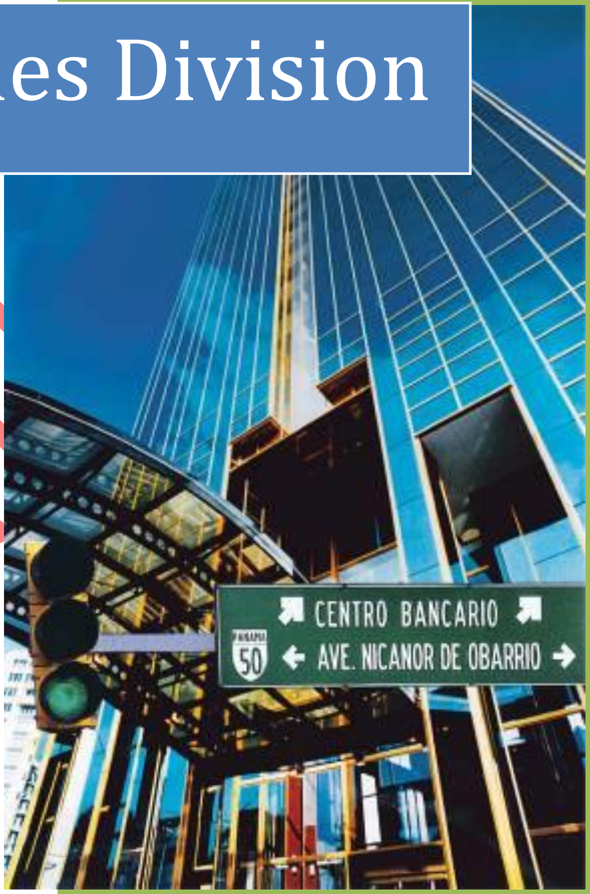
Superintendencia de Bancos de Panamá

Financial Studies Division



Banking Activity Report

NOVEMBER 2016

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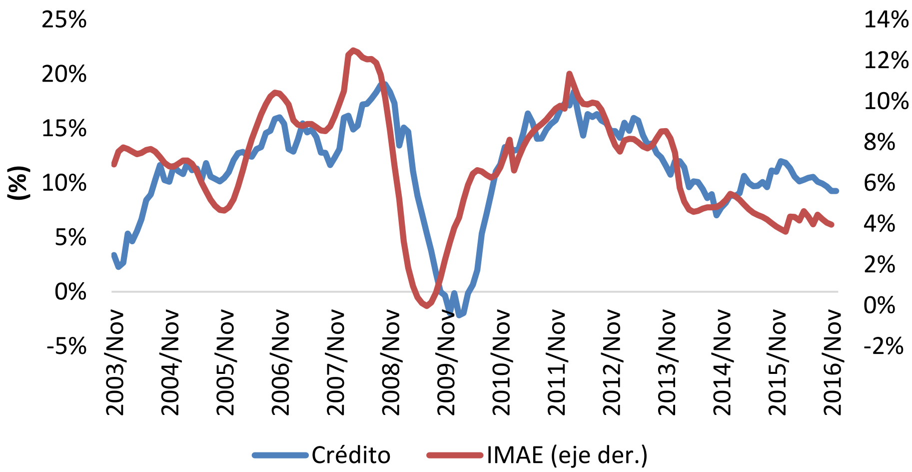
I. Economic Environment

A. Monthly Indicator of Economic Activity (MIEA)

The recently updated Monthly Indicator of Economic Activity (MIEA)[1], estimated by the Comptroller General, showed a range of activities that grew 4.4% compared to the same period in 2015.

As we will see below, the domestic loan portfolio has continued to grow this year along the lines expected by economic agents. As of November 2016, the domestic loan portfolio recorded a 9.3% increase on annual basis.

Chart 1: Loan and economic activity growh
November 2003 - November 2016



Source: SBP with NISC data.
* In both cases, data corresponds to the monthly variation over the same month in the previous year. The MIEA corresponds to the component of the cycle.

Similarly, we observe that bank deposits continue to grow, which generally reflects adequate economic performance. This is important because deposits still represent the main source of resources for financial intermediation and its growth shows user trust in the stability and soundness of the Financial System.

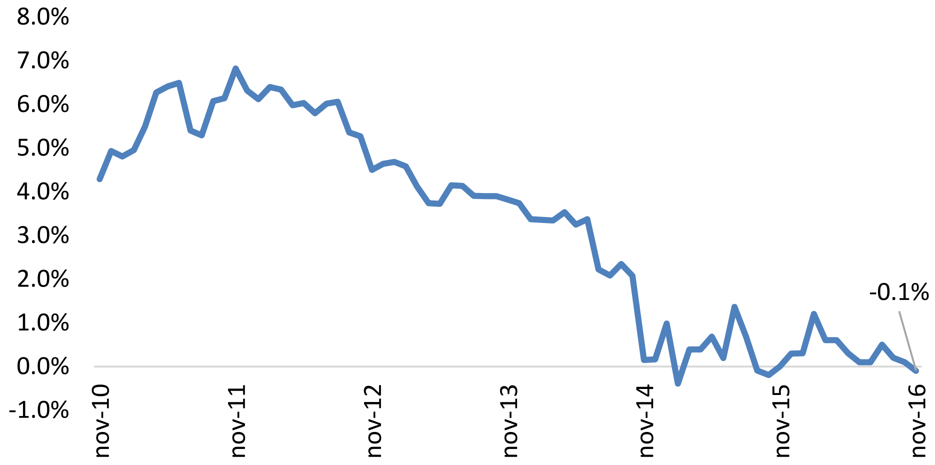
Regarding economic performance, financial intermediation maintained a favorable position both in banking and insurance, with the latter capturing a higher volume of underwritten premiums.

[1] NISC's most recent available data runs through October 2016.

B. Consumer Price Index (CPI)

As of November 2016, Panama's consumer price index registered a -0.1% decrease. The CPI components linked to domestic demand are still stable. Inflation in meals outside the home and non-tradeable goods showed slight increase, suggesting there is no excess demand in the economy.

Chart 2: Inflation
November 2010 - November 2016

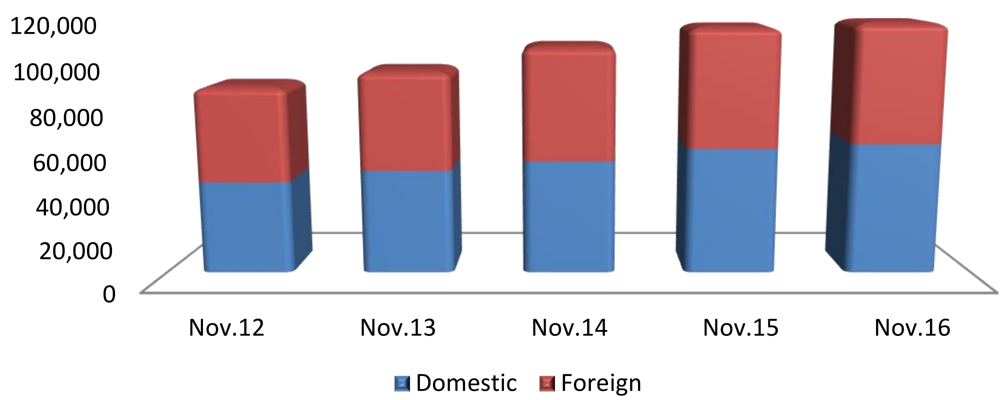


Source: SBP with NISC data.

II. Performance of the International Banking Center

Banking operations still show positive activity, characterized by the sustained growth of the domestic portfolio and domestic collections, despite the international environment. As for the financial soundness indicators, the IBC maintains liquidity and solvency ratios well above the minimum required by law. At the same time, the access to banking and quality of portfolio ratios are higher than regional ratios; for example, access to banking measured by Loans/GDP and Deposits/GDP surpasses 90%.

Chart 3: Assets Distribution
November 2012 - November 2016



A. Balance Sheet and Income Statement

The IBC ended November 2016 with assets totaling US$119.28 billion, a 1.8% increase over November 2015. For this period, the asset with the highest growth was the loan portfolio with 3.2%. For liabilities, deposits ended at US$84.55 billion, a 1.6% increase over the same period in 2015. It is worth noting that obligations grew by 1.8% through November 2016, equivalent to US$325 million.

Table 1: International Banking Center
Balance Sheet
(in millions of US$)

International Banking Center	2015	2016	November Var. 16 / 15	
	November	November	Absolute	%
Liquid assets	20,938	20,784	-154	-0.7%
Loan portfolio	72,482	74,778	2,296	3.2%
Securities investment	19,474	19,936	462	2.4%
Other assets	4,325	3,777	-548	-12.7%
Total Assets	117,219	119,276	2,057	1.8%
Deposits	83,241	84,548	1,307	1.6%
Obligations	17,803	18,128	325	1.8%
Other liabilities	3,808	3,011	-797	-20.9%
Equity	12,367	13,588	1,221	9.9%

Source: General and international license banks.

Analyzing the balance sheet of the National Banking System (general license banks only), total assets for November 2016 reached US$99.53 billion, a 1.9% increase over November 2015. Asset growth was mainly the result of the Loan portfolio (4.3%). The overall loan portfolio increased by US$2.69 billion, driven by a **9.3% growth in domestic loans**. On the liabilities side, total deposits ended at US$72.50 billion, a 2.1% increase. As of November 2016, obligations increased 3.1% over November 2015, equivalent to US$403 million.

Table 2: National Banking System
Balance Sheet
(in millions of US$)

Banking System	2015	2016	November Var. 16 / 15	
	November	November	Absolute	%
Liquid assets	16,081	15,358	-723	-4.5%
Loan portfolio	61,712	64,394	2,682	4.3%
Securities investment	15,941	16,391	450	2.8%
Other assets	3,943	3,381	-562	-14.3%
Total Assets	97,677	99,524	1,847	1.9%
Deposits	71,022	72,497	1,475	2.1%
Obligations	13,136	13,539	403	3.1%
Other liabilities	3,582	2,726	-856	-23.9%
Equity	9,936	10,761	825	8.3%

Source: General license banks

The International Banking Center registered accrued profits of US1.50 billion through November 2016. The results of the banking system during this period were stable and supported by recurrent operating income due to acceptable margins, controlled quality of assets and coherent loan growth.

Table 3: International Banking Center
Income Statement
(in millions of US$)

Banking Center	2015	2016	Difference 16/15	
	Jan. – Nov.	Jan. – Nov.	Absolute	%
Net interest income	2,140	2,309	169	7.9%
Other income	1,828	1,973	145	7.9%
Operating income	3,968	4,282	314	7.9%
General expenses	2,275	2,422	147	6.5%
Profit before provisions	1,693	1,860	166	9.8%
Provisions for bad debt	236	401	164	69.4%
Profit for the period	1,457	1,459	2	0.2%

Source: General and international license banks.

Analyzing the results of the National Banking System (general license banks only), the accrued portfolio for November 2016 reached US$1.19 billion. That figure came from net interest income of US$2.1 billion (a 6.9% increase) and other income of US$1.69 billion (a 12.0% increase), aided by a policy of diversification of income-generating products and services.

Table 4: National Banking System
Income Statement
(in millions of US$)

Banking Center	2015	2016	Variation 16/15	
	Jan. – Nov.	Jan. – Nov.	Absolute	%
Net interest income	1,955	2,091	136	6.9%
Other income	1,508	1,689	181	12.0%
Operating income	3,463	3,780	317	9.2%
General expenses	2,031	2,224	193	9.5%
Profit before provisions	1,433	1,556	124	8.6%
Provisions for bad debt	210	375	165	78.5%
Profit for the period	1,222	1,181	-41	-3.4%

Source: General license banks.

It is worth mentioning that on the expenses side, an increase was noted in provisions for bad debts in the loan portfolio. These are created when there is deterioration in these operations. Although provisions affect profits on the income statement, from a prudential point of view, this is a best practice for banks because it strengthens their financial condition.

B. Loans

The National Banking System loan portfolio grew 4.5% but **the increase was 9.3% if the domestic portfolio alone is considered**. As of November 2016, loans to the private sector grew by 9.7% compared to November 2015. On the other hand, foreign loans of the banking system retreated — which is a sign of prudence by banks, considering the complex, uncertain external environment.

Table 5: National Banking System
Domestic loan portfolio by sector and activity
(in millions of US$)

Description	2015		2016	Absolute Var. 16/15	Difference %
	November	December	November (P)		
TOTAL	44,432	45,136	48,584	4,152	9.3%
Public sector	978	1,224	923	-55	-5.6%
Private sector	43,454	43,912	47,661	4,207	9.7%
Finance and insurance companies	1,132	1,246	1,271	139	12.3%
Agriculture	389	395	412	23	5.8%
Livestock	1,075	1,087	1,179	104	9.7%
Fishing	109	108	88	-21	-19.6%
Mining and quarrying	53	49	42	-11	-20.8%
Commerce	11,679	11,473	11,266	-413	-3.5%
Industry	2,001	2,096	2,454	453	22.6%
Mortgages	13,039	13,162	14,658	1,619	12.4%
Construction	5,172	5,286	6,148	976	18.9%
Consumption	8,805	9,009	10,144	1,339	15.2%

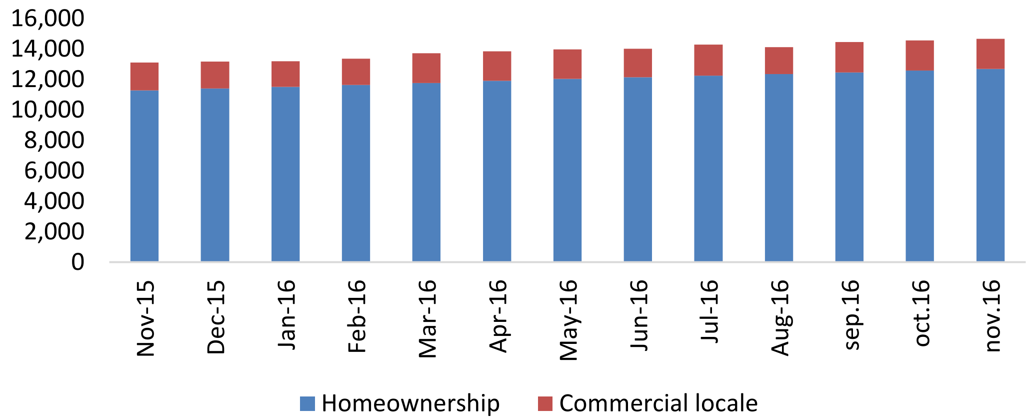
Source: General license banks.

The activity having the greatest increase in absolute value during November 2016, compared to November 2015, was mortgages at US$1.62 billion, followed by consumption at US$1.34 billion and construction with US$976 million. These were the most significant activities.

1. Mortgage Portfolio

For banking, mortgages are still one of the loans with rising demand. This is shown by their 12.4% increase in November 2016. For the period analyzed, mortgages granted totaled US$14.66 billion, a US$1.62 billion increase compared to the same period in 2015.

Chart 4: Balance of Mortgages - NBS
November 2015 - November 2016
(in millions of US$)



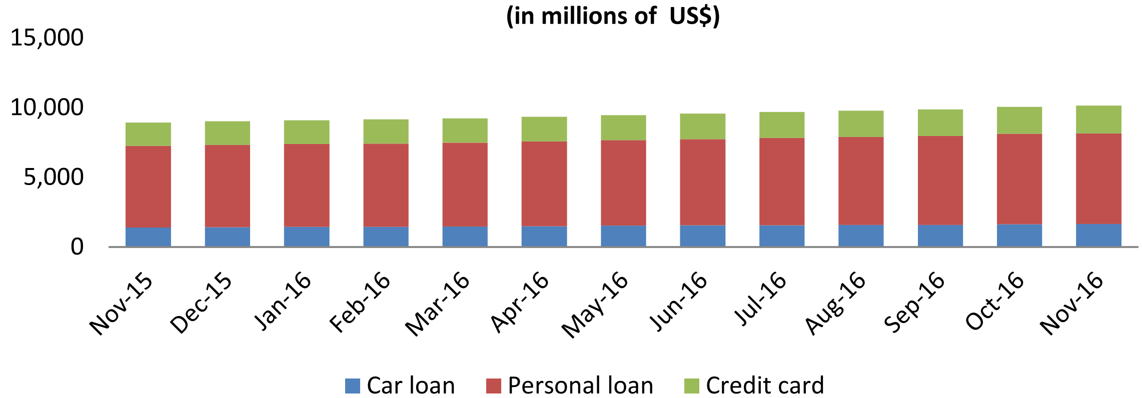
Regarding composition, this sector also had an important place in debt distribution within the Banking System. Mortgages, which have a 30% share, are in first place, followed by commercial loans (23%) and personal consumption loans (21%).

The improvement of conditions for residential mortgages in recent years has been the principal promoter of housing. For commercial banking, lower interest rates and higher average terms have increased the purchasing power of families. It is estimated that the demand for mortgages could remain strong due to increasing housing demand and greater loan access in a framework of sustained growth.

2. Personal Consumption Portfolio

By type of loans, consumption loans continued growing at a sustained pace of 15.2%. One of the most dynamic sectors was car loans which grew 17.5% in November 2016 compared to the same period in the previous year. Similarly, credit cards were also significant, growing 19.3%.

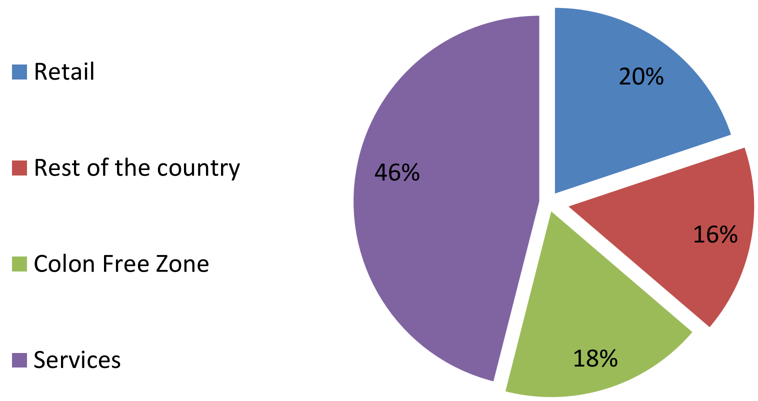
Chart 5: Balance of Consumption - NBS
November 2015 - November 2016
(in millions of US$)



3. Commercial Portfolio

Loans granted to the commercial sector decreased 4.4% due to decreases in Colon Free Zone (CFZ) trading activity, which directly affects commercial loans. It is worth noting that CFZ loans have been shrinking and represent a small percentage of this portfolio.

Chart 6: Balance of Commercial Loans - NBS
November 2016
(Ein millions of US$)

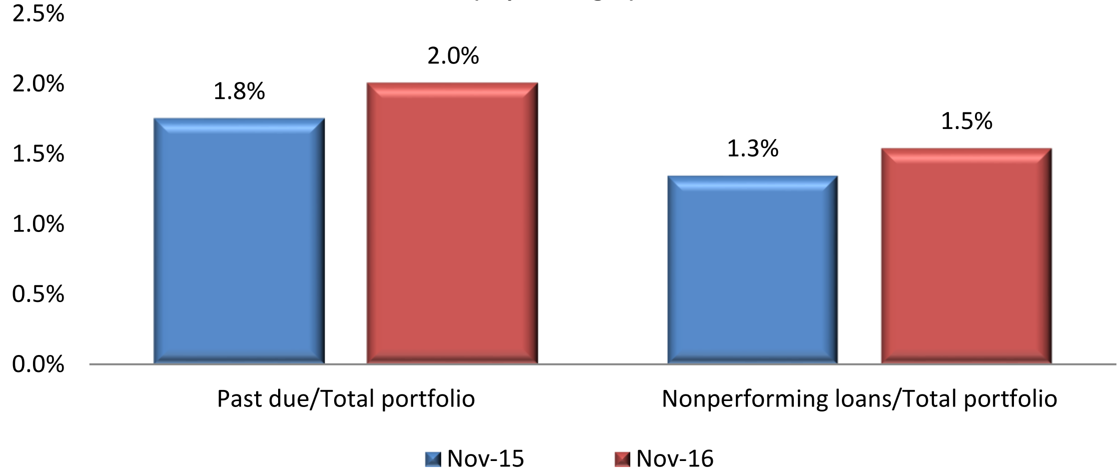


Colon Free Zone portfolio behavior is directly related to the downward trend of international trading in countries such as Venezuela and Colombia, which were traditionally the most important clients for the Colon-based free zone.

Portfolio Quality

As for the quality of the domestic loan portfolio, the past due portfolio was 2.0% of the total domestic portfolio, while nonperforming loans represented 1.5% of total domestic portfolio. the sum of the past due and nonperforming loans represented 3.5% of the portfolio as of November 2016.

Chart 7: National Banking System
Quality of domestic loan portfolio
(in percentges)



Source: General license banks.

Despite an increase in nonperforming loans, all portfolios (with the exception of consumption loans) are backed by provisions and collateral covering 100% of the portfolio.

It is worth noting that the regulatory framework for prudential measures for mitigating credit risk has been strengthened recently. In that sense, data through November 2016 showed an increase in specific provisions for the different risk categories (**Rule 4-2013**).

The cited Rule requires the creation of provisions to cover the possibility of the bank incurring losses decreasing its asset value, if debtors were to fail to comply on time or fully with the terms of the loan agreements. As of November 2016 and under this rule, the provisions were at US$546 million which is more than that required under the parameters of the previous rule (**Rule 6-2000**).

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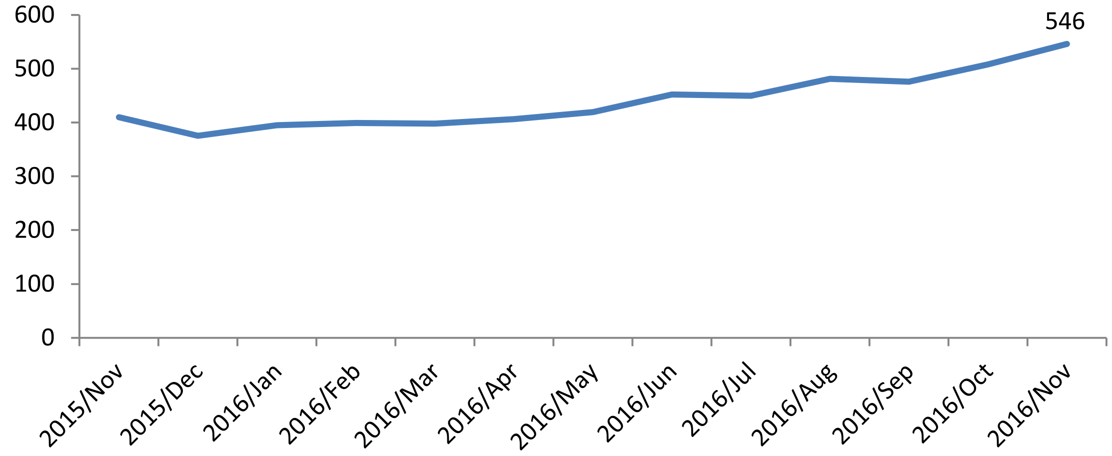
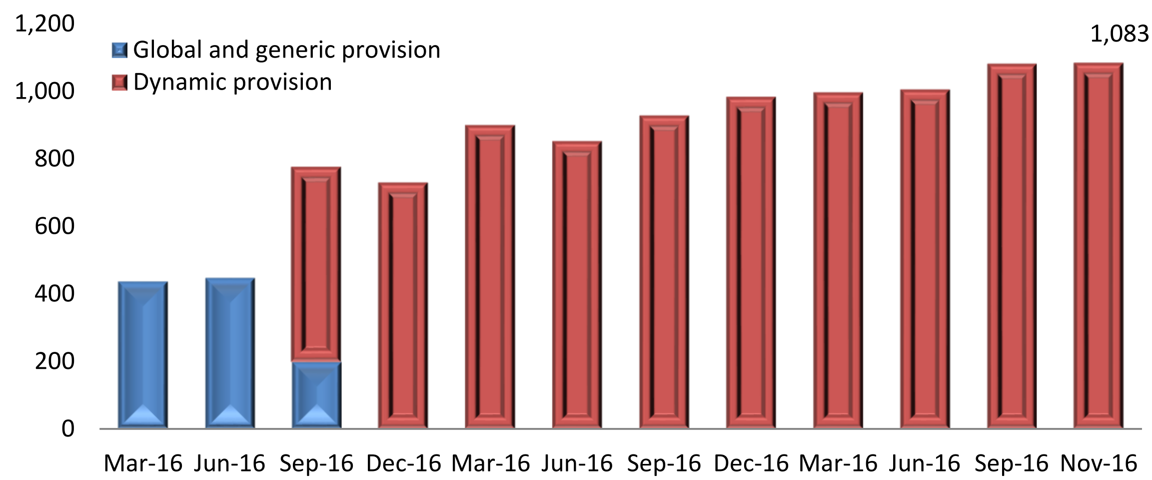
Chart 8: NBS Provisions
November 2015 - November 2016



Source: General license banks.

This year, on the other hand, dynamic provisions were created for all loans lacking an assigned specific provision under the prudential criteria provided by the Basel Committee on Banking Supervision; i.e. on loans classified as Normal. This bank reserve registered US1.09 billion as of November 2016.

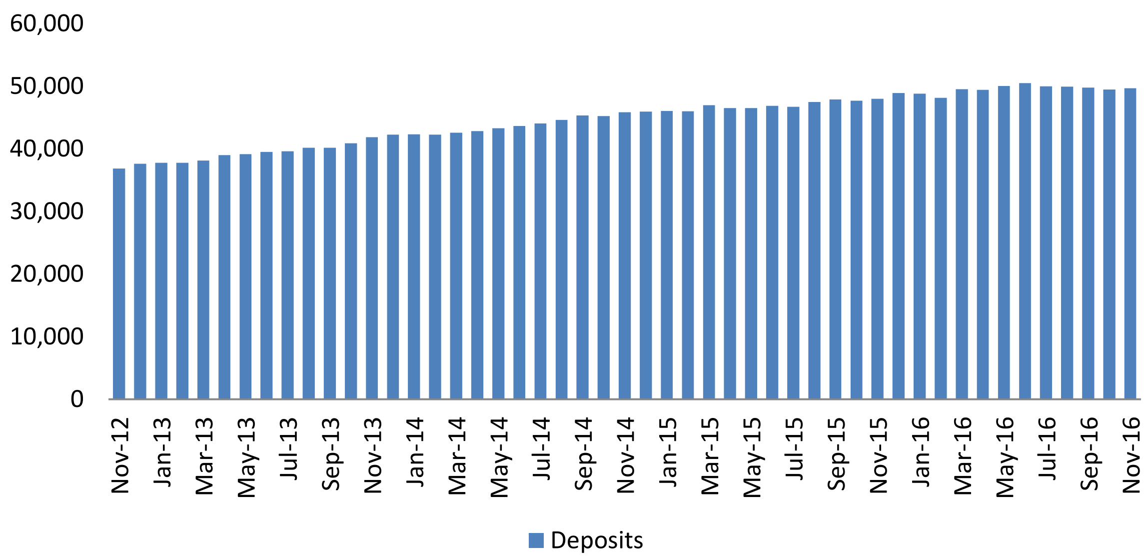
Chart 9: Provisions



C. Deposits

Domestic deposits represent 68.5% of the total deposits in the National Banking System. The chart below shows the progression of domestic deposits and its annual variation. It is worth noting that domestic deposits maintain a positive trend of 3.5%.

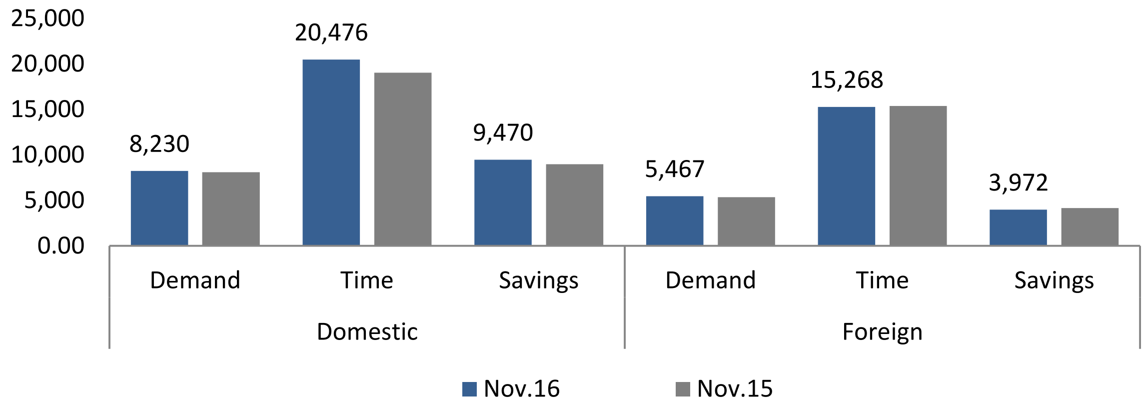
Chart 10: National Banking System
Total domestic and foreign deposits and annual variation
(in millions of US$ and percentages)



Source: General license bank

For November 2016, domestic private deposits consisted of US$8.23 billion in demand deposits, US$20.48 billion in time deposits, and US$9.47 billion in savings deposits.

Chart 11: International Banking Center
Private Deposits
(in millions of US$)



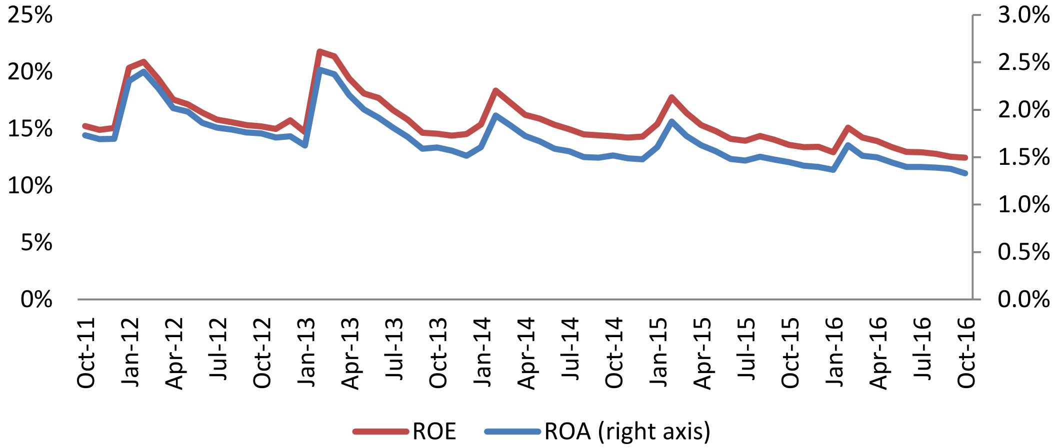
Source: General and international license banks.

The growth of domestic allocations showed an upward trend of 3.5%. Deposits reported increases in an environment of a growing domestic economy, which translates into greater income and an increase in monetary surpluses (especially in the short term) for economic agents, who appear to prefer banks due to the financial and legal stability of the Panamanian banking system. The increase observed in deposits can also be explained by the campaigns launched by banks to bring in those individual and company surpluses to cover the bank's loans.

D. Indicators

The Return on Assets (ROA) for the International Banking Center registered 1.4% for 2016, while the same indicator for the National Banking System (general license banks only) registered 1.31%. These indicators are consistent with the growth of profits and assets.

Chart 12: Profitability Indicators
November 2010 - November 2016



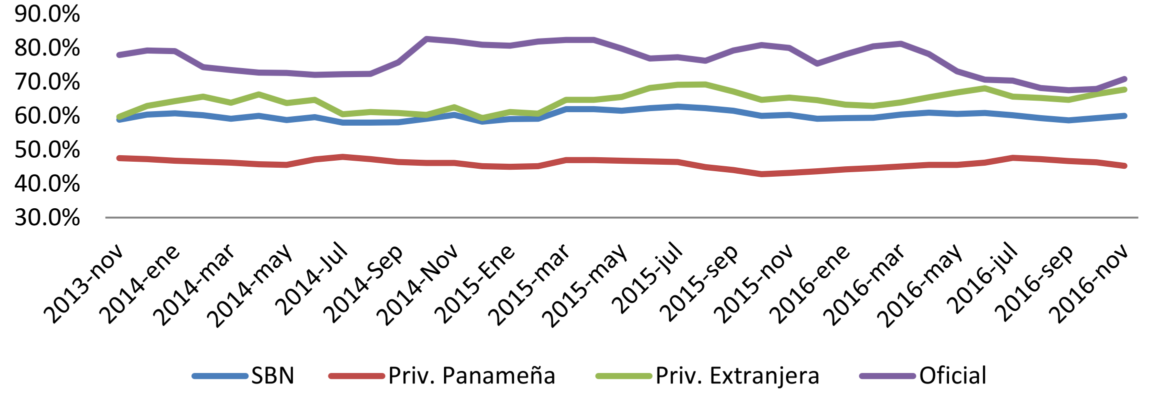
Source: General and international license banks.

The banking business registered good equity profitability. The ROE — which measures the return to shareholders for each dollar invested in the International Banking Center — registered 12.3% through November 2016, while the indicator registered 12.5% for the National Banking System.

We highlight that the generation of returns has made it possible for banks to keep reinforcing their solvency position, which permits them to almost double the minimum amounts required by the regulations.

As of November 2016, the monthly average liquidity was 60.0% for the National Banking System. By type of banking, the average was 70.8% for state-owned banking, 67.7% for foreign banking, and 45.2% for Panamanian banking. The strong liquidity position should permit banks to face short- and medium-term maturities comfortably.

Chart 13: International Banking Center
Monthly Average Liquidity Ratio
(in percentages)



Source: General and international license banks.

III. Advances towards Basel III:

As for the advances towards Basel III, Panama has given a great step in Pillar I, adopting the additions included in the most recent Basel document for capital quality and risk-weighted assets, leverage ratio and counterparty risk.

Capital Quallity BIS III	1-2015
APR according to BIS III	3-2016
Leverage Coefficient BIS III	1-2015
Counterparty Risk	3-2016
Anti-cyclical Dynamic Provision	4-2013

Within the advances towards Basel III, we have envisioned addressing the following topics in 2017:

- Short-term liquidity Ratio (SLR)
- Market Risk Capital Requirement
- Operating Risk Capital Requirement

IV. New Banking Regulations

Below we have included the most relevant regulatory changes to date for the system's stability, especially on accounting, risks, and AML/CFT/WMD. These changes are a set of measures that are part of the agenda adopted by the Superintendency of Banks of Panama to improve the quality of capital, measure the risk to which the banks are exposed, update to International Financial Reporting Standards and remove Panama from discriminatory or non-cooperative jurisdictions list.

Similarly, all of the information on the current regulations for banking operations in Panama is available on the SBP's website. The Superintendency of Banks' URL address is http://www.superbancos.gob.pa

Table 7: Recent Regulations

Instrument	topic
2015 -2016	
Rule 7 (2016)	Guidelines are established for the prevention of money laundering, the financing of terrorism and the financing of the proliferation of weapons of mass destruction that may arise from cross-border correspondent banking relationships provided by correspondent banks in the Panamanian market. Establishes that banks established in Panama providing correspondent services to banks located in foreign markets must put in place and apply due diligence procedures and have knowledge of entities the banks intend to represent or with whom they have previously established correspondent banking services.
Rule 6 (2016)	Guidelines are established for managing risks related to the prevention of money laundering, the financing of terrorism and the financing of the proliferation of weapons of mass destruction that may arise due to new products and technologies. Requires regulated entities to apply a risk-based approach, i.e. an assessment of the new products and services they will offer their customers, as well as of the geographical location where the regulated entity will be providing, offering or promoting its new products and services. Additionally, regulated entities must apply a risk-based approach to new or developing technologies for new or pre-existing products. The risk assessment must be conducted before launching new products or new commercial practices, as well as before the use of new or developing technologies.

Rule 4 (2016)	Amended Rule 4-2011 on the rules for the collection of certain fees and surcharges applied by banks to require banks to include the guidelines on the collection of fees and surcharges on lending and deposit operations in banking contracts or separate documents that must be provided to the bank customer.
Rule 3 (2016)	Establishes the rules for determining credit and counterparty risk-weighted assets.
Rule 2 (2016)	Adds Article 33-A to Rule 7-2014, which establishes standards for the consolidated supervision of banking groups, requesting banking groups consolidating their operations in Panama and falling under the home supervision of the Superintendency publish their consolidated financial statements.
Rule 1 (2016).	Establishes the general guidelines on ACH settlement and funds available.
Rule 12 (2015)	Establishes punitive administrative proceedings to be conducted by the Superintendency of Banks for those cases without a special administrative proceeding.
Rule 11 (2015)	Amends Article 3 of Rule 2-2012 to expand the services banks may offer through nonbanking correspondents.
Rule 10 (2015)	Establishes the measures banks and trust companies must adopt to prevent the misuse of banking and trust services. The Rule mainly covers the following aspects: • Appropriate measures for customer identification. • Measures to identify individuals and legal entities. • Enhanced due diligence measures for Politically Exposed Persons (PEPs). • Update and safekeeping of information and documentation records. • Due diligence measures for trust funds.
Rule 9 (2015)	Establishes the punitive administrative proceedings for potential violations of the provisions for the Prevention of Money Laundering, the Financing of Terrorism and Financing the Proliferation of Weapons of Mass Destruction applicable to regulated entities.

Rule 7 (2015)	Updates the suspicious transactions guide for banks and trust companies based on the Warning Signs manual prepared by the Financial Analysis Unit (based on the recommendations made by several supervisory and control bodies). The Warning Signs catalog contains those customer, employee or company behaviors and the characteristics of certain financial operations that could lead to detect a suspicious transaction related to Money Laundering, the Financing of Terrorism and Financing the Proliferation of Weapons of Mass Destruction. Regulated entities must detect and pay special attention to the behavior described in the Rule and must determine whether those behaviors constitute Suspicious Transactions taking into consideration other factors, signs and criteria.
Rule 6 (2015)	Updates Article 17 of Rule 4-2008 on compliance with the Legal Liquidity Ratio in order to provide timely information to monitor liquidity risk. It establishes that the legal liquidity ratio will now be calculated pursuant to a schedule determined by the Superintendency, while it had previously restricted the calculation of the legal liquidity ratio to once a week.
Rule 5 (2015)	Establishes the necessary AML measures other regulated entities under the supervision of the Superintendency must take to prevent that their operations and/or transactions being conducted with funds or on funds resulting from activities related to the crimes of Money Laundering, the Financing of Terrorism and Financing the Proliferation of Weapons of Mass Destruction.
Rule 4 (2015)	Further develops the procedure and requirements that must be met by entities interested in obtaining an authorization to act as domestic and foreign custodians of bearer shares. Similarly, it defines the obligations they must meet and the Events in which that authorization will be revoked if there are deficiencies in providing services.
Rule 3 (2015)	Modifies Articles 9 and 14 of Rule 4-2010 on External Auditing to update the special external reports auditors must submit to comply with the International Financial Reporting Standards (IFRS) and the period for the rotation of the external auditing team.
Rule 1 (2015)	Establishes rules for capital adequacy applicable to banks and banking groups in order to update the regulatory framework governing the capital requirements to international standards to keep strengthening the

	solvency of the baking system, limit leveraging and encourage banks to have sustainable growth strategies that will improve the financial stability of the banking center.
Resolution SBP-GJD-0003-2015	Establishes the technology guidelines and requirements for inspections of regulated financial entities supervised by the Superintendency on the prevention of money laundering, the financing of terrorism and financing the proliferation of weapons of mass destruction.
General Resolution SBP-RG-0001-2015	Updates the Resolution on the contents, form, frequency, accuracy and quality of information banks are required to provide and the sanctions for noncompliance.