *El Tiempo*. In the Colombian Penal Code, fraud is defined as benefiting from deceiving another person to the detriment of that person.

bank to buy 74% of the new shares, giving him full control of the bank (Castrillón, 1983, pp. 61-63; Donadio, 1983, p. 70).[69] Next, Mosquera founded 25 companies that took out large loans with the bank (Castrillón, 1983, p. 65).

Between 1978 and 1982, *Banco del Estado* did not comply with reserve requirements, underestimated unperforming loans, made illegally large loans to Mosquera, concentrated loans on shareholders, made loans for company acquisitions, and made loans to employees of the Banking Superintendency—the regulatory agency for banks.[70]

In August 1982, journalists discovered that the loan for the public offering had been obtained through identity fraud (Donadio, 1983, pp. 65-79). This discovery induced a bank run that forced the bailout and nationalization of the bank in October 1982.[71] Jaime Mosquera was sentenced to four years of prison in 1996 for fraud.[72]

Jaime Mosquera likely learned his modus operandi while working for Unibank, a Panamanian bank owned by World Finance Corporation, an American financial group. He was president of Unibank between 1973 and 1977. Unibank acquired 20% of *Banco del Estado* in 1973, a stake that Unibank sold to Mosquera in 1977 (Donadio, 1983, p. 83). Later, in 1977, the Panamanian banking commissioner took control of Unibank in response to large financial losses.[73] Unibank borrowed from investors and other banks in the U.S. and the United Arab Emirates and made loans in South America. However, the loan repayments never entered Unibank's books but were instead laundered into bank accounts of World Finance Corporation, its companies, and its owner.[74] World Finance Corporation was liquidated after a federal investigation in the U.S. revealed these irregularities in 1978.

Banco de los Trabajadores

[69] The transaction was part of a public offering of new shares.
[70] Sentencia 1443 del Consejo de Estado, 1995
Executive resolution 203 of 1982.
[71] Resolution 5387 of 1982
Executive resolution 203 of 1982.
[72] Condena por crisis financiera de 1982 (1996, June 20). *El Tiempo*. In the Colombian Penal Code, fraud is defined as benefiting from deceiving another person to the detriment of that person.
[73] First National Finds Venture in Panama Less than Success. (1978, January 15). *The Courier-Journal.*
[74] Arab Sheiks sue Exile over 37 million. (1978, March 8). *The Miami Herald.*
Fortune Built on paper, Telex. (1980, May 11). *The Miami Herald.*
U.S. Readies Indictment on Bank Scam Charges. (1980, May 11). *The Miami Herald.*

Founded by labor unions and cooperatives in 1974, *Banco de los Trabajadores* was eventually acquired by the Cali Cartel.[75] The leader of the Cali Cartel, Gilberto Rodríguez Orejuela, owned 67% of the bank and was part of its board of directors by 1980.[76] In addition to the bank, the Cali Cartel owned multiple financial companies in Colombia, an automotive parts distributor, a chain of drugstores, a radio network, an educational institution, a football team, and a bank in Panama.[77] The bank in Panama, used to launder money from narcotics sales, was seized by the Panamanian Banking Commission in 1985.[78]

In 1980, Rodríguez Orejuela sold *Banco de los Trabajadores* to real estate developer, government contractor, and politician Rafael Forero (Rodríguez Olarte, 2013). The new owner used the bank to make large loans to their companies.[79] By 1985, 34% of assets were non-performing according to official financial statements, but the actual ratio was 46%—the bank had underestimated nonperforming loans through transactions with other companies owned by Forero.[80] According to regulators, the non-performing loans were the result of bad risk assessments and loan concentration on Forero and other shareholders.[81] As the bank was becoming insolvent, the government bailed out and nationalized the bank in 1986.[82] Forero was sent to prison in the 1990s for an election crime not related to his banking activities (Rodríguez Olarte, 2013).

Banco Tequendama

Founded by Colombian and Venezuelan investors in 1976, *Banco Tequendama* was part of a financial group specialized in insurance services: the *Tequendama* Group. Colombians owned

[75] Por $ 3.225 Millones Se Vendió Bantrabajadores. (1991, August 31). *El Tiempo.*
[76] Nexos de 'narco' y un rector. (2008, January 22). *El Espectador.*
Banco de los Trabajadores. Annual Report. 1980.
[77] El Diario Oculto de Alberto Giraldo. (1995, June 4). *El Espectador.*
Nexos de 'narco' y un rector. (2008, January 22). *El Espectador.*
Así influyó el cartel de Cali de los Rodríguez Orejuela en el fútbol colombiano (2022, June 1). *El Espectador.*
[78] El Rodríguez Modelo 83. (2008, January 22). *Semana*
Colombians' bank seized by Panama. (1985, March 13) *The Miami Herald*
U.S. Freezes Colombian Bank's Accounts. (1985, April 5) *The Miami Herald*
[79] Letter DAB-0780 from the Banking Superintendency's first delegate to the director of FOGAFIN. 1986/17/03.
Por $ 3.225 Millones Se Vendió Bantrabajadores. (1991, August 31). *El Tiempo.*
[80] Letter DAB-0780 from the Banking Superintendency's first delegate to the director of FOGAFIN. 1986/17/03.
[81] Letter DAB-0780 from the Banking Superintendency's first delegate to the director of FOGAFIN. 1986/17/03.
[82] Resolución 12 de 1986, FOGAFIN.
A Subasta, El Banco de los Trabajadores. (1991, June 5). *El Tiempo.*

52% of the bank.[83] The bank's headquarters as well as nine of the ten branches were in Colombia.[84] The bank also had a subsidiary in Curaçao.[85]

The bank's loan portfolio was heavily concentrated on the *Tequendama* group's shareholders, especially the *Kassin* Group—a Colombian business group that produced textiles, auto parts, and automobiles.[86] The *Kassin* Group experienced financial difficulties throughout the 1980s, weakening the bank's loan portfolio.[87] In 1984, the group capitalized the bank through loans rediscounted by the central bank—an indirect bailout by the central bank (Misas, 1987).

By 1985, given that 34% of the bank's loan portfolio was non-performing, the bank regulator ordered an increase in stockholder equity.[88] The stockholders did not comply. As a result, the government nationalized and bailed out the bank in 1986. By that year, 88% of the loan portfolio was non-performing, 71% of which was not backed by collateral. For the subsidiary in Curaçao, 61% of the loan portfolio was not performing due to loans to the Venezuelan shareholders of the bank.

After nationalizing the bank, the Colombian government found that "the Venezuelan branches had been sacked; there were no ledgers nor promissory notes."[89] Regulators also found that the bank's financial statements had overestimated profits and omitted loans from international

[83] *Banco Tequendama*, Annual Report, 1979.
Recupérase el hemisferio. (1976, May 30). *El Miami Herald.*

[84] *Banco Tequendama*, Annual Report, 1979.

[85] Letter DAB-0570 from the Banking Superintendency's first delegate to the director of FOGAFIN. 1986/06/03.

[86] Letter DAB-0570 from the Banking Superintendency's first delegate to the director of FOGAFIN. 1986/06/03.
Informe de Labores. Banking Superintendency, 1987, p. 88.
Banco Tequendama. Annual Reports, 1980 and 1982.

[87] Informe de Labores. Banking Superintendency, 1987, p. 88.
Colombia: Fiat sale may have hidden component (1982, August 27). *LatinNews.*
Los bancos aceptan el reto japonés (1986, June 15). Semana
¿Solución Salomónica? (1986, July 27). Semana
No a los Kassin (1987, July 13). Semana
Superintendencia de Sociedades (2012, pág. 26)

[88] The sources for this paragraph are:
Informe de Labores. Banking Superintendency, 1987, p. 86-88.
Letter DAB-0570 from the Banking Superintendency's first delegate to the director of FOGAFIN. 1986/06/03.

[89] Statement by the chair of FOGAFIN during a debate in the House of Representatives, August 10-30, 1988, cited by Child and Arango (1988, p. 267).

banks.[90] These loans were prohibited by foreign exchange regulations, which the bank had also infringed by taking deposits in Curaçao.[91]

Banco del Comercio

Founded in 1948 by the National Merchants Guild, the bank remained fully in Colombian hands until 1967, when Chase acquired a 35% stake (Herrera, 1983; Granados, 2019). Another 36% belonged to three companies whose shareholders were almost identical—five were shareholders of the three companies, four were shareholders of two companies, and one was shareholder of one company (Herrera, 1983). The only representative of Chase on the bank's board was also a shareholder in the three companies.

The bank began making loans to board members and their companies since at least 1979.[92] In 1982, these loans amounted to 300% of equity, had subsidized rates, and were often not backed by adequate collateral.[93] Furthermore, the bank used accounting tricks to overestimate its income from non-performing loans.[94] In addition, the bank overreported the quality of its loan portfolio.[95]

In 1982, a Chase employee denounced that the loan portfolio of *Banco del Comercio* was concentrated on its own shareholders and board members, including the Chase representative on the board (Donadio, 1983, pp. 128-129; Lernoux, 1984, pp.. 138-139). The same employee also revealed that some loans were approved in exchange for bribes. Furthermore, he revealed that the Chase representative on the board: (i) made a proposal to over-report expenses and split the difference with the employee and (ii) tried to bribe him in exchange for not reporting his findings to Chase headquarters in New York.[96] The whistleblower, a Chase employee since 1974, was fired, and Chase did not change its representative on the board. A Colombian

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[90] Letter DAB-0570 from the Banking Superintendency's first delegate to the director of FOGAFIN. 1986/06/03.
[91] Table 5 and Letter DAB-0570 from the Banking Superintendency's first delegate to the director of FOGAFIN. 1986/06/03.
[92] Statement by the chair of FOGAFIN during a debate in the House of Representatives, August 17, 1988. Cited by Ordoñez (1989, págs. 27, 99)
[93] Report to the banking superintendent by a subordinate, November 24, 1982. Transcribed in Ordoñez (1989, pág. 45).
[94] Statement by the chair of FOGAFIN during a debate in the House of Representatives, August 17, 1988. Cited by Ordoñez (1989, pág. 94)
[95] Informe de Labores. Banking Superintendency, 1987, p. 85
[96] Autopréstamos en Banco del Comercio revela publicación en EE.UU. (1982, October 4). *El Tiempo*

congressman later denounced that the family of the Chase representative owned stakes in companies that in turn owned *Banco del Comercio* shares and received loans from *Banco del Comercio* (Ordoñez, 1989, pp.. 25-26). The Chase representative became the president of *Banco del Comercio* in 1984.[97] The regulator eventually fined the Chase representative for approving larger and riskier loans than regulations allowed.[98]

By 1986, 18% of the loan portfolio of the bank was non-performing.[99] In 1987, the government proposed a relief program in which the government would purchase toxic assets from the bank through a repurchase agreement expiring five years later.[100] This relief program was not proposed to other banks with financial problems during the crisis. A plausible explanation for this special treatment is that a shareholder and former board member held a high position within the Colombian government at that time. Pressure from the press and the Colombian congress prevented the relief program from being implemented. In consequence, the bank regulator ordered an increase in stockholder equity, with which the shareholders did not comply.[101] The government bailed out and nationalized the bank in 1987.

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[101] Informe de Labores. Banking Superintendency, 1987, p. 85

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