

# PANAMA

## FINANCIAL SECTOR ASSESSMENT PROGRAM

# DETAILED ASSESSMENT OF OBSERVANCE

## BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

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INTERNATIONAL MONETARY FUND



THE WORLD BANK

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## GLOSSARY

BAC	Board Audit Committee
BCBS	Basel Committee on Banking Supervision
BoD	Board of Directors
BNP	<i>Banco Nacional de Panama</i> (National Bank of Panama)
BRC	Board Risk Committee
CCSBO	Council of Superintendents of Banks, of Insurance and other Financial Institutions
CCF	Financial Coordination Council
CET1	Common Equity Tier 1
CRO	Chief Risk Officer
DSIB	Domestic Systemically Important Bank
FSAP	Financial Sector Assessment Program
FSR	Financial Stability Report
GDP	Gross Domestic Product
GREN-P	Supervisory Risk Methodology
KRI	Key Reporting Indicators
IA	Internal Audit
ICAAP	Internal Capital Adequacy Assessment Process
ILAAP	Internal Liquidity Adequacy Assessment Process
IPACO-OP	Panamanian Autonomous Cooperative Institute
IRRBB	Interest rate risk in the banking book
LCR	Liquidity Coverage Ratio
LLI	Legal Liquidity Index
MEF	Ministry of Economy and Finance
MOU	Memorandum of Understanding
MUSBER	<i>Manual Unico Supervision Basada en Riesgos</i> (Supervisory Manual)
NII	Net Interest Income
NSFR	Net Stable Funding Ratio
SBP	<i>Superintendencia de Bancos de Panamá</i> (Superintendency of Banks of Panama)
SER	Risk Assessment System
SIAT	Early Warning System
SMV	<i>Superintendencia del Mercado de Valores de Panamá</i> (National Securities Commission)
SREP	Supervisory Review and Evaluation Process
SSRP	<i>Superintendencia de Seguros y Reaseguros de Panamá</i> (Superintendence of Insurance and Reinsurance)
TLC	Technical Liaison Committee
UAF	Financial Analysis Unit
UBO	Ultimate Beneficial Owner

VAR

Value at Risk

## EXECUTIVE SUMMARY<sup>1</sup>

**Since the last Financial Stability Assessment Program (FSAP) in 2012, the Superintendency of Banks of Panama (SBP) has made significant progress in updating its regulatory and supervisory framework.** The SBP has implemented key elements of the international regulatory reform agenda, including Basel III and IFRS9, and has introduced comprehensive new regulations in a number of important areas, including corporate governance and risk management. The SBP has also adopted a structured risk-based approach to its supervision that is supported by a sophisticated IT system. Notwithstanding the progress made in many regulatory and supervisory areas since the last FSAP, there remain a number of gaps in the legal and regulatory framework and some areas for improvement in the SBP's supervisory approach.

**The Banking Law sets the SBP four objectives, two of which (namely safeguarding the soundness and efficiency of the banking system and fostering the development of the Republic of Panama as an international financial sector) have the potential to conflict with each other.** The SBP's primary objective should be to safeguard the soundness of the financial system, with the remaining three objectives subordinate to this objective. The remaining two objectives, namely promoting trust in the banking system and safeguarding the judicial balance between the banking system and its clients, do not conflict with the SBP's safety and soundness objective.

**The Banking Law established the SBP with full legal status as an autonomous agency of the government, including administrative, budgetary, and financial independence, but this autonomy has from the SBP's perspective been significantly constrained following the passing of annual Budget Laws since 2019.** Successive Budget Laws passed since 2019 have required the SBP to seek pre-approval and obtain budget verification and registration from the relevant institutions for all recruitment and other human resource decisions that have a budgetary impact. Prior to 2019, the SBP had only to notify the Ministry of Economics and Finance (MEF) of such expenditure. Delays in getting approval to initiate recruitments have given rise to the high level of current vacancies in the SBP. The current Budget Law should be amended to restore the SBP's independence of action in respect of all budgetary issues, and future Budget Laws should maintain this autonomy.

**There is no requirement in the law or in regulations for banks or banking groups to notify the SBP of any acquisition or investment below 25 percent of their capital.** Banks and banking groups are prohibited from acquiring or owning stock or participations in any other ventures not related to the banking or financial business whose aggregate value exceeds 25 percent of their capital, but there is no requirement to inform the SBP of acquisitions or investments up to this limit. The lack of such notification hinders the SBP's ability to assess risks that acquisitions of non-banking activities can pose to a banking group.

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<sup>1</sup> This Detailed Assessment Report has been prepared by Christopher Wilson, IMF and Alan Ball, World Bank.

**The SBP's supervisory framework provides an effective methodology for identifying risks that banks are running at the time of assessment, but greater emphasis should be placed in the methodology on forward-looking elements of individual banks' and banking groups' risk profiles.** Although banks are required periodically to undertake stress testing of their capital adequacy requirements, this process is not systematically built into the framework. The SBP has drafted the framework for an Internal Capital Adequacy Assessment Process (ICAAP), but no timetable has been set for implementation. Systematic stress testing by banks and an effective ICAAP roll-out would provide the SBP with useful data on a bank's forward-looking risk profile and capital needs. In addition, regular engagement with Board members and heads of key control functions should be built into the supervisory framework. Such meetings would provide useful insight on developments and challenges in implementing a bank's strategic plans, and on any strains that expected growth may be placing on the risk and internal control framework within the bank.

**The SBP collects and analyzes a wide range of prudential reports from banks on both a solo and a consolidated basis, but does not collect data on banks' consolidated liquidity positions, wider concentration risks that may be run by banks or banking groups (e.g., geographic, sectoral, currency), and interest rate risk in the banking book (IRRBB).** Verification of the accuracy of the data within the reports submitted by banks is undertaken by supervisors through on-site examinations, but the timing of such examinations is periodic and not systematic, and there is no regulation requiring the prudential reports to be signed-off by an appropriate level of the bank's senior management certifying their accuracy.

**The liquidity regulations are generally comprehensive, however, the Liquidity Coverage Ratio (LCR) is calculated and reported on a Level 1 basis and not L2 or group-wide.** Material subsidiaries are omitted from the calculation. In relation to offshore bank operations, the SBP places reliance on the host supervisor to set liquidity limits and to ensure compliance with liquidity requirements and risk management standards. In relation to domestic non-bank subsidiaries, the liquidity needs of these group entities are not captured in LCR reporting. As a result, a consolidated view of group-wide liquidity is not achieved.

**Off-site analysis occurs on a frequent basis using a comprehensive suite of indicators and data points.** The regulatory reports submitted by banks and banking groups to the SBP provide a broad range of data for review by analysts to inform their assessment of group-wide risks, but the SBP does not receive reported data on banking groups' consolidated liquidity positions. Banks report detailed credit information relating to the counterparty, valuations of collateral, loan-to-value ratios, details regarding serviceability, vintage, loan type, region, geography, etc. Using this information, the SBP is able to undertake analyses on an individual bank basis and across the sector to identify early vulnerabilities, and any build-up in credit risks and outliers.

**The SBP has implemented a framework for credit concentration risk and large exposure limits, but the framework does not apply to all material sources of concentration risk.** The SBP has a strong focus on credit risk management and undertakes extensive analysis to assess concentration risk based on detailed reporting. The regulations for concentration risk are focused predominantly

on the management of credit-related exposures. Analysis undertaken by supervisors is detailed in respect of large exposures and credit concentration risks, however, a broader definition is needed together with data and supervisory processes. There is no formal requirement for stress testing concentration risks which would enhance risk management.

**Regulations issued by the SBP set out a comprehensive set of requirements for a bank's Board and senior management to be responsible for preparing financial statements that adhere to international accounting standards.** All banks apply IFRS and thus meet international standards for accounting treatment. The SBP has not implemented a framework for prudential valuations such as promulgated by the Basel Committee on Banking Supervision (BCBS). The SBP regularly publishes data on its website pertaining to the performance of the banking system. These reports provide insights into the performance of the banking system on a regular basis that is publicly accessible, granular, and contains individual bank data. The SBP undertakes on- and off-site activities to test and verify banks' compliance with SBP requirements. The SBP routinely liaises with the Financial Analysis Unit (UAF), exchanging data relevant to the supervision of banks. Panama's grey listing by the Financial Action Task Force (FATF) has helped make this risk a high priority for the SBP.

**Regulation sets out minimum standards for market risk management and the necessary policies and processes, but the regulatory framework has not been updated to include IRRBB.** Banks must identify and appropriately manage the market risks they face, and the Board of Directors has primary responsibility for establishing policies and procedures to identify these risks. Guidance for IRRBB remains in draft form. The draft guidance is closely aligned with the BCBS frameworks (2016) and the SBP plans to formalize the draft in due course.



## INTRODUCTION

1. **The BCP assessment was conducted in Panama City, Panama, from January 17 – February 6, 2023.** This assessment of the implementation of the BCPs by the SBP is part of the Financial Sector Assessment Program (FSAP) undertaken by the International Monetary Fund (IMF) and the World Bank (WB).
2. **The mission met with various departments of the SBP involved in supervision, regulation, and financial stability.** The mission also met with external stakeholders including the Ministry of Economy and Finance, the Panama Banking Association, the Financial Analysis Unit (UAF), several consulting firms, and domestic Panamanian banks. The assessors had the full cooperation from the Panamanian authorities and received all information necessary for the assessment. The team extends its thanks to the management and staff of the various agencies and institutions for their openness and participation in the process. The authorities provided comments on a draft version of this assessment, which are reflected in the final assessment.
3. **Compliance was measured against standards issued by the Basel Committee on Banking Supervision (BCBS) in 2012.<sup>2</sup>** Since the previous assessment, conducted in 2012, the BCBS standards have been revised and reflect the international consensus for minimum standards based on global experience. The view is that supervision should be based on a process involving well-defined requirements, supervisory on-site and off-site determination of compliance with requirements and risk assessments, and a strong program of enforcement and corrective action and sanctions. The 2012 revision placed increased emphasis on corporate governance, on supervisors conducting reviews to determine compliance with regulatory requirements, and on thoroughly understanding the risk profile of banks and the banking system.
4. **The assessment was performed in accordance with the guidance set out in Annex 2 of the BCP.** It assessed the compliance with the “essential” criteria. The guidance requires that the assessment be based on the legal and other documentary evidence, combined with a review of the work of the supervisory authority as well as its implementation. The assessment of compliance with the core principles is not, and is not intended to be, an exact science. Banking systems differ from one country to the next, as do their domestic circumstances. Furthermore, banking activities are changing rapidly around the world and theories, policies, and best practices of supervision are swiftly evolving. Nevertheless, it is internationally acknowledged that the core principles set minimum standards. The 2012 methodology provides three options for assessment: (i) assessed and graded against only ECs, (ii) assessed against both ACs and ECs, but graded only against ECs, or (iii) assessed and graded against both ECs and ACs. In this report, only ECs are described and graded.

## INSTITUTIONAL AND MARKET STRUCTURE—OVERVIEW

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<sup>2</sup> Basel Committee on Banking Supervision: *Basel Core Principles for Effective Banking Supervision*, May 2012: <https://www.bis.org/publ/bcbs230.pdf>

## A. Institutional Setting

**5. The SBP has exclusive competence to regulate and supervise banks and is granted powers to address identified risks and weaknesses.** The Superintendency is granted exclusive authority to “regulate and supervise the banks, the banking business and other entities and activities assigned” (Article 4, Banking Law). The objective and function of the SBP is, inter alia, to “safeguard the soundness and efficiency of the banking system” and to inspect and supervise all banks “to confirm their financial stability and their compliance with” the Banking Law and its implementing regulations. The SBP’s supervisory powers over banks to address identified risks or weaknesses—and eventually liquidate a bank—are set forth in the Corrective Action provisions of the Banking Law (see, Banking Law, Chapter 1, and Title 111; Chapters 15-18, Articles 124-183). With this objective in mind, the SBP maintains a framework of macroprudential and microprudential supervision.

**6. SBP’s macroprudential supervision has the objective of preventing and mitigating systemic risks that can threaten financial stability, thereby guaranteeing the soundness of the entire financial system.** The macroprudential supervision of the Panamanian banking system is conducted at the highest level within the SBP, using input provided by the Division of Financial Studies and the Division of Risk Management. The Division of Regulation aids in drafting the rules necessary to strengthen the banking system and increase its resilience. At the same time, the microprudential supervision focuses on the soundness of each banking institution. The Division of Supervision leads the planning and execution of the on-site and off-site examinations of the different banks and banking groups, with the support of the Specialized Divisions of Risk Management and Prevention and Control of Illicit Operations.

**7. The SBP adopted a risk-based approach and methodology to supervision in 2012.** The methodology is set out clearly in the SBP’s supervisory manual - “Manual Unico Supervision Basada en Riesgos” (MUSBER). The SBP has applied, calibrated, and adjusted the risk-based supervision methodology and procedures according to internal assessments and new international procedures for banking supervision. The MUSBER is an internal document for use by the SBP staff, describing the processes, procedures and methodology for supervising banks and banking groups. This document is fundamental for guaranteeing consistency of approach across all regulated entities, without constraining the supervisor’s professional judgement.

**8. The SBP is granted certain specific powers to supervise non-bank and non-financial entities operating within banking groups.** The SBP is given authority to “carry out the consolidated supervision of the activities of all non-banking and non-financial entities that are affiliated or related to banking groups” (Banking Law; Article 63). With respect to non-bank or non-financial affiliates, SBP supervisory powers extend to the ability to require groups, including their holding companies, to take corrective actions to “address material risks to the bank(s) within the group.”

**9. SBP possesses a range of supervisory enforcement tools that it can employ to address bank weaknesses.** These powers include the ability to demand increased capital, improve liquidity, sell, or divest businesses or assets, and restructure the banks’ operations. As a support for early

remediation, the SBP operates an early warning system (Sistema de Alerta Temprana or SIAT) that collects a wide range of data to generate various metrics that track banks' financial conditions (e.g., capital, liquidity, credit, asset quality, and other key indicators). These data are employed to establish trigger levels that are set for each bank given its business model, risk exposures, and risk management strength or weakness. The SBP employs this early warning system to bring prompt attention to existing or emerging supervisory issues. In instances where bank management is unable to address identified weaknesses to the SBP's satisfaction or directives, the SBP will seek prompt remediation, and should conditions continue to deteriorate, seek the bank's voluntary liquidation or closure.

**10. The SBP has responsibility for supervising banks' compliance with obligations under the AML/CFT regulations and sets of laws.** In 2017, Panama introduced a national strategy for combating money laundering, the Financing of Terrorism and financing the proliferation of weapons of mass destruction. Panama is currently on the "grey list" of FATF with pending obligations.

**11. SBP is the de facto resolution authority for banks in Panama.** The SBP is empowered to take administrative actions involving increasing levels of intervention: commencing with the appointment of an advisor, to the appointment of a reorganizer or administrator to sell, reorganize or merge the bank, and culminating in the bank's compulsory liquidation. The SBP works throughout to avoid compulsory liquidation of banks, preferring early identification and remediation of troubled banks.

**12. The Ministry of Economics and Finance (MEF) has no formal role in bank supervision or resolution, but it would be obligated to support the resolution of state-owned banks.** Under the current framework the MEF is given no formal role, authorities, or powers to effect corrective actions and resolve insolvent banks. However, given the presence of comprehensive, legislated state guarantees for all liabilities of the two, large state-owned banks, the MEF retains a contingent exposure to provide equity and funding support to these banks and, as a result, would play a key role in their resolution.

**13. The Corrective Action powers set out in the Banking Law, which represent the current resolution toolkit in Panama, are applicable only to banks, including state-owned banks.** The SBP is the only agency granted power to exercise the current set of corrective actions and resolution tools applicable to Panamanian banks. These powers include the authority to close or transfer banking establishments, to authorize the voluntary liquidation of banks, to order the seizure of administrative control, compel reorganization, and order the compulsory liquidation of banks. These supervisory powers and prudential requirements are applicable on equal terms to all banks, including state-owned (Banking Law; Articles 59-60). However, the corrective action provisions of the Banking Law extend only to banks, and not to non-bank or non-financial affiliates operating within banking groups.

**14. Non-bank financial entities operating within banking groups are supervised by sector-based regulators.** Insurance companies are supervised by the Superintendency of Insurance and Reinsurance (SSRP or Insurance Commission), and securities brokers, investment and pension funds

are overseen by the Superintendency of the Securities Market (SMV or Securities Commission). Each agency is separately responsible for administering a supervision, crisis management and resolution regime that is unique to each type of entity.

**15. The SMV is responsible for regulating and supervising issuers, investment companies, intermediaries and other participants in the stock market, whose legal framework is established by laws.** As of December 2016, the Panama Stock Market maintains eighty-nine (89) current licenses for Brokerage Houses, 63 of which are classified as Independent Brokerage Houses, 16 as Brokerage Houses of Securities Subsidiaries of Banks and 10 as Banks with a Brokerage House License.

**16. The authorities established a Financial Coordination Council (FCC) in 2011 for domestic interagency cooperation.** The FCC consists of six domestic supervisory agencies, with the main objective to strengthen information exchange and coordination on regulatory policies across supervisory agencies. The FCC Board is chaired by the Superintendent of Banks and meets quarterly. As per Article 9 of Title I of Law No. 67, the FCC has power to make recommendations to its members ("soft power").

**17. Panama does not have its own currency or Central Bank.** A state-owned commercial bank, the National Bank of Panama (NBP), plays some of the roles that a Central Bank might ordinarily undertake (for example, the NBP operates the payments system and implements a liquidity fund that Panamanian banks have recourse to if they experience liquidity difficulties). The absence of a Central Bank means Panama has relatively limited ex-post capacity to manage financial and macro stability problems.

## B. Market Structure

**18. The banking sector is large and dominates the financial system.** The financial sector contributes around 6.5 percent to GDP, on average, each year. Banks represent approximately 90 percent of financial system assets and are split between general license banks and international license banks. Total assets of the banking system were USD137.3 billion (191 percent of GDP) as of end-June 2022. General license banks dominate the banking sector. Of the 56 banks, 42 are general license banks that can take deposits and grant loans both within and outside Panama. The largest five general license banks account for half of all general license bank assets. There are ten Domestically Systemically Important Banks (D-SIBs). General license banks have varied ownership structures and include two state-owned, 13 Panamanian, and 27 foreign-owned banks. There are 14 international license banks which are funded from offshore (typically via a parent) and grant loans outside Panama. Both the general and international license banking sectors have been consolidating over the last decade, with international license banks declining in aggregate relative to general license banks.

**19. General license and international license banks have different business models.** General license banks focus on lending for house purchases (mortgages), personal consumption, trade, and to the construction sector. Household lending represents about 60 percent of private sector lending,

comprising mortgages and consumer loans. Many mortgages issued by state banks (46 percent of the total mortgage stock) are offered at subsidized rates. Corporate lending is concentrated in the trade and construction sectors. Sectoral lending shares have been stable. All banks have significant fixed-income portfolios (including significant corporate bond investments) but pursue different investment strategies as general license banks hold more shorter-term securities and Panamanian government securities whereas international license banks invest in foreign government bonds and longer duration securities.

**20. General and international license banks are authorized to conduct distinct permissible activities under Panamanian law.** The domestic activities of banks with international licenses are restricted. General license banks engage in the full complement of traditional bank activities and services that support the Panamanian economy and financial system. General license banks can take deposits and grant loans both within and outside Panama. International banks may not take deposits from or grant loans to Panamanian persons or entities. International license banks hold 16 percent of the assets of the banking sector and 14 percent of deposits. Although barred from conducting banking business locally, they are authorized by the SBP to place deposits in banks holding general licenses and invest in Panamanian government securities.

**21. General license banks are funded primarily by deposits, while international license banks are funded primarily via their related offshore parent groups.** General license banks' total funding is composed of 70 percent deposits, 16 percent securities issuance, 10 percent shareholder capital, and 3 percent other liabilities. General license banks' funding profile has been migrating towards increased reliance upon domestic deposits (away from foreign sourced deposits).<sup>3</sup> General license banks' share of local deposits in total deposits has significantly increased from 60 percent in 2013 to 72 percent. International license banks' operations are reliant upon their respective parent for funding.

**22. The official currency of the Republic of Panama is the Balboa, whose value is on a par with the United States dollar.** According to the Panamanian legislation, the US dollar circulates freely in Panama without restrictions in commercial and financial transactions.

**23. Bank capitalization faced pressures during and after the pandemic.** Bank capital ratios stood at 15.8 percent at end-2022, close to 8 percentage points above the minimum requirement of 8 percent. The Legal Liquidity Index is strong at 57.8 percent of short-term deposits as of end-April 2022—almost double the regulatory minimum of 30 percent, but banks require significant liquidity buffers because of the absence of a Lender of Last Resort. Profitability fell during COVID-19 and remains a challenge. NPL ratios have remained stable at around 2.5 percent since the moratorium on servicing bank loans formally ended in June 2021.

**24. Panama remains on the FATF-ICRG grey list and needs to quickly address remaining action items to further strengthen the overall effectiveness of its AML/CFT regime and secure**

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<sup>3</sup> Note that the interlinkages between the onshore banks and offshore banks needs to be considered. For example, a Panamanian company with a foreign beneficial owner would qualify as a domestic deposit.

**removal from the list.** Panama has been subject to increased monitoring by the FATF since 2019 due to strategic deficiencies identified affecting the effectiveness of its AML/CFT regime. As such, Panama should take urgent action to fully address the remaining items of the Action Plan, notably ensuring collection of and access to beneficial ownership of Panamanian legal entities, as all timeframes have already expired, to avoid harsher measures for insufficient progress that could undermine confidence in the financial system and capital flows and impact correspondent banking and credit relationships with financial institutions abroad.

## PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION

### A. Sound and Sustainable Macroeconomic and Financial Sector Policies

**25. The Panamanian economy is recovering from the COVID-19 pandemic.** Real GDP contracted by 17.9 percent in 2020 (the largest contraction ever recorded) and unemployment peaked at 18.5 percent during the pandemic period. The economy has subsequently recovered strongly as the pandemic eased and containment measures were gradually loosened. Panama implemented a comprehensive support program during the pandemic which included a moratorium on loan service from March until the end of 2020, in the form of voluntary loan restructurings, grace periods, and in some cases interest rate reductions. Loans subject to this moratorium (“modified loans”) peaked at around 50 percent of loans outstanding during the height of the pandemic but have declined significantly to around 5 percent of total loans in August 2022<sup>4</sup>. A consequence of the moratorium was that nonperforming loans (NPLs) did not increase significantly during the pandemic.

### B. Well-Developed Public Infrastructure

**26. The financial infrastructure within Panama appears to support effective implementation of banking supervision.**<sup>5</sup> Many aspects of the necessary financial infrastructure are available to support banking supervision: e.g., commercial law framework, independent judiciary, well defined rules governing, and adequate supervision of, other financial markets and, where appropriate, their participants. In addition, the accounting framework is closely based on IFRS and the auditing profession is represented by the major global firms. The private credit bureau (Asociación Panameña de Crédito) is reported to work efficiently, and contract and property laws are modern. Banks reported that taking possession of collateral is a relatively efficient process and that the court system is not considered to be a general hindrance.

### C. Framework for Crisis Management, Recovery and Resolution<sup>6</sup>

<sup>4</sup> The Government introduced a mandatory period of loan forbearance inflating the percentage of loans categorized as modified.

<sup>5</sup> The assessors were not able to make an in-depth assessment of the public infrastructure.

<sup>6</sup> For an in-depth assessment of the framework for crisis management, recovery and resolution in Panama, a technical note will be produced as part of the FSAP.

**27. Large and complex banking groups operating in Panama present unique resolution challenges.** The largest Panamanian banks present complex organizational and ownership structures. These banks can include multi-tiered holding companies, include bank and non-bank subsidiaries and affiliates, as well as non-bank/non-financial subsidiaries and affiliates (commercial and operational entities). The funding and operational interconnections and inter-dependencies established between the material legal entities of such groups must be fully understood and resolution strategies adopted to ensure the continuity of critical functions conducted within, or without, the regulated financial entities. At this stage, SBP does not have a mapping of critical functions to the various multiple legal entities contained in these broad groups to determine which entities must be maintained and supported during periods of financial stress to ensure an orderly resolution.

**28. SBP has drafted legislation to strengthen the bank resolution framework and improve compliance with international standards.** The legislation is intended to address the identified gaps and expedite the resolution process. The draft law has been submitted to the Minister of Economics and Finance and remains under deliberation. Should the legislation be approved by the National Assembly, this framework will override the existing legal framework on bank resolution in Panama.

#### **D. Appropriate Level of Systemic Protection (or Public Safety Net)**

**29. Key institutional pillars of a financial safety net have not been established in Panama.** While state-owned banks benefit from an explicit government guarantee, Panama does not possess a deposit insurance framework, lender-of-last resort (LOLR) or emergency liquidity assistance (ELA) mechanism, or other government safety net to provide financial stability. These gaps limit the authorities' capacity to respond to adverse scenarios in case of severe, systemic stress.

#### **E. Effective Market Discipline**

**30. Corporate governance in Panama is generally governed by, among others, Law 32 of 1927 (the Corporation Law), and the Panamanian Commercial Code of 1917.** In the case of publicly traded companies, Decree Law 1 of 1998 (the Securities Law) and its regulations govern tender offers, proxy statements and rules of disclosure among other matters. The Panama Corporate Governance Institute (IGCP) is the main center in Panama for training, dissemination, and research in relation to corporate governance (GC) and the center for knowledge sharing. It is a member of the regional network of similar institutes in Latin American countries, Latin American Corporate Governance Institutes (IGCLA), so is recognized as the local corporate governance authority.

**31. In Panama, the Companies Law of 1927 establishes the types of legal companies, while the Code of Commerce of 1916 and subsequent amendments requires companies to keep books of accounts and provides the basic legal framework for accounting.** The Law No. 57 of 1978, amended by the Law 280 of 2021 on the Accounting Profession, authorizes the Technical Board of Accounting (JTC), an agency under the Ministry of Commerce and Industries, to set accounting and auditing standards. For this purpose, the JTC created the Commission of Financial

Accounting Standards to recommend regulation regarding the accounting and auditing standards for all companies, aside from regulated companies. The Law No. 6 of 2005 requires the application of IFRS and IFRS for Small- and Medium-sized Entities (SMEs) since 2006. The tax authority also requires IFRS and IFRS for SMEs through modification to the Tax Code of 1956 and amendments for tax purposes.

**32. In addition, domestic financial sector regulators are empowered to set sector-specific accounting rules for the companies they regulate.** Listed companies and financial institutions are required to use IFRS or the U.S. Generally Accepted Accounting Principles, in accordance with the SBP Agreement No. 4 of 1999 and SMV Agreement No. 8 of 2000, respectively. Insurance companies are required to apply IFRS as per SSRP Law No. 12 of 2012.

## MAIN FINDINGS<sup>7</sup>

### A. Responsibilities, Objectives, Powers, Independence (CP 1–2)

**33. The Banking Law sets out the SBP’s four separate objectives, two of which (namely safeguarding the soundness and efficiency of the banking system and strengthening and fostering the Republic of Panama as an international financial sector) have the potential to conflict with each other.** The SBP’s primary objective should be to safeguard the soundness of the financial system, with the remaining three objectives subordinate to this objective.

**34. Although independence of the SBP is clearly prescribed in law, its operational independence has been significantly constrained following the passing of successive annual Budget Laws since 2019.** From 2019, all SBP recruitment and other personnel decisions which have a budgetary impact need to be pre-approved by other state institutions. Prior to 2019, the SBP had only to notify the MEF of its recruitment and other personnel expenditure. Delays in getting approval for the initiation of recruitments has given rise to the high level of vacancies in the SBP.

### B. Supervisory Cooperation and Cross Border Supervision (CP 3, 12)

**35. The SBP has effective MOUs in place to support information sharing as well as co-operation and co-ordination between all relevant domestic and foreign regulatory authorities.** In addition to bilateral meetings with regulators, the SBP is also a key participant in multilateral college meetings under the umbrella of the CCSBSO. Although coordination to remediate weak banks is undertaken through sub-Committees of the CCSBSO (namely the Liaison and Resolution and Crisis Committees), these meetings do not specifically consider resolution plans for distressed banks.

### C. Licensing, Changes in Control, and Acquisitions (CP 4–7)

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<sup>7</sup> A detailed explanation of the grading mechanism for the assessment can be found in section IV of the *Basel Core Principles for Effective Banking Supervision* (see footnote 2).



**36. The regulatory framework requires transfers of ownership of a bank or banking group beyond 25 percent of capital to be pre-approved by the SBP and requires all transfers of shares below this 25 percent threshold to be notified to the SBP.** The SBP should consider introducing a threshold above which such notifications are required and specify that such notifications should be immediate. In addition, the SBP has no power to reverse a share transaction or remove voting rights if a transfer of significant ownership were undertaken without prior approval or based on misleading information.

**37. There is no requirement in law or in regulations for banks or banking groups to notify the SBP of any acquisition or investment below 25 percent of their capital.** Banks and banking groups are prohibited from acquiring or owning stock or participations in any other ventures not related to the banking or financial business whose aggregate value exceeds 25 percent of their capital, but there is no requirement to inform the SBP of acquisitions or investments up to this limit. The lack of such notification hinders the SBP's ability to assess risks that acquisitions of non-banking activities can pose to a banking group. A threshold should be set for acquisitions or investments above a percentage of a bank's capital that require immediate notification to the SBP.

#### **D. Supervisory Approach (CP 8–10)**

**38. The SBP's supervisory framework provides an effective methodology for assessing the risks that banks are running at the time of assessment, but greater emphasis should be placed on forward-looking risks in the methodology.** Bank's strategic plans are reviewed during the planning phase of the risk assessment process, and progress against those plans are discussed with senior management during on-site inspections. But regular engagement with Board members and heads of the key control functions is not built into the supervisory framework and internal management reports are not submitted on a systematic basis. The SBP requires banks periodically to stress their capital projections, but this process is not systematically built into the supervisory framework. The SBP has drafted the framework for an Internal Capital Adequacy Assessment Process (ICAAP), but has not set a deadline for its implementation. Proposals to roll out implementation of the ICAAP should be incorporated into the SBP's strategic plan.

**39. The SBP employs an effective range of examination techniques and tools to support its supervisory processes and approach.** On-site and off-site monitoring is integrated within supervisory departments, and multiple bank-specific and macro-economic analyses are taken into consideration when scoping and conducting examinations. Supervisory planning is thorough and structured, and the examination program is risk-based, ranging from full scope inspections to targeted reviews.

**40. The SBP collects and analyzes a wide range of prudential reports from banks on both a solo and a consolidated basis, but the scope of the reports does not include consolidated liquidity returns, wider concentration risks that banks or banking groups may run (e.g., geographic, sectoral, currency), or a bank or banking group's exposure to interest rate risk in the banking book.** Verification of the accuracy of the data within the reports submitted by banks is undertaken by supervisors through on-site examinations, but the timing of such examinations is

periodic and not systematic, and there is no regulation requiring the prudential reports to be signed-off by an appropriate level of the bank's senior management certifying their accuracy.

## E. Corrective and Sanctioning Powers of Supervisors (CP 11)

**41. The SBP does not have a formal resolution regime, but it has demonstrated through its actions that it has a full range of supervisory tools at its disposal to address serious weaknesses identified in banks and the ability to revoke banking licenses.** Corrective actions taken include dismissing Board and senior management, forcing mergers, assuming control of a distressed bank as well as revoking banking licenses.

**42. The SBP does not have the specific power to ringfence a bank from the actions of wider group entities which may impair its safety and soundness.** This gap in the regulatory toolbox should be addressed.

## F. Consolidated Supervision (CP 12)

**43. The legal and regulatory framework for conducting consolidated supervision is robust and, through its supervisory processes and practice, the SBP has a good understanding of the overall structure of banking groups and of their material activities (including non-banking activities), both domestic and cross-border.** The SBP applies most prudential standards to consolidated entities but does not collect any data on the consolidated liquidity positions of entities within banking groups.

## G. Corporate Governance and Internal Audit (CP 14, 26)

**44. The SBP has a comprehensive regulation covering the corporate governance requirements in banks and banking groups, and monitors compliance with the regulation effectively through regular on- and off-site supervisory approaches.** The supervisory assessment is tailored to the risk profile and systemic importance of the entity and covers, inter alia, Board and senior management recruitment, responsibilities and compensation, the effectiveness of the risk and internal control functions, and whether the organizational structure presents any hindrance to effective consolidated supervision.

**45. The regulations stipulate the need for banks to establish an appropriate control environment and audit arrangements.** Governance arrangements are established for audit committees to oversight compliance and internal controls to ensure compliance with prudential requirements. As part of on-site examinations (and follow-up examinations/processes), the SBP dedicates considerable attention to line 2 (compliance and back-office staff) and Internal Audit (line 3). Given on-site examinations involve extensive teams across multiple weeks and themes, there is a wide range of opportunities for the SBP to gain insights into the quality, resourcing independence and effectiveness of compliance and Internal Audit functions within the banks. The area where there is scope for improvement is more frequent and structured engagements with internal audit. The SBP could make use of more frequent and structured engagements with the Head of Internal Audit and the Board Audit Committee to keep apprised of findings and the internal audit plan.

## H. Risk Management Process (CP 15)

**46. The regulations require banks to implement a comprehensive risk management framework, yet there is need for further progress to achieve higher standards.** The SBP undertakes an annual on-site examination program for D-SIBs and higher risk banks while other banks will be assessed according to the GREN-P rating methodology but not less than once every two years. The supervisory manual is extensive and contains guidance for supervisors to assess bank risk management frameworks for all material risks. In preparation for the on-site inspection, banks are required to complete a self-assessment with materials to evidence which are assessed by the SBP. Weaknesses and high-risk areas are explored in detail during the on-site with interviews, file sampling, testing and review of reporting and policies. While the regulations are generally comprehensive, there are several areas that need to be developed:

- There is no regulation which stipulates a comprehensive approach to stress testing where all risks are considered against an assessment of capital and liquidity;
- There is no regulation for banks to undertake recovery planning; and
- There is no explicit provision in the regulation for a bank to notify the SBP if the CRO is removed.

**47. An area where there is scope to improve the assessment of all materials risks and capital strength is the ICAAP framework.** The SBP plans to implement this process in the near-term future. The ICAAP would contribute to a structured approach to the assessment of all material risks on an individual bank basis including the results of stress testing which would inform the assessment of the adequacy of capital. In terms of supervisory practice, there is a lack of routine contact with the Board to assess its role in the effective implementation of the risk management framework. Implementation of an ICAAP and ILAAP would help structure an assessment of all material risks.

## I. Capital (CP 16)

**48. The capital framework is largely aligned with the Basel III Accord, yet internationally active banks do not meet Basel III standards.** Definitions of capital, thresholds, calibration of risk-weighted assets and deductions are equivalent the Basel standards. The SBP has developed and implemented a D-SIB supervision framework where enhanced supervision is applied to this cohort of banks, however, a systemic risk buffer has not been implemented. A deviation from the Basel Capital Framework is that no formal buffer framework (as envisaged by Basel III such as the capital conservation buffer and countercyclical buffer) has been implemented. The average capital adequacy ratio of the sector is approximately 15 percent. The addition of a formal buffer framework is warranted to allow a structured process to standardize responses to capital deterioration.

**49. There is scope to deepen the assessment of capital adequacy to include a broader range of materials risks, including Pillar II.** A comprehensive assessment of capital and all

material risks was not evidenced such as: (i) the potential loss absorbency of the instruments included in the bank's capital base, (ii) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (iii) the adequacy of provisions and reserves to cover loss expected on its exposures and (iv) the quality of its risk management and controls. The implementation of the ICAAP will help support the assessment of all material risks at least annually for all banks. Integrated risk management assessment across the entire bank with inputs qualitative and quantitative and uses stress testing.

## J. Credit Risk and Problems Assets, Provisions and Reserves (CP 17–18)

**50. The SBP has a strong focus on credit risk management.** The off-site analysis occurs on a frequent basis using a comprehensive suite of indicators and data points. Banks report detailed credit information relating to the counterparty, valuations of collateral, loan-to-value ratios, details regarding serviceability, vintage, loan type, region, geography etc. Using this information, the SBP undertakes analysis on an individual bank basis and across the sector to identify early vulnerabilities, build-up in credit risks and outliers. The on-site examination samples files from a range of portfolios and loan files are tested and verified for compliance with banks' internal policies and the SBP's regulations. The regulations consist of a detailed suite of risk management for risk governance and risk management. The regulations emphasize, amongst other things: segregation of duties, governance, delegations, the three lines of defense, hind sighting, appropriate due diligence to assess serviceability and collateral management.

**51. The regulations are generally sound and require banks to classify all on- and off-balance sheet exposures using a prescribed framework.** Guidance for classifying loans is extensive and reporting to the supervisor is both extensive and frequent. On-site the SBP focuses on the appropriate classification of loans, handling of problem assets and the calculation of provisioning. Guidance surrounding collateral valuation is extensive and there is a prescribed set of eligible collateral types for provisioning.

## K. Risk Management (CP 19–25)

**52. The SBP has implemented a framework for credit concentration risk but monitoring of all material sources of concentration risk needs to be expanded.** The SBP undertakes extensive analysis to assess concentration risk based on detailed reporting. The regulations for concentration risk are focused predominantly on management of credit-related exposures. The SBP sets prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties of 25 percent of total capital. Analysis undertaken by supervisors is detailed in respect of large exposures and credit concentration risks, however, a broader consideration of concentration risk is needed (such as market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies). There is no formal requirement for the stress testing of concentration risks which would augment risk management.

**53. The regulations for the approval of related party exposures should be strengthened for a greater role of the BoD in monitoring these exposures and write-offs.** The SBP receives

comprehensive regulatory reporting pertaining to related party exposures. Banks are required to have policies and processes to identify individual exposures with related parties with an expansive definition of related parties. The regulation contains several prohibitions to ensure banks enter into related party exposures on an arms' length basis. The Banking Law also places a maximum limit of related party exposures to 25 percent of total capital. Furthermore, the SBP has the discretion to classify an exposure as a related party if it deems necessary. The regulations are not sufficiently comprehensive in terms of the following:

- The requirement for material related party exposures to be monitored and reported to the Board;
- Expansion of the definition of exposures to be more than credit-related (such as service contracts);
- Need for Board approval to write-off.
- Notification to the SBP when a material related party exposure has been entered into.

**54. The regulation sets out minimum standards for market risk management and the necessary policies and processes.** Banks must identify and appropriately manage the market risks they face, and the BoD has primary responsibility to establish policies and procedures and identify these risks. The measurement and management tools most commonly used by banks in the market are: concentration limits, loss limits, Value at Risk (VaR), limits, and sensitivities to movements in interest rates. This information is reported by the banks' Risk Units and the meetings of the Risk Committee and Board of Directors. Exposure to market risk is *de minimis* in terms of proportion of total income derived from trading and in terms of market risk weighted assets.

**55. The regulatory framework has not been updated to include IRRBB, instead guidance remains in draft form.** The draft guidance is closely aligned with the BCBS frameworks (2016) and the SBP plans to formalize the draft in due course. There are other aspects that can be strengthened: (i) There is a reliance on on-site examinations to assess exposure to IRRBB (ii) Off-site reporting is not adequate and therefore problematic in terms of ongoing surveillance for risks to NII and capital; and (iii) There are no specific stress testing requirements.

**56. The liquidity regulations are generally comprehensive for risk management however a consolidated view of liquidity is not achieved.** Banks need to establish and update regularly funding plans that take into account disruptions to liquidity and funding conditions. The plans are regularly stress tested and contingency funding plans are developed taking account of changes in market conditions (both idiosyncratic and market-wide). The BoD takes responsibility for developing and implementing the liquidity risk management framework. LCR is calculated and reported on a Level 1 basis and not L2 or group wide. As a result, material subsidiaries are omitted from the calculation. In relation to offshore bank operations, the SBP places reliance on the host supervisor to set liquidity limits and to ensure compliance with liquidity requirements and risk management

standards. In relation to domestic non-bank subsidiaries, the liquidity needs of these group entities are not captured in LCR reporting.

**57. Comprehensive regulations provide a solid foundation for a bank's management of operational risks.** The regulations are specific in terms of requiring elements of the governance framework for BoD to be responsible for setting a risk appetite and for KRIs to be developed as forward-looking indicators. In terms of governance, board reporting is via the risk committee. SBP dedicates time during on-site examinations to review the adequacy of reporting and identifies weaknesses. Capital is calculated using the basic indicator approach. Banks collect loss data that is included in their risk measurement and monitoring. Responsibilities for contingency planning is clearly described in the regulations.

## **L. Disclosures and Transparency (CP 27–28)**

**58. All banks apply IFRS and thus meet international standards for accounting treatment. The SBP has not implemented a framework for prudential valuations such as promulgated by the BCBS.** Regulations issued by the SBP set out a comprehensive set of requirements for banks' Board and senior management to be responsible for preparing financial statements that adhere to international accounting standards. There is scope for the SBP to have a more frequent and periodic engagement with the external auditors to discuss the scope of the audit, main findings and seek their views in terms of: vulnerabilities, risk management standards and opinion on the soundness of internal controls. The SBP does not have the power to establish the scope of external audits. Only by exception does the external auditor meet with the SBP to discuss individual banks. Informally the SBP has the ability to influence and can demonstrate examples, especially recently in relation to the Pandemic where loan moratoria were made law by the Government.

**59. The SBP regularly publishes data on its website pertaining to the performance of the banking system and an implementation of Pillar III would strengthen public disclosures further.** These reports provide insights into the performance of the banking system on a regular basis that is publicly accessible, granular, and contains individual bank data. The SBP also publishes data on the system so that historical data series can be evaluated. Equally publish individual reports consistently, regularly and according to international standards which are available on their websites. The disclosure requirements are relatively comprehensive, SBP has not formally adopted Pillar III of the Basel Accord. Public disclosure requirements of financial statements are stipulated, however, the full extent of qualitative and quantitative information particular to a bank is not required to be publicly disclosed. There has been no direct guidance to banks in terms of disclosures for remuneration and or additional disclosures for systemically important banks.

## **M. Abuse of Financial Services (CP 29)**

**60. The regulations clearly establish the responsibility of the SBP for supervision of the banking sector's compliance with AML/CFT standards of risk management.** The SBP has responsibility for different types of financial institutions with respect to ML, however this assessment focuses specifically on banks. The SBP undertakes on and off-site activities to test and verify banks'

compliance with SBP requirements. The SBP routinely liaises with the UAF exchanging data relevant to the supervision of banks. Panama's grey listing by FATF has helped make this risk a high priority for the SBP. Data shared with the SBP on STR reporting was found to be extensive and frequent. Issues are routinely followed up between the two agencies which demonstrated good cooperation. A strengthening of the notification requirements is needed to stipulate the banks inform the SBP immediately if they become aware of suspicious activity that may impact the safety and soundness of a bank.

## DETAILED ASSESSMENT

**Table 1. Panama: Detailed Assessment of Compliance with the Basel Core Principles**

<b>A. Supervisory Powers, Responsibilities, and Functions</b>	
<b>Principle 1</b>	<b>Responsibilities, objectives, and powers.</b> An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. <sup>8</sup> A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns. <sup>9</sup>
<b>Essential criteria</b>	
<b>EC1</b>	The responsibilities and objectives of each of the authorities involved in banking supervision <sup>10</sup> are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings re EC1	<p>The Superintendency of Banks of Panama (SBP) was established by Executive Decree No 52 of 30 April 2008 (the Banking Law). Article 4 of the Banking Law provides that the SBP has 'exclusive competence to regulate and supervise the banks, the banking business and other entities and activities assigned by it in law.'</p> <p>The objectives of the SBP are set out explicitly in Article 5 of the Banking Law as:</p> <ol style="list-style-type: none"> <li>1. To safeguard the soundness and efficiency of the banking system;</li> <li>2. To strengthen and foster favorable conditions for the development of the Republic of Panama as an international financial center;</li> <li>3. To promote public trust in the banking system; and</li> <li>4. To safeguard the judicial balance between the banking system and its clients.</li> </ol>

<sup>8</sup> In this document, "banking group" includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example non-bank (including non-financial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

<sup>9</sup> The activities of authorizing banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

<sup>10</sup> Such authority is called "the supervisor" throughout this paper, except where the longer form "the banking supervisor" has been necessary for clarification.



	In addition to 57 banks <sup>11</sup> regulated and supervised by the SBP, the Panamanian banking system also includes 171 cooperative enterprises, which are supervised by the Panamanian Autonomous Cooperative Institute (IPACO-OP). Cooperatives are deposit-taking organizations controlled by their members, representing a small proportion of the overall banking sector. Although the SBP does not have a formal Memorandum of Understanding (MoU) with IPACO-OP as there is no Cooperative enterprise within a banking group, there is regular and effective liaison between the two regulators. The SBP should consider establishing a bilateral MoU agreement between the two authorities to formalize their existing co-ordination and data-sharing arrangements.
<b>EC 2</b>	The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.
Description and findings re EC2	As noted in EC1, the SBP has four separate objectives, which include safeguarding the soundness and efficiency of the banking system. The safety and soundness objective is considered the primary objective, but this is not explicit in the Banking Law. This gives rise to a potential conflict with the SBP's separate objective to strengthen and foster the Republic of Panama as an international financial center. The Banking Law should be amended to make explicit that the SBP's primary objective is to promote safety and soundness, and the remaining three objectives of the SBP should become subordinate to this objective. The remaining two objectives, namely promoting trust in the banking system and safeguarding the judicial balance between the banking system and its clients, do not pose a potential conflict with the SBP's safety and soundness objective.
<b>EC3</b>	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile <sup>12</sup> and systemic importance. <sup>13</sup>
Description and findings re EC3	Paragraph 2 of Article 6 of the Banking Law provides the SBP with the power to 'develop the regulatory framework for the banking system', and paragraph 10 of Article 11 provides the SBP with the power to issue the necessary technical standards to comply with the Banking Law.  Article 70 of the Banking Law provides that banks should maintain a minimum capital adequacy ratio of 8 per cent, and primary capital (equity) of no less than 4 percent of total risk weighted assets. It also provides the SBP with the power to require a bank to maintain a higher capital adequacy rate when its risk profile makes it advisable. Similarly, Article 75 provides the SBP with the power to set and adjust the percentage of liquid assets that a bank should hold. Beyond these specific regulatory powers, the Banking Law is enabling legislation, delegating to the Directors of the SBP in Article 11 the power, inter alia, "to

<sup>11</sup> The SBP is responsible for the supervision of 2 State Banks, 40 General License banks and 15 International License banks. In addition, there are 2 banks under voluntary liquidation and 4 banks under compulsory liquidation.

<sup>12</sup> In this document, "risk profile" refers to the nature and scale of the risk exposures undertaken by a bank.

<sup>13</sup> In this document, "systemic importance" is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.



	approve general standards for the identification, regulation, and consolidated supervision of banks and banking groups”.
<b>EC4</b>	Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.
Description and findings re EC4	<p>The SBP updates its prudential and other standards on a regular basis to ensure that they remain effective and relevant. All revisions to Rules, Regulations, Circulars, and other supervisory requirements are disclosed fully on the SBP’s website. By way of example, 13 new Rules and 86 Circulars were issued in 2022.</p> <p>The SBP consults on all material changes to its regulatory framework, specifically with the Bankers’ Association and more widely with the public, by posting consultation documents on its website. The SBP also engages at an early stage of proposals to introduce major changes to the regulatory framework with the Bankers’ Association to understand the implementation challenges. But timelines for responses to routine changes to Regulations etc. are short (usually one month). The SBP should review its approach to consultation against international practice to ensure that it involves meaningful engagement with stakeholders and that respondents are given sufficient time to prepare responses.</p>
<b>EC5</b>	<p>The supervisor has the power to:</p> <ul style="list-style-type: none"> <li>(a) have full access to banks’ and banking groups’ Boards, management, staff, and records to review compliance with internal rules and limits as well as external laws and regulations;</li> <li>(b) review the overall activities of a banking group, both domestic and cross-border; and</li> <li>(c) supervise the activities of foreign banks incorporated in its jurisdiction.</li> </ul>
Description and findings re EC5	<p>The SBP has the following powers:</p> <ul style="list-style-type: none"> <li>(a) Article 86 of the Banking Law provides the SBP with the power to request documents and reports on the activities and operations from any regulated bank or firm in the banking group, including parent companies and affiliates. Although there is no explicit legislation or regulation providing the SBP with access to the Board, management and staff of regulated banks, such meetings occur on a regular basis during routine supervision and inspections of banks. The power is therefore implicit in Articles 59 and 66 of the Banking Law, which provides the SBP with the power to conduct inspections of all regulated banks.</li> <li>(b) Article 61 of the Banking Law provides the SBP with the power to undertake consolidated supervision of banking groups, both domestic and cross border; and</li> <li>(c) Article 62 of the Banking Law provides the SBP with the power to undertake consolidated supervision of all foreign banks, their subsidiaries, and branches.</li> </ul>
<b>EC6</b>	<p>When, in a supervisor’s judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the bank or the banking system, the supervisor has the power to:</p> <ul style="list-style-type: none"> <li>(a) take (and/or require a bank to take) timely corrective action;</li> <li>(b) impose a range of sanctions;</li> <li>(c) revoke the bank’s license; and</li> </ul>

	(d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.
Description and findings re EC6	<p>The following sections of the Banking Law provide the relevant powers to the SBP:</p> <ul style="list-style-type: none"> <li>(a) Paragraph 18 of Article 16 provides the SBP with the power to issue regulations to mitigate or correct weaknesses in a bank's operations which may threaten the interests of depositors, the stability of the bank or of the banking system more generally. In addition, Articles 124-130 provide for the SBP to appoint an independent advisor if there exists, or may arise, a deterioration or weakness (operational, administrative, financial) in a bank or banking group.</li> <li>(b) Articles 184-190 set out the sanctions that the SBP may apply to a bank or banking group, ranging from fines to generic sanctions such as private or public admonition. (See BCP 11.) The fines and generic sanctions may be applied to the bank or to its directors or wider staff.</li> <li>(c) Paragraph 5 of Article 16 and Article 56 provide the powers for the SBP to revoke a bank's license and set out the specific reasons that the SBP may invoke to do so. These are as follows: <ul style="list-style-type: none"> <li>1. Failure to start operations within six months following the granting of a permanent license. The bank may solicit an extension of this term based on verified justifications.</li> <li>2. Ceasing in the exercise of the banking business.</li> <li>3. The intervention of the parent bank or the cancellation of its license by the home supervisor or, in the SBP's best judgment, a lack of effective consolidated supervision by the home supervisor.</li> <li>4. Submission of false or fraudulent information or omission of information relevant to the obtainment of a license.</li> <li>5. Repeated serious violations of the provisions of this Decree Law.</li> <li>6. In all other cases provided for in this Decree Law (e.g., not maintaining the specified minimum capital requirement)</li> </ul> </li> <li>(d) Although there is no Resolution Framework in Panama, the SBP has successfully cooperated and collaborated with both domestic and overseas regulators to effect an orderly winddown and/or liquidation of banks (See BCP11 EC2).</li> </ul>
<b>EC7</b>	The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.
Description and findings re EC7	Article 63 of the Banking Law provides the SBP with the power to conduct consolidated supervision of the activities of all non-banking and non-financial entities that are affiliated or related to banking groups. This also extends to holding companies. The Article specifies that the SBP is authorized to require banking groups, including their holding companies to take those measures necessary to prevent or correct practices or conditions that, in the SBP's judgment, might represent a material risk to the banks owned by these banking groups. It also provides the SBP with the power to require the information necessary to evaluate the risks that these activities may pose to the banks within those banking groups, and the quality and scope of management and control of those risks, including capital adequacy.

<b>Assessment of Principle 1</b>	Materially non-compliant
Comments	<p>The legal framework provides the SBP, as sole regulator of banks and banking groups in Panama, with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness.</p> <p>The Banking Law sets out the SBP's four separate objectives, which have equal status in the Law. These include two objectives, namely safeguarding the soundness and efficiency of the banking system and strengthening and fostering the Republic of Panama as an international financial sector, which have the potential to conflict with each other. The SBP's primary objective should be to safeguard the soundness of the financial system, with the remaining three objectives subordinate to this objective. The remaining two objectives, namely promoting trust in the banking system and safeguarding the judicial balance between the banking system and its clients, do not pose a potential conflict with the SBP's safety and soundness objective.</p> <p>The SBP consults on all material changes to its regulatory framework, but timelines for responses are short (usually one month).</p> <p>Recommendations:</p> <ul style="list-style-type: none"> <li>• Amend the Banking Law to make explicit that the SBP's primary objective should be to promote safety and soundness.</li> <li>• Establish a bilateral agreement between the SBP and IPACO-OP to formalize co-ordination and data-sharing arrangements between the two authorities.</li> <li>• Review the current approach to consultation against international practice to ensure that it involves meaningful engagement with stakeholders and that respondents are given sufficient time to prepare responses.</li> </ul>
<b>Principle 2</b>	<b>Independence, accountability, resourcing and legal protection for supervisors.</b> The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.
<b>Essential criteria</b>	
<b>EC1</b>	The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.
Description and findings re EC1	Article 4 of the Banking Law established the SBP with full legal status as an autonomous agency of the government with its own capital and administrative, budgetary, and financial independence. Paragraph 4 of the Article states that the SBP will act independently in the discharge of its functions and will be subject from an accountability perspective to the supervision of the Office of the Comptroller General of the Republic, as established in the

	<p>Republic's Political Constitution. The Article also states clearly that this supervision will not imply interference in any way with the administrative powers of the SBP.</p> <p>Article 4 also provides the SBP exclusive power to regulate and supervise banks, the banking sector, and other entities and activities that may be assigned to it.</p> <p>To ensure its autonomy, paragraph 1 of Article 1 of the Banking Law establishes that the SBP shall have its own funds that are separate and independent from the central government, and which it administers independently and with full freedom and autonomy. The SBP's main sources of income are from Banking Regulation Fees and Inspection Fees. However, this power has been heavily circumscribed following the passage of the Budget Law in 2019. Since the passing of that Law, all recruitment and other personnel decisions which have a budgetary impact need to be pre-approved by the relevant state institutions. Prior to 2019, the SBF had only to notify the MEF of its recruitment and other personnel expenditure. The Budget Law should be amended to restore the SBP's independence of action in respect of budgetary issues. In particular, the revisions should expressly provide that appointments made by the Superintendent of Banks, as legal representative of the SBP, are not subject to interference by any other State authority; and that said appointments are only sent to the MEF for its information, and to the Comptroller General of the Republic for its incorporation into the corresponding payroll, in order to restore the independence of action of the SBP with respect to all budgetary matters, and the future Budget Laws must maintain this autonomy.</p>
<b>EC2</b>	<p>The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.</p>
Description and findings re EC2	<p>Article 13 of the Banking Law sets out details regarding the position of the Superintendent. It specifies that the Superintendent is appointed for a term of five years, renewable for one additional term. Article 14 sets out the prerequisites for becoming Superintendent. These include the requirement to be a Panamanian citizen, have no close relationships with any members of the Board of Directors, have relevant executive/managerial experience in banking, finance or related activities, have no significant holdings above five percent in a regulated entity, and have not been subject to bankruptcy proceedings or convictions of intentional or malicious crimes. Similar prerequisites for becoming a Director of the SBP are set out in Article 9. Article 10 sets the term of a director at ten years, renewable once only for an equal term.</p> <p>Article 17 of the Banking Law specifies that the Superintendent and Directors of the SBP may only be dismissed by a decision of the Supreme Court of Justice for the reasons set out in Article 18. These are limited to:</p> <ol style="list-style-type: none"> <li>1. Permanent inability to discharge his/her duties</li> <li>2. Declaration of bankruptcy, involvement in insolvency proceedings or being in a manifest state of insolvency</li> <li>3. Failure to comply with the prerequisites for becoming a director or Superintendent</li> </ol>

	<ol style="list-style-type: none"> <li>4. Lack of integrity in the discharge of his/her duties</li> <li>5. Repeated and unjustified absence from meetings of the Board of Directors; and</li> <li>6. Failure to comply with the obligations and prohibitions imposed by the Banking law.</li> </ol> <p>The last two Superintendents fulfilled their five-year mandates in full (2009-2015 and 2015-2020, and the current Superintendent has been in situ since January 2021. Although the Banking Law does not require the reasons for removal of the Superintendent or Director to be made public, the decision to remove the Superintendent or Director is taken by the Supreme Court which would be in the public domain.</p>
<b>EC3</b>	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives. <sup>14</sup>
Description and findings re EC3	<p>The objectives of the SBP are clearly stated in Article 5 of the Banking Law (see BCP 1 (EC1)) and the SBP's strategic plan for the period 2020-2024 is published on its website. On an annual basis, the SBP presents its results to the International Banking Center (CBI). The presentation includes the SBP's regulatory roadmap.</p> <p>At a governmental level, Article 26 of Law 6 – 2002 requires:</p> <p>"Annually, all public institutions (including the SBP) shall include in the reporting materials submitted to the Legislative Body a report that contains the following:</p> <ol style="list-style-type: none"> <li>1. The number of information requests submitted to the institution.</li> <li>2. The number of requests resolved and denied.</li> <li>3. A list of the administrative acts subject to public participation with a report on the observations and the decisions ultimately adopted." </li></ol>
<b>EC4</b>	The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.
Description and findings re EC4	<p>The SBP has a structured approach to decision-making on banking supervisory matters, with internal committees chaired at the appropriate level. The composition of the committees is set out in the MUSBER. Regulation 27-2022 sets out the rules of procedure of the Board of the SBP. Article 2 of the regulation specifically provides for the Chair of the Board to convene regular and, as necessary, special meetings of the Board.</p> <p>Article 19 of the Banking Law sets out a requirement for the Superintendent or a member of the Board of Directors to abstain from attending a Board meeting when a subject is to be discussed with which any member may have a conflict of interest. In the absence of a voluntary recusal, the Board may formally require the Superintendent to refrain from attending the meeting.</p>
<b>EC5</b>	The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.

<sup>14</sup> Please refer to Principle 1, Essential Criterion 1.

Description and findings re EC5	<p>The SBP has a very comprehensive training and career development program for its supervisory staff which is enshrined in the Banking Law (Articles 24-37). The integrity of staff is undoubted, and their professionalism remarked upon in discussions with industry. The SBP has issued a Code of Ethics for its staff (Resolution 46-2011). Sections 4 and 15 of the Code cover the issue of confidentiality when dealing with information obtained in the course of working in the SBP, and Section 7 sets out the requirements around managing potential conflicts of interest. Article 25 of the Code sets out the sanctions to be imposed in the event of non-compliance with the Code.</p>
EC6	<p>The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes:</p> <ul style="list-style-type: none"> <li>(a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised;</li> <li>(b) salary scales that allow it to attract and retain qualified staff;</li> <li>(c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks;</li> <li>(d) a budget and program for the regular training of staff;</li> <li>(e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups; and</li> <li>(f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g., supervisory colleges).</li> </ul>
Description and findings re EC6	<p>Although paragraph 2 of Article 4 of the Banking Law states that the SBP approves its income and expenditure budget, as noted in (EC1), the SBP no longer has autonomy over its ability to recruit new staff or promote staff internally. Approval for such decisions is required from the MEF.</p> <ul style="list-style-type: none"> <li>(a) The annual budget for staff is set on the basis that it is sufficient to recruit and retain the staff required to conduct effective supervision, but recruitment is constrained by the need to get prior approval from the MEF. Vacancies within the SBP at 96 are at an all-time high.</li> <li>(b) The salary scale of the SBP is based on a study of several salary surveys of the financial market. The objective of the compensation policy is to develop and retain individuals with appropriate skills, but vacancies remain in certain specialist areas such as market risk, operational risk, technological risk and cybersecurity where competition from the private sector is strongest. Currently, 18 percent of positions assigned (230) to the technical areas of the SBP remain vacant. Turnover levels in general are at acceptable levels at 5.03 percent for on-site supervision staff and 5.58 percent for supervisors overall.</li> <li>(c) Article 66 of the Banking Law provides that the SBP may carry out inspections of banks with its own personnel or may outsource them to independent external auditors or to specialized, qualified professionals.</li> </ul>

	(d) , (e) and (f) The SBP sets internal budgets for training, technology, and travel expenditure on an annual basis, but these have been blocked in line with the issues raised in EC1 around the provisions in the Budget Law.
EC7	As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill-sets identified.
Description and findings re EC7	The SBP conducts a thorough annual assessment of resources to identify its projected needs, both in the short and medium term. As noted in EC6, the level of vacancies is at an all-time high. With its autonomy over budget decisions constrained by the need for pre-approval by MOF, the SBP is constrained in adjusting its compensation package to attract specialist staff, given that competition with the private sector remains strong.
EC8	In determining supervisory programs and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.
Description and findings re EC8	The SBP has adopted a risk-based approach to supervision, applying greater resources to those banks which pose the greatest risk. (See BCP 8.) The SBP's supervisory model varies the timing of bank examinations according to the risk profile and systemic importance of the bank.
EC9	Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.
Description and findings re EC9	Article 21 of the Banking Law provides all staff of the SBP, including former staff, with the right to the payment of all legal expenses and costs necessary for their defense when they are the subject of legal actions, proceedings, trials or lawsuits resulting from their actions or decisions taken in discharge of their duties, functions or obligations. In the past five years, there have been 19 cases of litigation against SBP decisions, none of which was successful.
<b>Assessment of Principle 2</b>	Materially non-compliant
Comments	<p>Although Article 4 of the Banking Law established the SBP with full legal status as an autonomous agency of the government, including administrative, budgetary, and financial independence, this autonomy has been significantly constrained following the passing of the Budget Law in 2019. Since the passing of that Law, all recruitment and other personnel decisions which have a budgetary impact need to be pre-approved by the MEF. Prior to 2019, the SBF had only to notify the MEF of its recruitment and other budgetary expenditure. Delays in getting MEF approval for new recruits have given rise to the high level of vacancies in the SBP.</p> <p>Recommendation:</p> <ul style="list-style-type: none"> <li>Amend the Budget Law to restore the SBP's independence of action in respect of budgetary issues.</li> </ul>

<b>Principle 3</b>	<b>Cooperation and collaboration.</b> Laws, regulations or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information. <sup>15</sup>
<b>Essential criteria</b>	
<b>EC1</b>	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	<p>Paragraph 21 of Article 16 of the Banking Law provides the SBP with powers to establish cooperation links with public institutions, including all other domestic regulatory authorities. The SBP has signed MoUs with the following domestic regulatory authorities: Superintendency of Insurance and Reinsurance of Panama and National Securities Commission of Panama; Superintendence of the Securities Market of Panama; Superintendence of Insurance and Reinsurance of Panama (coordinated inspections); Superintendence of the Securities Market of Panama (coordinated inspections); and Superintendency of the Securities Market of Panama (Prevention BC/FT/FPADM-Supervision of Retirement and Pension Funds).</p> <p>In addition to the above MoUs, the SBP has agreements with the Ministry of Trade and Industry (MICI), the Financial Analysis Unit (UAF), the Superintendency of Non-financial Institutions, the Public Prosecutor's Office, the General Revenue Directorate under the Ministry of the Economy and Finance (MEF-DGI), and the Government Innovation Authority. The SBP is also represented on the Financial Coordination Council (CCF), which was established in 2011 (Law 67) as a forum for the exchange of information among financial sector regulators. The FCC meets every two months.</p> <p>As noted in BCP1 (EC1), the SBP does not have a formal MoU with the Panamanian Autonomous Cooperative Institute (IPACO-OP).</p> <p>Assessors reviewed correspondence and minutes of the discussions between the regulatory bodies and were satisfied that the collaboration and communication is effective.</p>
<b>EC2</b>	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC2	The SBP has Agreements or Memoranda of Understanding with the foreign supervisors of all overseas banks operating in Panama and countries in which Panamanian banks are operating. Evidence was cited of SBP active participation in Colleges of Supervisors held for regional banking groups that have operations in Panama and for domestic banks which have operations in the region. Cross-border inspections are carried out in different

<sup>15</sup> Principle 3 is developed further in the Principles dealing with "Consolidated supervision" (12), "Home-host relationships" (13) and "Abuse of financial services" (29).



	countries where these regional groups have an operational presence. In addition, the SBP is party to the "Multilateral Memorandum of Exchange of Information and Mutual Cooperation for consolidated and cross-border supervision among the members of the Council of Superintendents of Banks, of Insurance and other financial institutions" (CCSBSO MOU). The CCSBSO MOU covers eight Latin American countries with a ninth (Ecuador) in the process of joining. The CCSBSO MOU provides a forum for the exchange of information through monthly meetings of its Technical Liaison Committee (TLC). Discussions at the TLC are informed by the regular exchange of prudential information on banking groups with cross border activities between member countries of the CCSBSO.
<b>EC3</b>	The supervisor may provide confidential information to another domestic authority or foreign supervisor but must take reasonable steps to determine that any confidential information so released will be used only for bank-specific or system-wide supervisory purposes and will be treated as confidential by the receiving party.
Description and findings re EC3	The MoUs signed by the SBP with both domestic and overseas regulators contain a clause to ensure confidential information is used only for bank specific purposes.
EC4	The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession. In the event that the supervisor is legally compelled to disclose confidential information it has received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information.
Description and findings re EC4	Article 110 of the Banking Law specifies that "information related to individual clients of a bank obtained by the Superintendency in the discharge of its functions shall be maintained under strict confidentiality and may only be revealed when required by a competent authority in the course of criminal proceedings, as required by legislation in force." In practice, the SBP treats all information shared by other regulators under the terms of MoUs as strictly confidential and would not share such information with third parties unless with the express consent of the supervisor providing the information. However, only the latest MoU signed with the regulatory authorities of Colombia. contains an express clause which covers the issue of disclosure of confidential information received from other regulators. The clause will be added to all other MoUs as and when they are updated. In practice, there have been no examples of the SBP receiving requests to disclose confidential information received from another regulator to a third party. If such a request were received and the SBP legally compelled to disclose the information, it would notify the relevant regulator.
EC5	Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.
Description and findings re EC5	Although the SBP is not defined legally as the Resolution Authority in Panama, it effectively undertakes this role under the powers in Chapters XVI (Administrative and Operating

	Control of the Bank), XVII (Reorganization of the Bank), and XVIII (Compulsory Liquidation) of the Banking Law, which provide that it should appoint an administrator, receiver, or liquidator, as appropriate, in the event of a bank failure. As and when a resolution framework is established in Panama, the SBP should ensure that it meets the standards of cooperation and collaboration to undertake recovery and resolution planning and action.
<b>Assessment of Principle 3</b>	Compliant
Comments	<p>The Banking Law provides the SBP with appropriate powers to establish cooperation links with all domestic and foreign regulatory authorities and MoUs, both bilateral and multilateral, have been agreed with all relevant authorities. The Banking Law also enshrines strict confidentiality requirements on information received in the course of supervisory activities. Recent MoUs have specifically included full confidentiality clauses, and these should be incorporated in all MoUs when updated.</p> <p>Recommendation:</p> <ul style="list-style-type: none"> <li>• Update existing MOUs with clause that covers the issue of disclosure of confidential information received from other regulators</li> </ul>
<b>Principle 4</b>	<b>Permissible activities.</b> The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word “bank” in names is controlled.
<b>Essential criteria</b>	
<b>EC1</b>	The term “bank” is clearly defined in laws or regulations.
Description and findings re EC1	Paragraph 4 of Article 3 of the Banking Law defines the term ‘bank’ as any person engaged in the banking business or acting as a representative office. ‘Banking business’ is defined in paragraph 30 of Article 3 – see EC2.
<b>EC2</b>	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
Description and findings re EC2	Article 2 of the Banking Act provides that only those persons who have obtained a license from the SBP may undertake ‘banking business’. This is defined in paragraph 30 of Article 3 as “principally, the receipt of resources from the public or from financial institutions by means of the acceptance of time deposits or by any other means determined by the SBP or by banking practices, and the use of such resources for the bank’s benefit and at its own risk, to grant loans, make investments or for any other transaction authorized by the SBP.”
<b>EC3</b>	The use of the word “bank” and any derivations such as “banking” in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	Article 44 of the Banking Law provides that only those banks with a banking license may use the word “Bank” or any of its derivatives in any language, be it in their everyday name, their corporate name, their commercial denomination, description, letterheads, invoices, printed letter paper, announcements, advertising or by any other means or form that may indicate or induce anyone to think that they are engaged in or dedicated to the banking

	business. Specifically excluded from these provisions are institutions or associations that are exclusively dedicated to humanitarian or charitable activities, governmental entities engaged in the financing of social interest sectors, and multilateral or international organizations recognized by the Republic of Panama. In exceptional cases the SBP may authorize the use of the word “bank” or any of its derivatives in any language, to a person or legal entity that does not engage in the banking business, if the word “bank” or its derivatives is to be used only as part of the name of the applicant and does not create confusion or doubt about the nature of the operations and activities to be realized. There have been no such cases to date.
<b>EC4</b>	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks. <sup>16</sup>
Description and findings re EC4	Article 2 of the Banking Law provides that only those persons who have obtained a banking license may engage in the banking business in or from the Republic of Panama. Article 45 provides the SBP with powers to investigate potential deposit taking by unlicensed entities and, if necessary, to take control of them. If such deposit taking is proven, Article 45 also provides the SBP with the power to close the operation.
<b>EC5</b>	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings re EC5	A schedule of banks licensed by the SBP is published on the SBP’s website.
<b>Assessment of Principle 4</b>	Compliant
Comments	The permissible activities of institutions that are licensed and subject to supervision by the SBP as banks are clearly defined and the use of the word “bank” in names is controlled.
<b>Principle 5</b>	<b>Licensing criteria.</b> The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management) <sup>17</sup> of the bank and its wider group, and its strategic and operating plan, internal controls, risk management and projected financial condition-(including capital base). Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.

<sup>16</sup> The Committee recognizes the presence in some countries of non-banking financial institutions that take deposits but may be regulated differently from banks. These institutions should be subject to a form of regulation commensurate to the type and size of their business and, collectively, should not hold a significant proportion of deposits in the financial system.

<sup>17</sup> This document refers to a governance structure composed of a board and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier board structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, in contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific board structure. Consequently, in this document, the terms “board” and “senior management” are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

<b>Essential criteria</b>	
<b>EC1</b>	<p>The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.</p>
Description and findings re EC1	<p>The SBP is the authority responsible for granting and withdrawing a banking license. Paragraph 1(1) of Article 16 of the Banking Law provides the SBP with the power to approve temporary operating permits and banking licenses, and paragraph 1(5) provides the SBP with the power to order the cancellation of banking licenses.</p> <p>The SBP has the power in Article 7 of Regulation 3-2001 to impose prudential conditions or limitations on a newly licensed bank. In practice, the SBP has set higher capital requirements for newly licensed banks above the minimum specified in the Banking Law. The SBP undertakes a formal inspection of each newly licensed bank after six months to ensure that it has fully complied with the terms of the license.</p>
<b>EC2</b>	<p>Laws or regulations give the licensing authority the power to set criteria for licensing banks. If the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or-supervisor determines that the license was based on false information, the license can be revoked.</p>
Description and findings re EC2	<p>Article 48 of the Banking Law sets out the broad criteria for the approval or refusal of a banking license. These cover the identity, probity and experience of the principal shareholders, the capacity of the principal shareholders to contribute the minimum capital required, the viability of the business plan, submission of comprehensive corporate governance policies and procedures, and any other criteria that the SBP may consider relevant. These criteria are expanded upon in Articles 3 for the fit and proper assessment of management (see EC7) and Article 4 which covers the corporate governance requirements (see EC8).</p> <p>Article 56 sets out the causes for cancelling a bank's license. These include failure to commence operations within six months of the license being granted (unless an extension is approved), ceasing to undertake banking business, intervention by the parent overseas regulator leading to closure of the bank or the SBP deciding that effective consolidated supervision is no longer possible, submission of false or misleading information in the application process, repeated serious violations of the Banking Law or any other causes determined by the SBP.</p> <p>The procedure for granting licenses is as follows:</p> <ul style="list-style-type: none"> <li>• Before the application for a banking license is submitted to the SBP, the bank or its promoter must request a meeting with the Superintendent of Banks to present the details of the bank, its perspectives and aspirations. This meeting is chaired by the Superintendent and is attended by the SBP's General Secretary and the directors of relevant directorates.</li> </ul>

	<ul style="list-style-type: none"> <li>• If the SBP has no objection to the license application being submitted, a formal note of no objection is sent to the bank or its promoter.</li> <li>• Once the application is received, the SBP reviews the documentation received to ensure it is comprehensive and satisfies the criteria set out in the Banking Law. If considered complete, a Notice to the Public will be prepared for publication in a national newspaper to inform the public of the application. This includes the names and general information of the applicants, directors and officers, and operational background of the applicants. If there are persons who have reason to oppose the granting of the license, they must submit them in writing to the SBP, with their respective evidence, within 15 calendar days following the date of the last publication of the notice to the public.</li> <li>• If there is no opposition to the granting of the license, the application is first considered for approval or rejection by the SBP's Analysis Committee. The Evaluation Committee then approves or not the recommendation made by the Analysis Committee, to be sent to the Superintendent.</li> <li>• If the temporary permit is granted, it is valid for 90 days, extendable, upon request and evaluation by the SBP. Once the temporary permit has been granted by the Superintendent and the new entity has been registered in the Public Registry of Panama, the applicant must comply with the minimum paid-up capital, as appropriate.</li> <li>• Once the License has been granted, the bank must notify the SBP, at least 2 months in advance, of its date of commencement of operations, to coordinate the pre-operational inspection, as well as the training of the personnel of the new bank.</li> </ul> <p>There have been no applications for new commercial banks in the past five years, but three applications for foreign banks have been approved. No applications have been denied.</p>
<b>EC3</b>	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Description and findings re EC3	The criteria for issuing licenses are the same as those applied in ongoing supervision.
<b>EC4</b>	The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis. <sup>18</sup> The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.
Description and findings re EC4	Article 27 of Regulation 7-2014 specifies that the SBP should, as part of the licensing process, evaluate the structure and organization of the banking group and the economic group to which the bank belongs, to determine whether there are impediments for the consolidated supervision or circumstances that make it difficult. The SBP should not grant the license unless the impediments or circumstances that make consolidated supervision difficult are corrected to its satisfaction. In practice, this involves an assessment of (i) the corporate governance structure of the banking group (ii) a feasibility study of the parent

<sup>18</sup> Therefore, shell banks shall not be licensed. (Reference document: BCBS paper on shell banks, January 2003.)

	and wider group entities (iii) management manuals for all material risks of the bank and the consolidated risks of the banking group and, (iv) internal control structure of the bank and the banking group, to establish any hindrance to effective supervision of the banking group.
<b>EC5</b>	The licensing authority identifies and determines the suitability of the bank's major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.
Description and findings re EC5	Article 48 of the Banking Law specifies that the SBP should consider the identity of the principal shareholders and the professional competence of the administrative staff based on their experience, integrity, and professional background. Section 9 (c) of Regulation 3-2001 provides additional detail on the specific documentation required to undertake this assessment. Banks are required to submit detailed and precise information to confirm the identity, residence, address, nationality (identity card and/or passport), occupation and participation percentage in the capital of the stockholders of the applicant, its promoter and the promoter's directors and officials, and their stock participation. The assessment is pursued through to the ultimate beneficial owners. This assessment also considers the ability of prospective shareholders to provide additional financial support as required. This process was checked by assessors in the course of reviewing files. All reasonable efforts were made to identify the ultimate beneficial owners, including looking behind the trustees in Foundations.
<b>EC6</b>	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC6	Article 68 of the Banking Law establishes the minimum amount of paid-up share capital, net of losses, required to maintain a banking license according to the type in question. Banks may not, at any time, allow their capital to fall below the minimum amount required. The minimum amounts are as follows: <ul style="list-style-type: none"> <li>• General license: USD 10 million</li> <li>• International License: USD 3 million of which, USD 2.5 million will be held as collateral in any of the official banks.</li> <li>• Representation License: no minimum capital requirement.</li> </ul> During the analysis of the application, among other aspects, the sufficiency of the capital is verified according to the business plan presented.
<b>EC7</b>	The licensing authority, at authorization, evaluates the bank's proposed Board members and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank. <sup>19</sup> The licensing authority determines whether the bank's Board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks.

<sup>19</sup> Please refer to Principle 14, Essential Criterion 8.

Description and findings re EC7	<p>Article 2 of Regulation 3-2001 requires the SBP to ensure that the directors, officials and main stockholders of newly formed banks must possess a renowned moral and financial solvency. The license will not be granted if any of the Board or senior management:</p> <ul style="list-style-type: none"> <li>(a) Has been convicted of money laundering, illicit traffic of drugs, fraud, illegal traffic of arms or persons, kidnapping, extortion, embezzlement, corruption of public servants, acts of terrorism, international traffic of vehicles, or of any crime against property or legal authority.</li> <li>(b) Is disqualified to practice commercial activities in Panama or in another country.</li> <li>(c) Has been declared bankrupt or in civil contest of creditors.</li> <li>(d) Has been identified by the SBP as responsible for acts that lead to the compulsory liquidation of the bank.</li> </ul> <p>Article 3 expands on the fit and proper criteria for Board members and senior management. It states that the applicant bank must have proven experience in the operations for which they are requesting a banking license, with a history that shows the gradual increment of their financial capacity, without major or repeated drawbacks. The SBP will also require sufficient information about the directors, officials and executives to assess individually and collectively their experience in financial businesses, professional competence, moral integrity and relevant background. Assessors verified that these procedures were followed in practice.</p>
<b>EC8</b>	<p>The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.<sup>20</sup></p>
Description and findings re EC8	<p>Article 4 of Regulation 3-2001 sets out the corporate governance requirements for license applications. It states that "the applicants must prove that the bank for which they are applying will have an administrative structure that clearly takes into consideration the separation of responsibilities in various functions, an independent audit, the execution of the functions related to abiding by the laws, regulations and applicable internal policies, and a Board of Directors capable of carrying out an independent vigilance over the bank management. The applicant bank may prove compliance with this Article by presentation of documents that clearly describe the roles and responsibilities of the authorities that make the decisions in the bank, the hierarchical line of approvals required in all levels of the corporate government structure, starting with the Board of Directors, and also the mechanism for its interaction and cooperation between itself, the senior management and the internal and external auditors."</p> <p>Article 9(n) of Regulation 3-2011 sets out the additional documentation required from new bank applicants in respect of their business projections. This includes a description of the short, medium and long term plans the applicant proposes to develop once the license has been granted to demonstrate the bank's viability and its contribution to the Panamanian</p>

<sup>20</sup> Please refer to Principle 29.

	<p>economy. In the case of banking groups that will be subject to home supervision, the reporting lines of the business, risk management, and audit divisions are assessed in terms of the group's structure. The information requested in the business plan includes the following:</p> <ul style="list-style-type: none"> <li>(a) The reasons that support the creation of the proposed banking entity and its role within its banking group.</li> <li>(b) The strategy and business plan of the bank and the banking group (target market, sector analysis, market penetration and analysis of its competition).</li> <li>(c) Assessment of the risks inherent in the business plan.</li> <li>(d) Evaluation of measures to manage these risks.</li> </ul> <p>Risk management manuals must also be provided for all material risks of the bank and the consolidated risks of the banking group.</p> <p>Assessors verified from file reviews that the SBP's processes and procedures for reviewing the strategic and operational plans for the bank, including those for the necessary risk management, internal controls and governance arrangements, were followed in practice.</p>
<b>EC9</b>	<p>The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.</p>
Description and findings re EC9	<p>For new domestic banks, Article 9(o) of Regulation 3-2011 specifies that new applicants should submit their financial projections, projected organizational structure and expected profitability as part of the licensing process. Article 9(e) requires the submission of personal financial statements which detail the financial solvency of the directors, the major shareholders and/or those who would exercise control of the bank.</p> <p>In the case of branches, Article 10(r) of the Regulation requires the submission of comparative consolidated and audited financial statements of the applicant corresponding to the last two closed fiscal years, together with temporary financial statements no more than sixty days old. Article 10(s) also requires reports on the classification of the parent bank's asset portfolio and the expiry structure of assets and liabilities, details of the position of the bank in its place of origin, the main financial indicators (total assets, portfolio, deposits and equity), and the most recent rating of the supervising authority. Assessors confirmed that these procedures and processes are followed from file reviews.</p>
<b>EC10</b>	<p>In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.</p>
Description and findings re EC10	<p>Article 43 of the Banking Law specifies that foreign banks must have the authorization or non-objection from their home supervisor to request a license to engage in banking business in or from Panama or to request a representative office.</p> <p>Article 62 of the Banking Law requires foreign banks, their branches and subsidiaries in Panama to be subject to the consolidated supervision of their corresponding foreign supervisor. File reviews demonstrated that these procedures were followed in practice.</p>



<b>EC11</b>	The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
Description and findings re EC11	The SBP does not impose additional reporting requirements on newly licensed banks, but monitors progress against the bank's plans in its first six months after the license is approved. Evidence was provided of Directors and senior management being called in to the SBP to revise their plans shortly after approval as insufficient progress had been made. Full inspections of newly licensed banks are undertaken after six months and remedial action is required for any weaknesses identified in the bank's business plan or internal controls.
<b>Assessment of Principle 5</b>	Compliant
Comments	The SBP's approach to licensing banks is thorough. The legal framework provides the SBP with the necessary powers to set criteria and reject applications for applicants that do not meet those criteria. The process involves discussions with applicants at an early stage to assess the viability of the application, and detailed assessment as the application proceeds of the ownership structure, fitness and properness of Board members and senior management, financial viability of the proposal and of the proposed corporate governance arrangements. Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
<b>Principle 6</b>	<b>Transfer of significant ownership.</b> The supervisor <sup>21</sup> has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
<b>Essential criteria</b>	
<b>EC1</b>	Laws or regulations contain clear definitions of "significant ownership" and "controlling interest".
Description and findings re EC1	<p>Article 3 of Regulation 1-2004 defines a change of control when, as a result of the transfer, the buyer or other linked natural or juridical person, or a group of natural or juridical persons acting in concert:</p> <ol style="list-style-type: none"> <li>1. Become the sole or majority owners; or</li> <li>2. Obtain direct or indirect control over its management.</li> </ol> <p>Management control occurs when the buyer or other linked or natural or juridical persons may directly or indirectly appoint the majority of the Board of Directors, members, the corporation's President and legal representative, or the General Manager, or top executives.</p> <p>Article 4 of Regulation 1-2004 defines significant interference (control) as "Transfers of shares of Banks and Economic Groups of which Banks are a member shall require prior authorization by the SBP whenever the acquirer or other natural or juridical persons, acting individually or in concert, obtain a Significant Interference by controlling 25 percent or more of the total shares as a result of said transfer."</p>

<sup>21</sup> While the term "supervisor" is used throughout Principle 6, the Committee recognizes that in a few countries these issues might be addressed by a separate licensing authority.

<b>EC2</b>	There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.
Description and findings re EC2	<p>Under Article 2 of Regulation 1-2004, transfers of shares of banks, and economic groups of which banks are a member, require the prior authorization of the SBP, whenever such action causes a change in control, or there exists a concerted action causing a change in control or an acquisition of significant interference.</p> <p>Article 4 defines the threshold at which prior authorization of the SBP is required. It states that prior approval is required for transfers of shares of banks and economic groups of which banks are a member whenever the acquirer or other natural or juridical persons, acting individually or in concert, obtain a significant interference by controlling 25 percent or more of the total shares. The SBP has approved 16 applications for changes in significant interference in the past 5 years. No application has been declined. There is no threshold below 25 percent above which the SBP should be notified of an acquisition of shares in a bank, although Rule 4-2021 provides that "any transfer of banks and economic groups stocks, of which banks are part, as well as any modification in stockholders' participation in the equity of said banks, even if this does not cause a Change in Control or Significant Interference, must be notified to the SBP in advance. This notification must be made by the bank." There was evidence cited of such notifications being received.</p>
<b>EC3</b>	The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership meets criteria comparable to those used for licensing banks. If the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.
Description and findings re EC3	<p>Article 14 of Regulation 1-2004 sets out the criteria that the SBP apply to reject a proposed change in significant ownership. These are as follows:</p> <ol style="list-style-type: none"> <li>1. The consolidated supervisor lacks the legal ability to supervise in a consolidated manner, or, if vested with such authority, has not exercised it at the time of submission of the application.</li> <li>2. The consolidated supervisor refuses to certify that it will provide all the information and cooperation necessary to carry out an effective supervision.</li> <li>3. The transaction may cause an adverse effect to banking competition in Panama that exceeds its potential positive effect to the public interest.</li> <li>4. The application is deemed incomplete after the term for submission to the Superintendency has expired.</li> <li>5. The information regarding the reputation and integrity of the applicants cannot be verified and confirmed.</li> <li>6. There is reasonable doubt concerning the reputation, integrity and experience of the applicants.</li> <li>7. There is reasonable doubt concerning the source of funds for the acquisition or transfer of shares leading to a change of control.</li> <li>8. The applicants submitted false information or documentation or omitted</li> </ol>

	<p>substantial information or documentation.</p> <p>9. There are marked weaknesses in the programs for the prevention of money laundering and prevention of financing of terrorism.</p> <p>10. The analyses and evaluations made by the SBP determine the inconvenience of the operation for the banking center.</p> <p>11. The analyses and evaluations made by the SBP determine the inconvenience of the operation for the acquired or acquiring entity.</p> <p>Article 16 (18) of the Banking Law provides the SBP with the general power to “issue regulations to avoid or correct irregularities or flaws in bank operations which, in the SBP’s judgment, may jeopardize the interests of depositors, the stability of a bank or the soundness of the banking system.” In broad terms, this power could be employed to reverse a share transaction or remove voting rights if a transfer of significant ownership were undertaken without prior approval or based on misleading information. But this has not been tested in practice as no such transfer of significant ownership without prior approval has occurred. The SBP would be in a stronger legal position if there were an explicit regulation which gave it the power to reverse an illegal share transfer or to remove voting rights in such a situation. As such, the SBP has no explicit power to reverse a share transaction or remove voting rights if the transaction were undertaken without prior approval or based on misleading information.</p>
<b>EC4</b>	The supervisor obtains from banks, through periodic reporting or on-site examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.
Description and findings re EC4	The SBP receives an annual statement from banks setting out the names and holdings of all significant shareholders and verifies these details as part of the on-site inspection process.
<b>EC5</b>	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.
Description and findings re EC5	See EC3. Although there has been no past incidence of a change of control that has taken place without the requisite notification or approval by the SBP, there is no specific law or regulation in place which provides the SBP with the power to modify, reverse or otherwise address such a change of control.
<b>EC6</b>	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Description and findings re EC6	There is no specific law or regulation which requires banks to notify the SBP immediately of any material change to the suitability of a major shareholder or a party that has a controlling interest.
<b>Assessment of Principle 6</b>	Materially non-compliant

Comments	<p>The definitions of significant ownership and change of control are clearly set out in the Banking Law. A threshold of 25 percent is set for pre-approval by the SBP of transfers of significant ownership or controlling interests held directly or indirectly in existing banks to other parties. It is common for an additional threshold to be set (often 10 percent) above which any transfer of shares in a bank must be pre-notified to the SBP. At present, any transfer of shares in banks below the 25 percent pre-approval threshold must be notified by the bank in advance.</p> <p>Although Article 16 (section 18) of the Banking Law provides the SBP with the general power to “issue regulations to avoid or correct irregularities or flaws in bank operations which, in its judgment, may jeopardize the interests of depositors, the stability of a bank or the soundness of the banking system”, the SBP has no specific power to reverse a share transaction or remove voting rights if a transfer of significant ownership were undertaken without prior approval or based on misleading information.</p> <p>There is no specific law or regulation which requires banks to notify the SBP immediately of any material change to the suitability of a major shareholder or a party that has a controlling interest.</p> <p>Recommendations:</p> <ul style="list-style-type: none"> <li>• Introduce a regulation that provides the SBP with the power to modify, reverse or otherwise address a change of control that has taken place without the necessary approval.</li> <li>• Consider introducing a threshold below the 25 percent pre-approval level at which immediate notification to the SBP of transfers of bank ownership is required.</li> </ul>
<b>Principle 7</b>	<p><b>Major acquisitions.</b> The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.</p>
<b>Essential criteria</b>	
<b>EC1</b>	<p>Laws or regulations clearly define:</p> <ul style="list-style-type: none"> <li>(a) what types and amounts (absolute and/or in relation to a bank’s capital) of acquisitions and investments need prior supervisory approval; and</li> <li>(b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank’s capital.</li> </ul>
Description and findings re EC1	<ul style="list-style-type: none"> <li>(a) Article 99 of the Banking Law states that “Banks and bank holding companies are prohibited from acquiring or owning stock or participations in any other ventures not related to the banking or financial business whose aggregate value exceeds twenty-five percent of their capital funds. Investments made by the bank as trustee are excepted, as well as participations or stocks that the bank or the bank holding company has acquired in payment of obligations. In this case, they must be liquidated at the earliest opportunity in accordance with the bank’s best economic interests as judged by the SBP. The SBP may establish a timeline for this action.</li> </ul>

	(b) There is no requirement in law or in regulations for banks or banking groups to notify of any acquisition or investment below the pre-approval level of 25 percent of capital.
<b>EC2</b>	Laws or regulations provide criteria by which to judge individual proposals
Description and findings re EC2	<p>Rule 1-2004 sets out the process and criteria by which the SBP assesses applications by banks for major acquisitions. A preliminary meeting is held with representatives of the bank to discuss the proposal. The SBP undertakes a technical evaluation of the documentation provided at the preliminary meeting and decides whether to issue a preliminary opinion either to discourage or encourage the application. The preliminary opinion is without prejudice to the final decision and is issued within three working days as of the date of the preliminary meeting.</p> <p>If the application proceeds, Article 14 of Rule 1-2004 sets out the criteria that the SBP consider when deciding whether to reject the proposal. These criteria are as follows:</p> <ol style="list-style-type: none"> <li>1. The Consolidated Supervisor lacks the legal ability to supervise in a consolidated manner, or, if vested with such authority, has not exercised it at the time of submission of the application.</li> <li>2. The Consolidated Supervisor refuses to certify that it will provide all the information and cooperation necessary to carry out an effective supervision.</li> <li>3. The transaction may cause an adverse effect to banking competition in Panama that exceeds its potential positive effect to the public interest.</li> <li>4. The application is deemed incomplete after the term for submission to the Superintendency has expired.</li> <li>5. The information regarding the reputation and integrity of the applicants cannot be verified and confirmed.</li> <li>6. There is reasonable doubt concerning the reputation, integrity and experience of the applicants.</li> <li>7. There is reasonable doubt concerning the source of funds for the acquisition or transfer of shares leading to a Change of Control.</li> <li>8. The applicants submitted false information or documentation or omitted substantial information or documentation.</li> <li>9. There are marked weaknesses in the programs for the prevention of money laundering and prevention of financing of terrorism.</li> <li>10. The analyses and evaluations made by the SBP determine the inconvenience of the operation for the banking center.</li> <li>11. The analyses and evaluations made by the Superintendency of Banks determine the inconvenience of the operation for the acquired or acquiring entity.</li> </ol> <p>In the past five years, the SBP has received and approved 16 applications representing a major acquisition or investment. No applications have been declined. The assessors reviewed file documentation and confirm that the above procedures were followed in all cases reviewed.</p>
<b>EC3</b>	Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of

	corrective measures in the future. <sup>22</sup> The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.
Description and findings re EC3	See EC2. The criteria applied for considering a new acquisition or investment include an assessment by the SBP as to whether it, as the consolidated supervisor, would lack the legal ability to supervise in a consolidated manner should the proposal be approved. The SBP has the power to prohibit banks from major overseas acquisitions if the host country refuses to certify that it will provide all the information and cooperation necessary for the SBP to carry out an effective supervision.
<b>EC4</b>	The supervisor determines that the bank has, from the outset, adequate financial, managerial and organizational resources to handle the acquisition/investment.
Description and findings re EC4	Rule 1-2004 sets out the information that should be submitted by the bank in support of its proposal for a major acquisition. This includes evidence of the funds available and their origin and of the ability of the bank to execute the transaction. The acquirer is also required to submit a business plan setting out the development plans once the acquisition has been authorized. File reviews evidenced that the SBP considered the financial and other resources, including managerial and operational resources, available to the acquirer in such applications.
<b>EC5</b>	The supervisor is aware of the risks that non-banking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in non-banking activities.
Description and findings re EC5	There is no law or regulation that requires banks to notify the SBP of any acquisitions of non-banking activities up to the pre-approval level of 25 percent of capital. Banks provide an annual notification of their organizational structure to the SBP when interests in non-banking activities will be reviewed by the SBP, but banks can acquire interests in non-banking activities up to 25 percent of their capital throughout the year without notification or prior approval to the SBP.
<b>Assessment of Principle 7</b>	Materially non-compliant
Comments	<p>The SBP has the power to approve or reject major acquisitions or investments by banks or banking groups above a threshold of 25 percent of capital. There is no requirement in law or in regulations for banks or banking groups to notify of any acquisition or investment below this threshold of 25 percent of capital. This hinders, in particular, the SBP's ability to assess risks that non-banking activities may pose to a banking group.</p> <p>Recommendation:</p> <ul style="list-style-type: none"> <li>• Introduce a threshold below the 25 percent pre-approval level at which immediate notification to the SBP is required after an acquisition or investment is made.</li> </ul>

<sup>22</sup> In the case of major acquisitions, this determination may take into account whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

<b>Principle 8</b>	<b>Supervisory approach.</b> An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.
<b>Essential criteria</b>	
<b>EC1</b>	<p>The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact and scope of the risks:</p> <ul style="list-style-type: none"> <li>(a) which banks or banking groups are exposed to, including risks posed by entities in the wider group; and</li> <li>(b) which banks or banking groups present to the safety and soundness of the banking system</li> </ul> <p>The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment and the resolvability of banks, and permits relevant comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.</p>
<b>Description and findings re EC1</b>	<p>The SBP adopted a risk-based approach and methodology to supervision in 2012. The methodology is set out clearly in the supervisory manual - "Manual Unico Supervision Basada en Riesgos" (MUSBER). MUSBER sets out the details of the SBP's banking supervisory framework and bank rating system (GREN-P). The supervisory framework is risk-based, focusing on assessing a bank and wider banking group's risk profile and the quality of a governance and risk management to manage those risks. MUSBER also sets out the processes for populating the SBP's Risk Assessment System (SER). The SER provides a detailed methodology for supervisors to assess a bank's residual risks, by matching the inherent risks within a bank against the quality of risk management and internal controls within the bank for those risks. The residual risks are those which are not adequately mitigated by the bank's risk management and internal control framework. Those areas within a bank with the greatest residual risk arising from the assessment are subject to more rigorous scrutiny and evaluation by the supervisor and form the basis on which the scope of supervisory work in the year ahead is determined.</p> <p>The GREN-P components of the bank rating system cover Governance (G), Risks (R), Economic and financial evaluation of a banking group at the consolidated level (E), Regulatory compliance (N), and Prevention (P), which measures and monitors the bank's risk of money laundering, terrorist financing and financing of the proliferation of weapons of mass destruction. Each GREN-P component is divided into a series of subcomponents. The components G, R and P, assess the quality of corporate governance and risk management in the bank, its risk profile and its measurement and monitoring of the bank's risk of money laundering etc. Component E considers the economic and financial threats posed to a banking group at the consolidated level and component N assesses compliance with SBP and other laws and regulations. The methodology combines both qualitative and quantitative elements. Assessment of the quality of a bank's risk management and internal</p>

	control framework is based on a combination of findings from previous on-site inspections and from the results of annual questionnaires that banks are required to submit on their compliance with the corporate governance regulations. The quantitative input derives from off-site analysis of prudential, regulatory, and other data. A senior committee within the SBP decides the ratings (1-5) for each GREN-P component based on the supervisory analysis, and a composite rating for the bank is derived from these component ratings. The rating process is conducted annually between August and December for all banks. Peer analysis is built into the assessments of composite bank ratings. The methodology does not consider resolvability of banks.
<b>EC2</b>	The supervisor has processes to understand the risk profile of banks and banking groups and employs a well-defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each bank is based on the results of this analysis.
Description and findings re EC2	<p>See EC1. The SBP's GREN-P supervisory model provides an effective methodology for assessing the residual risks that banks are running at the time of the assessment, but there is limited consideration of the future risks a bank or banking group may run. The methodology does include a review of a bank's strategic plan within the Governance (G) component of the framework, and discussions on the strategic plans are held with management during on-site inspections. Regular engagement with Board members and heads of the key control functions is not built into the supervisory framework. Such meetings provide useful information on developments and challenges in implementing the bank's strategic plan and on any strains that expected growth may be placing on the internal control framework. The SBP requires banks periodically to stress their capital projections, but this process is not systematically built into the supervisory framework. The SBP has drafted, but not implemented, an Internal Capital Adequacy Assessment Process (ICAAP) which, if implemented, would provide the SBP with useful data on a bank's forward-looking risk profile and capital needs. Implementation of the ICAAP should be incorporated within the SBP's strategic plan. The SBP should also consider introducing regular meetings with key members of a bank's senior management team (General Manager, Chief Risk Officer, Chief Financial Officer, and Head of Internal Audit) into its supervisory program – see BCP9 EC7.</p> <p>As noted in EC1, the intensity of the supervisory program for a bank or banking group is based on its composite rating derived from the SER, with higher risk banks/banking groups subject to greater supervisory oversight. The focus of the supervisory program is based on the residual risks identified from the SER analysis.</p>
<b>EC3</b>	The supervisor assesses banks' and banking groups' compliance with prudential regulations and other legal requirements.
Description and findings re EC3	<p>See EC1. The SBP specifically considers a bank and banking group's compliance with regulations under the 'N' component of its GREN-P regulatory model. The evaluation of compliance with regulations covers both prudential and other standards. The assessment is made through observations arising from on-site and off-site supervision.</p> <p>The subcomponents of the 'N' component which are assessed separately are:</p> <ul style="list-style-type: none"> <li>• Standards related to technical relations (liquidity and solvency).</li> <li>• Other standards.</li> </ul>



	<ul style="list-style-type: none"> <li>• Compliance with on-site and off-site monitoring observations.</li> <li>• Compliance with adaptation programs</li> </ul>
<b>EC4</b>	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also considers cross-sectoral developments, for example in non-bank financial institutions, through frequent contact with their regulators.
Description and findings re EC4	The Financial Research Directorate provides an assessment of the macro-economic environment in which a bank or banking group operates during the bank's risk assessment at the planning stage. The inspection planning stage involves an assessment of the bank's business, the nature of its transactions, and its information, accounting and control systems. The macroeconomic assessment feeds into the inherent risk profile of a bank at this stage. The SBP has active engagement with both domestic and overseas regulators to understand the risks that are presented to entities in the wider group or overseas.
<b>EC5</b>	The supervisor, in conjunction with other relevant authorities, identifies, monitors and assesses the build-up of risks, trends and concentrations within and across the banking system as a whole. This includes, among other things, banks' problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability.
Description and findings re EC5	Law No. 67 of 2011 established a system for coordination and inter-agency cooperation among financial control bodies. The forum for this coordination is the Financial Coordination Council (CCF), which is chaired by the Superintendent of Banks. The objectives of the CCF, which brings together all financial supervisory bodies of Panama, are to assess the main risks in the financial system and to enable the CCF to take the necessary corrective actions. File reviews indicated that the CCF is an effective forum for regulatory collaboration. Drawing on the work of the CCF, the Supervision Directorate, together with the Financial Research Directorate, the Risk Management Directorate, and the Directorate for the Prevention and Control of Illicit Operations, monitor the accumulation of risks, trends, and concentrations within the banking system as a whole and among the entities that comprise it. This analysis informs the planning stage of a bank risk analysis. The SBP also publishes an annual Financial Stability Report <sup>23</sup> setting out details of the performance of the financial sector in Panama and a wider assessment of the macro-prudential environment and threats posed to the financial system
<b>EC6</b>	Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank's resolvability where appropriate, having regard to the bank's risk profile and systemic importance. When bank-specific barriers to orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies,

<sup>23</sup> [Financial Surveys | Superintendency of Banks of Panama \(superbancos.gob.pa\)](https://superbancos.gob.pa/)

	managerial, operational and ownership structures, and internal procedures. Any such measures take into account their effect on the soundness and stability of ongoing business.
Description and findings re EC6	The SBP does not currently have a Resolution Framework in place and does not consider resolution issues in its supervisory framework.
<b>EC7</b>	The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.
Description and findings re EC7	The Banking Law (Articles 131-183) set out the grounds for seizing a failing bank (Chapter XVI), reorganizing a bank (Chapter XVII) and for compulsory liquidation of a bank (Chapter XVIII). The three chapters provide a clear framework and timelines for action in each stage of an orderly resolution or wind down of a bank. See also BCP 11 EC7.
<b>EC8</b>	Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.
Description and findings re EC8	See BCP 4 EC4. The SBP takes action when it becomes aware that an entity is conducting banking business without a license. The SBP is entitled to examine the books, accounts, and other documents of entities believed to be undertaking such activities. Any unjustified refusal to submit such documents shall be deemed to be a presumption that banking business is being conducted without a license. If necessary, the SBP may intervene in those establishments where it is presumed that banking business is being conducted without a license and, if such fact is proven, it shall order their closure. For these actions the SBP may receive assistance from the National Police and other authorities. The Law establishes fines of up to one million balboas for conducting banking business without a license. The SBP reviews the organizational structure of banking groups on an ongoing basis to ensure the structure does not hinder effective consolidated supervision.
<b>Assessment of Principle 8</b>	Largely Compliant
Comments	The SBP's supervisory framework provides an effective methodology for assessing the residual risks that banks are running at the time of the assessment, but there is limited consideration of the future risks a bank or banking group may run. The methodology includes a review of a bank's strategic plan within the Governance (G) component of the framework, and discussions on the strategic plans are held with management during on-site inspections. But regular engagement with Board members and heads of the key control functions is not built into the supervisory framework. Such meetings provide useful insight on developments and challenges in implementing the bank's strategic plan, and on any strains that expected growth may be placing on the risk and internal control framework within a bank. The SBP requires banks periodically to stress their capital projections, but this process is not systematically built into the supervisory framework. The SBP has drafted, but not implemented, an Internal Capital Adequacy Assessment Process (ICAAP) which, if implemented, would provide the SBP with useful data on a bank's forward-looking risk

	<p>profile and capital needs. Proposals to roll out implementation of the ICAAP should be incorporated within the SBP's strategic plan.</p> <p>Recommendations:</p> <ul style="list-style-type: none"> <li>• Introduce regular meetings with the heads of finance and control functions into the supervisory process.</li> <li>• Request regular submission of key internal management information (e.g., Internal Audit and Risk Committee reports) as part of the supervisory process to inform the ongoing risk assessment of banks and banking groups.</li> </ul>
<b>Principle 9</b>	<b>Supervisory techniques and tools.</b> The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor employs an appropriate mix of on-site <sup>24</sup> and off-site <sup>25</sup> supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between on-site and off-site supervision may be determined by the particular conditions and circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness, and integration of its on-site and off-site functions, and amends its approach, as needed.
Description and findings re EC1	<p>The SBP's banking teams comprise both on-site supervisors and off-site analysts. The Financial Conglomerate Department supervises 26 banking groups and comprises 63 staff, 9 of whom are off-site analysts. The Bank Department supervises 39 banks and 60 Trusts with 69 staff, 10 of whom are off-site analysts. There are 20 vacancies across these two teams. The Risk Department has 23 staff providing technical expertise across credit, market, operational, liquidity and technology risk. There are currently 6 vacancies in this area. The Prevention Department has 86 staff, with 13 vacancies, assessing AML systems and controls across 392 entities. The Regulatory Department, which develops supervisory policy, has a staffing complement of 6 staff, with 4 vacancies and the Financial Stability Department has 18 staff with 1 vacancy.</p> <p>The budgeted number of staff and mix between on- and off-site staff appears appropriate for the scale and nature of the Panamanian banking system, but vacancies within the departments are at an all-time high, exacerbated by the difficulties posed to recruitment imposed by the requirements of the Budget Law – see BCP2 EC1. The SBP undertakes</p>

<sup>24</sup> On-site work is used as a tool to provide independent verification that adequate policies, procedures and controls exist at banks, determine that information reported by banks is reliable, obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, monitor the bank's follow-up on supervisory concerns, etc.

<sup>25</sup> Off-site work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks and help identify the priorities, scope of further off-site and on-site work, etc.

	periodic reviews of the effectiveness of its on- and off-site regime. Such reviews result in updates to the MUSBER.
<b>EC2</b>	The supervisor has a coherent process for planning and executing on-site and off-site activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives, and outputs, and that there is effective coordination and information sharing between the on-site and off-site functions.
Description and findings re EC2	<p>The planning and implementation of the SBP's on-site and off-site inspection process is clearly defined in the MUSBER. There are two phases to the on-site process. A Planning Committee, composed of the Directors of Supervision, Risk Management, Legal and Prevention and Control of Illicit Operations, determines the banks and banking groups to be inspected during the inspection cycle, the type of visit (comprehensive inspection, follow-up inspection, special follow-up inspection, group visit and cross-border visit), the start date, duration and staff resources for each visit.</p> <p>The second stage involves planning for each inspection. This is developed in three sub-stages, involving a preliminary evaluation of the bank and its business, a preliminary assessment of the quality of risk management, and definition of the strategy and scope of inspection. All relevant areas of supervision are involved in this stage of the planning process, which results in a letter being sent to the bank at least 10 days before the start of the inspection setting out the scope of the inspection and the documentation and other information required by the SBP.</p> <p>The off-site process is described in Chapter VI of the MUSBER. It comprises three stages. Stage one is the monthly analysis of regulatory and other prudential data. Stage two involves a half-yearly update of a bank's risk profile for money laundering and terrorist financing and the third stage reviews compliance with regulations. The findings of the off-site analyses are used to update the SER in line with the schedule set out in the MUSBER. The MUSBER sets out in detail the processes to be followed by supervisors for both off-site and on-site.</p>
<b>EC3</b>	The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, information on a bank's related entities, and publicly available information. The supervisor determines that information provided by banks is reliable <sup>26</sup> and obtains, as necessary, additional information on the banks and their related entities.
Description and findings re EC3	The regulatory reports submitted by banks and banking groups to the SBP provide a broad range of data for review by analysts to inform their assessment of group-wide risks, but as noted in BCP 10 the SBP does not receive reported data on banking groups' consolidated liquidity positions. (See BCP 10 for a detailed schedule of regulatory reports submitted to the SBP.) This assessment is supplemented by sectoral analysis covering liquidity, solvency, non-performing loans, etc. conducted by the Financial Research and Risk Management Directorates. Internal management information is also reviewed as part of on-site

<sup>26</sup> Please refer to Principle 10.

	inspections but is not requested from banks as a matter of routine. The SBP validates the reliability of data provided by banks during on-site inspections.
<b>EC4</b>	<p>The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as:</p> <ul style="list-style-type: none"> <li>(a) analysis of financial statements and accounts;</li> <li>(b) business model analysis;</li> <li>(c) horizontal peer reviews;</li> <li>(d) review of the outcome of stress tests undertaken by the bank; and</li> <li>(e) analysis of corporate governance, including risk management and internal control systems.</li> </ul> <p>The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.</p>
Description and findings re EC4	<p>The SBP's risk assessment methodology documented in the MUSBER covers the following five components (See BCP 8):</p> <ul style="list-style-type: none"> <li>• Corporate governance (G)</li> <li>• Risks (R)</li> <li>• Economic-financial assessment (E)</li> <li>• Compliance(N)</li> <li>• Prevention (P)</li> </ul> <p>Within each of these components, there are further sub-components that the SBP assess separately. Between these components and sub-components, analysts conduct business model analysis and corporate governance analysis and financial statements are reviewed. The SBP has not issued specific guidance on the stress tests that banks should perform and the value of the tests submitted by banks is mixed. Those submitted by larger, systemically important banks add value to the SBP's risk analysis but those from smaller banks less so. The findings of the SBP's risk analysis, including the development of the supervisory program and GREN-P rating, are communicated to the bank in writing at the end of the inspection or earlier if required by the urgency of the inspection. All supervisory actions are subject to follow-up work.</p>
<b>EC5</b>	<p>The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerabilities that have the potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.</p>
Description and findings re EC5	<p>The Financial Research Directorate conducts research and analysis of the main macro-financial risks that could have an impact on the banking system. This work informs the Financial Stability Report (FSR) which is published annually by the SBP on its website. In addition, the three directorates (Financial Research, Risk, and Supervision) perform sensitivity analyses of liquidity risk, which include deposit withdrawals, decreases in the</p>

	<p>subscription of bonds expected to be paid within 186 days, and impairment in the value of investments (using legal liquidity as a basis).</p> <p>System-wide stress tests under baseline and adverse scenarios also form part of the SBP's macro-prudential toolbox. They are carried out both for systematically important entities and for the most vulnerable entities. The results are shared and discussed with risk and supervision management to inform the GREN-P ratings of the entities.</p>
<b>EC6</b>	The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.
Description and findings re EC6	The SBP assesses the effectiveness of banks' internal audit functions as part of its on-site inspection process and through the evaluation of an annual questionnaire that internal audit units need to submit to the SBP. The on-site inspection process involves reviews of the audit manuals, the reports generated, compliance with the annual work plan, and follow-up on the reviews carried out by the internal unit. Working documents and results are also reviewed to identify areas of risk.
<b>EC7</b>	The supervisor maintains sufficiently frequent contacts as appropriate with the bank's Board, non-executive Board members and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls. Where necessary, the supervisor challenges the bank's Board and senior management on the assumptions made in setting strategies and business models.
Description and findings re EC7	The Superintendent and his technical team meet members of banks' Boards and senior management to discuss serious concerns and the performance of their operations, but the frequency of such meetings is ad-hoc and not systematically built into the supervisory framework. Meetings with Board members, including the independent members and with the heads of finance, risk and internal audit, are held as part of on-site inspections, but rarely occur outside these visits. (See BCP 8.) The SBP should build regular meetings with the heads of material business units, finance and control functions into its supervisory plans for banks to gain an ongoing understanding of the performance and emerging risks that the bank faces. This would enhance the SBP's forward looking approach to supervision, with findings from such meetings informing the GREN-P rating of the bank and the planning of future supervisory inspections.
<b>EC8</b>	The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses in a timely manner by means of written reports or through discussions or meetings with the bank's management. The supervisor meets with the bank's senior management and the Board to discuss the results of supervisory examinations and the external audits, as appropriate. The supervisor also meets separately with the bank's independent Board members, as necessary.
Description and findings re EC8	Once the on-site inspection is completed, the supervision team holds a closing meeting with the bank's senior management to discuss the main findings identified and a written record is drawn up. A written Matrix of Findings and Recommendations is then presented to the bank. Meetings with a bank's Board are not held as a matter of routine during the on-site inspection process but are held when appropriate. Similarly, the SBP only meets a

	bank's independent board members when considered necessary and not as a matter of routine in all on-site inspections.
<b>EC9</b>	The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early escalation to the appropriate level of the supervisory authority and to the bank's Board if action points are not addressed in an adequate or timely manner.
Description and findings re EC9	The SBP requires banks to draw up an action plan, with specific deadlines, to address all issues raised in an inspection. Regular reports are submitted by the bank to report on progress made in remediating issues raised. Where necessary, the SBP will undertake follow up inspections to monitor progress.
<b>EC10</b>	The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.
Description and findings re EC10	Article 13 of Regulation 5-2011 refers to the responsibilities of the Board of Directors of a bank and states that the Board should "keep the SBP informed about situations, events or problems that significantly affect or could affect the bank and the concrete actions to face and/or correct the identified deficiencies." Other Regulations require a bank to notify the SBP on portfolio purchase and/or transfer of deposits (Regulation 2-2004), of legal proceedings (Regulation) and mergers and acquisitions (Regulation 1-2004 mergers and acquisitions).
<b>EC11</b>	The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration the biases that may influence third parties.
Description and findings re EC11	Article 66 of the Banking Law provides the SBP with the power to "carry out inspections with its own personnel or may outsource them to independent external auditors or to specialized, qualified professionals. In the latter case, the inspection reports submitted must be evaluated by qualified members of the Superintendency staff," the SBP has not, to date, used third parties as part of their supervisory activities.
<b>EC12</b>	The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.
Description and findings re EC12	The SBP has a sophisticated IT system (ITBANK) for recording and processing regulatory data. The system allows the relevant functions within the SBP (Supervision, Risk, and the Financial Research Directorates) to analyze the data and to follow up as necessary. The IT system also populates the SBP's early warning indicator system, which identifies trends across a number of metrics.
<b>Assessment of Principle 9</b>	Largely compliant
Comments	The SBP employs an effective range of examination techniques and tools to support its supervisory processes and approach. On-site and off-site monitoring is integrated within supervisory departments, and multiple bank-specific and macro-economic analyses are

	<p>taken into consideration in scoping and conducting examinations. Supervisory planning is thorough and structured, with detailed processes set out in the MUSBER. The examination program is risk-based, ranging from full scope inspections to targeted reviews. All banks must be inspected at least every two years. The risk assessment process involves reviews of regulatory reports, financial statement and accounts, business model analysis and horizontal peer reviews. Findings are communicated to banks in a timely fashion, with clear deadlines set for remedial action. Mandated corrective actions are monitored in quarterly updates and follow-up on-site examinations are conducted where necessary.</p> <p>Bank internal management information is reviewed during on-site examinations but is not requested from banks as a matter of routine supervisory practice, and regular meetings with the heads of material business units, finance and control functions do not form part of banks' supervisory plans. Greater use of internal management information and more frequent engagement with bank senior management would enhance the SBP's risk assessment of banks and inform the planning of future supervisory inspections (see BCP 8.)</p>
<b>Principle 10</b>	<b>Supervisory reporting.</b> The supervisor collects, reviews, and analyzes prudential reports and statistical returns <sup>27</sup> from banks on both a solo and a consolidated basis, and independently verifies these reports through either on-site examinations or use of external experts.
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor has the power <sup>28</sup> to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations (including by economic sector, geography, and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.
Description and findings re EC1	Article 86 of the Banking Law provides the SBP with the power to request information from banks or banking groups. Although not explicit, in practice this applies to both solo and consolidated entities. Resolution 2-2022 sets out the schedule of reporting requirements for banks. Amongst the reports that are required on both a solo and consolidated basis are those detailing balance sheet and profit and loss data (AT21 and BAN21); capital adequacy (ADECAP and BAN16); liquidity (AT7, and 10, LS03 and BAN12-14); large exposures (BAN03); asset quality and provisioning (AT03 and BAN10); and market risk (BAN 17 and 18). There are no reporting requirements for consolidated liquidity positions, wider concentration risk (e.g., geographic, sectoral, currency) or for interest rate risk in the banking book.

<sup>27</sup> In the context of this Principle, "prudential reports and statistical returns" are distinct from and in addition to required accounting reports. The former are addressed by this Principle, and the latter are addressed in Principle 27.

<sup>28</sup> Please refer to Principle 2.



<b>EC2</b>	The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
Description and findings re EC2	The SBP issues banks with detailed reporting instructions for each reporting requirement.
<b>EC3</b>	The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and are consistently applied for risk management and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether the valuation used for regulatory purposes is reliable and prudent. Where the supervisor determines that valuations are not sufficiently prudent, the supervisor requires the bank to make adjustments to its reporting for capital adequacy or regulatory reporting purposes.
Description and findings re EC3	Article 11 of Rule 3-18 specifies that banks “will use methods technically appropriate and validated in the international banking practice to identify, measure, analyze (risks and markets), value, monitor and mitigate the positions affecting the risk management process the bank faces, and must be periodically reviewed. The bank must include in its risk measurement, policies and procedures for the scenarios resulting from a retrospective analysis of stress and worst-case scenarios.” The SBP reviews banks’ compliance against this Rule in on-site inspections through sampling and measuring valuations against Bloomberg prices. Instruments bought and traded by Panamanian banks are mainly vanilla, with very few level three valuations. In addition, internal audit evaluates compliance with a bank’s policies and procedures as well as with the provisions of the Rule.
<b>EC4</b>	The supervisor collects and analyzes information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank.
Description and findings re EC4	See EC1. Regulation 1-2000 sets out the reporting schedule for banks. Reports are submitted on weekly, monthly, quarterly, and annual bases depending on the nature of the information presented. The frequency of reporting is considered appropriate. The reporting schedule does not differ between Domestic Systemically Important Banks (DSIBs) and other domestic banks.
<b>EC5</b>	To make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	The SBP has separate reporting requirements for banks and banking groups but they are prepared on a consistent basis and dates.
<b>EC6</b>	The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.

Description and findings re EC6	Article 86 of the Banking Law provides the SBP with the power to request documentation and reports regarding their operations and activities from any bank, any firm in the banking group, bank holding companies and non-banking affiliates. This extends to internal management information.
<b>EC7</b>	The supervisor has the power to access <sup>29</sup> all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management and staff, when required.
Description and findings re EC7	Article 16 of the Banking Law provides the SBP with the power to access all bank records for the performance of its functions. Although there is no specific power to have access to all staff within a bank, this power is implicit in various articles in the Banking Act, including Article 59 which provides that all banks that engage in the banking business in the Republic of Panama are subject to inspection and supervision by the SBP to confirm their financial stability and their compliance with the provisions of this Decree Law and its regulations. In practice, the SBP has full and free access to all staff.
<b>EC8</b>	The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines the appropriate level of the bank's senior management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.
Description and findings re EC8	<p>Paragraph 2 of Regulation 4-2014 sets out the sanctions imposed on banks for late reporting. It states:</p> <p>"When banks are late reporting Atoms, BAN Charts, Reports or any other documents required through Circulars, SBP's letters and any other legal provision, the SBP will impose, at its discretion, any of the following sanctions according to the severity of its noncompliance and the damages caused to third parties:</p> <ol style="list-style-type: none"> <li>1. Private admonition.</li> <li>2. A fine of up to five hundred thousand balboas (B/.500,000.00), to be calculated for each business day, cumulatively, that the report is late, as follows: <ol style="list-style-type: none"> <li>a. A fine of one hundred fifty balboas (B/.150.00) to two hundred fifty balboas (B/.250.00) for each of the first ten (10) business days that the report is late;</li> <li>b. A fine of two hundred fifty balboas (B/.250.00) to five hundred balboas (B/.500.00) for each of the next ten (10) business days that the report is late;</li> <li>c. A fine of five hundred balboas (B/.500.00) to one thousand balboas (B/.1,000.00) for each of the next ten (10) business days that the report is late;</li> <li>d. In the case of delays of over thirty (30) business days in reporting required Atoms, BAN Charts, reports and other documents, a fine of one thousand balboas (B/.1,000.00) to one thousand five hundred balboas (B/.1,500.00)</li> </ol> </li> </ol>

<sup>29</sup> Please refer to Principle 1, Essential Criterion 5.

	<p>for each business day exceeding the first thirty (30) business days that the report is late.</p> <p>The Superintendent will determine the amount of the fine that will be applied according to the provisions above and according to each case.”</p> <p>Regulations do not specify the seniority of the individual within a bank who should sign/attest to the accuracy of the reports submitted to the SBP. In practice, the regulatory reports are often signed by the Compliance Officer of the bank. Regulatory Reports should be signed off by a senior manager of the bank.</p>
<b>EC9</b>	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a program for the periodic verification of supervisory returns by means either of the supervisor’s own staff or of external experts. <sup>30</sup>
Description and findings re EC9	The SBP currently has tools that allow for the validation of information submitted by banks through the automated reporting information system, but these validations do not assure the accuracy of the data submitted. On-site inspections are used periodically to evaluate the accuracy of regulatory reports submitted by a bank to the SBP, but these exercises are not systematic. The SBP does not engage external experts to ensure the accuracy of regulatory reports submitted to the SBP.
<b>EC10</b>	The supervisor clearly defines and documents the roles and responsibilities of external experts, <sup>31</sup> including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated task(s) and the quality of the work and takes into consideration conflicts of interest that could influence the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks’ operations.
Description and findings re EC10	Although Article 66 of the Banking Law provides the SBP with the power to “outsource [inspections] to independent external auditors or to specialized, qualified professionals. In the latter case, the inspection reports submitted must be evaluated by qualified members of the Superintendency staff”, the SBP has not made use of this power to date.
<b>EC11</b>	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified in the course of any work undertaken by them for supervisory purposes.
Description and findings re EC11	See EC10. Not applicable. The SBP does not currently engage external experts in its supervisory process.
<b>EC12</b>	The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.
Description and findings re EC12	Although there is no systematic approach to reviewing the information collected by the SBP from banks, the reporting package is evaluated by supervision and technical teams on

<sup>30</sup> May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

<sup>31</sup> May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be satisfied with the results of the reviews conducted by such external experts.

	an ongoing basis to determine whether new reporting requirements or changes to existing reporting requirements are required.
<b>Assessment of Principle 10</b>	Largely compliant
Comments	<p>The SBP collects and analyzes a wide range of prudential reports from banks on both a solo and a consolidated basis, but they do not cover consolidated liquidity returns, the wider concentration risks that banks or banking groups may run (e.g., geographic, sectoral, currency), or a bank or banking group's exposure to interest rate risk in the banking book. Verification of the accuracy of the data within the reports submitted by banks is undertaken by supervisors through on-site examinations, but the timing of such examinations is periodic and not systematic, and there is no regulation requiring the prudential reports to be signed-off by an appropriate level of the bank's senior management certifying their accuracy.</p> <p>Recommendations:</p> <ul style="list-style-type: none"> <li>• Introduce reporting requirements capturing consolidated liquidity positions</li> <li>• Introduce reporting requirements capturing wider concentration risks run by banks and banking groups (e.g., geographic, sectoral, currency)</li> <li>• Introduce reporting requirements capturing interest rate in the banking book</li> <li>• Require regulatory reports to be signed off by a senior manager of the bank to verify the accuracy of reports.</li> </ul>
<b>Principle 11</b>	<b>Corrective and sanctioning powers of supervisors.</b> The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor raises supervisory concerns with the bank's management or, where appropriate, the bank's Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank's Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.
Description and findings re EC1	The SBP identifies concerns in banks through by both off-site analysis and on-site inspections. As a support for early remediation, the SBP operates an early warning system (Sistema de Alerta Temprana or SIAT) that collects a wide range of data to generate various metrics that track banks' financial conditions (e.g., capital, liquidity, credit, asset quality, and other key indicators). These data are employed to establish trigger levels that are set for each bank given its business model, risk exposures, and risk management strength or weakness. The SBP employs this early warning system to bring prompt attention to existing or emerging supervisory issues. In instances where bank management is unable to address identified weaknesses to the SBP's satisfaction or directives, the SBP will seek prompt remediation, and should conditions continue to deteriorate, seek the bank's voluntary

	liquidation or closure. Concerns raised through the analysis of information sent periodically by the bank will be assessed for materiality and raised with the bank as appropriate. The findings of all on-site inspections are communicated to the bank through a letter to the Chairman of the Board, copied to the General Manager. The bank is required to draw up a plan to address issues raised in the inspection report with timely deadlines set. The action plan is monitored closely, with quarterly updates required from the bank and follow up inspections when required.
<b>EC2</b>	The supervisor has available <sup>32</sup> an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory actions, is engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened.
Description and findings re EC2	<p>Paragraphs 15, 16, 18 and 22 of Article 16 of the Banking Law set out the supervisory tools available to the SBP to address unsafe or unsound practices in a bank. These provide the SBP with the power to:</p> <ul style="list-style-type: none"> <li>15. Appoint advisors, supervisors or administrators in those banks that require special attention from the SBP</li> <li>16. Impose the relevant sanctions for violations of the provisions contained in this Decree Law or in regulations issued thereby.</li> <li>18. Issue regulations to avoid or correct irregularities or flaws in bank operations which, in the SBP's judgment, may jeopardize the interests of depositors, the stability of a bank or the soundness of the banking system.</li> <li>22. Evaluate the financial indicators of banks and banking groups to permit an adequate follow-up on principal banking risks such as capital adequacy, credit, liquidity, operating and market risks, and other risks that the Superintendency may consider appropriate.</li> </ul> <p>A range of tools used by the SBP in the course of its supervision were evidenced. These included examples of removing the President, General Manager and Directors after identifying a capital shortfall in a bank, and requiring the main shareholder to recapitalize; requiring both a capital and liquidity injection in a separate case; two banks were forced into liquidation in 2017 and one in 2019; requiring banks to merge and sell assets; the ability to raise capital and liquidity standards and to stop dividends.</p>
<b>EC3</b>	The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.
Description and findings re EC3	<p>See EC2 for examples of supervisory action taken by the SBP to address capital and liquidity shortfalls in banks.</p> <p>Chapters XV (Corrective Measures), XVI (Administrative and Operating Control of the Bank), XVII (Reorganization of the Bank), and XVIII (Compulsory Liquidation) of the Banking Law</p>

<sup>32</sup> Please refer to Principle 1.

	<p>set out the broad powers available to the SBP when a bank falls below established prudential limits.</p> <p>Specifically, Article 124 provides the SBP with the power to appoint an Advisor if the SBP determines that there exists, or may exist, a deterioration or operating, administrative or financial weakness in a bank. The role of the Advisor is to advise the bank on specific or prepare a report for the SBP on the general measures that must be taken to correct the deterioration or weakness. Article 125 provides that at any time during the advisory process, the SBP may order or implement preventive, restrictive or limiting measures to protect the interests of the depositors and may delegate these powers to the advisor.</p> <p>Paragraph 7 of Article 132 provides that the SBP may seize administrative and operating control of a bank if it confirms that the capital adequacy, solvency, or liquidity of the bank has deteriorated so as to require the SBP's action.</p>
<b>EC4</b>	<p>The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.</p>
Description and findings re EC4	<p>Paragraphs 4, 9, 15, 18, and 22 of Article 16 of the Banking Law set out the broad powers available to the SBP to take corrective action against a bank. As noted in EC2, paragraph 22 specifically provides the SBP with the power "To evaluate the financial indicators of banks and banking groups to permit an adequate follow-up on principal banking risks such as capital adequacy, credit, liquidity, operating and market risks, and other risks that the Superintendency may consider appropriate". Regulations do not specify the range of supervisory tools available to the SBP to address weaknesses in a bank, but evidence was cited of a range of actions taken to increase prudential limits on a bank, which include dismissing Board and senior management; forcing mergers; assuming control of a distressed bank and revocation of a banking license.</p>
<b>EC5</b>	<p>The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.</p>
Description and findings re EC5	<p>Paragraph 9 of Article 16 of the Banking Law provides the SBP with the power "to order the banks to remove its directors, officers or executives if, in his/her judgment, there is sufficient reason to do so."</p> <p>See EC2. The SBP provided evidence of supervisory action taken to remove the President, General Manager and Directors of a bank, prior to requiring the major shareholder to inject new capital into the bank.</p>
<b>EC6</b>	<p>The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and</p>

	other related entities in matters that could impair the safety and soundness of the bank or the banking system.
Description and findings re EC6	<p>The SBP has broad powers to take corrective action against a bank. These include:</p> <ul style="list-style-type: none"> <li>• Article 63 of the Banking Law, which provides the SBP with the power to require: "banking groups, including their holding companies, to take those measures necessary to prevent or correct practices or conditions that, in the Superintendency's judgment, might represent a material risk to the banks owned by these banking groups;</li> <li>• Article 18 which provides the SBP with powers to issue regulations to avoid or correct irregularities or flaws in bank operations which may jeopardize the interests of depositors, the stability of a bank or the soundness of the banking system; and</li> <li>• Article 20 which provides the SBP with the power to establish cooperative agreements with foreign supervisory bodies to strengthen control mechanisms, update preventive regulations, and exchange useful information in the discharge of supervisory responsibilities.</li> </ul> <p>The above do not, however, specifically provide the SBP with the power to ringfence a bank from the actions of wider group entities which may impair its safety and soundness.</p>
<b>EC7</b>	The supervisor cooperates and collaborates with relevant authorities in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings re EC7	The SBP does not have a formal resolution regime but has successfully wound down banks in the past in a timely and orderly fashion with no loss to depositor funds or contagion to the wider banking sector. In such cases, the SBP has cooperated and collaborated with overseas regulators through the forum of the CCSBSO and through bilateral and multilateral MoUs. Meetings of the Liaison and Resolution and Crisis Committees of the CCSBSO continue to provide an effective forum for regulators in the region to share information about cross-border banking operations and, where necessary, to cooperate in the orderly wind down of distressed banks. At the domestic level, the SIB has MoUs in place with all relevant domestic regulators which would provide effective means to share information in the event that corrective measures for a banking group should be required.
<b>Assessment of Principle 11</b>	Largely compliant
Comments	<p>Although the SBP does not have a formal resolution regime, it has demonstrated through its actions that it has an adequate range of supervisory tools at its disposal to address concerns identified in banks and the ability to revoke banking licenses. The actions include dismissing Board and senior management, forcing mergers, assuming control of a distressed bank as well as revoking banking licenses. The SBP does not, however, have the specific power to ringfence a bank from the actions of wider group entities which may impair its safety and soundness.</p> <p>Recommendation:</p> <ul style="list-style-type: none"> <li>• Introduce the power to ring fence a bank from the actions of wider group actions which may impair its safety and soundness.</li> <li>• Consider introducing a Resolution framework.</li> </ul>

<b>Principle 12</b>	<b>Consolidated supervision.</b> An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide. <sup>33</sup>
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including non-banking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings re EC1	<p>Circular 200-2015 requires a bank holding group's Board of directors to submit an annual report to the SBP within 120 calendar days after its fiscal year closure. The annual report must contain, as a minimum, the following items:</p> <ul style="list-style-type: none"> <li>• Introduction with the banking group's general information</li> <li>• Banking group's structure</li> <li>• Economic, financial and regulatory context in which the banking group operates</li> <li>• Summary of the banking group's corporate governance structure</li> <li>• Established principles for the banking group's comprehensive risk management regarding: <ul style="list-style-type: none"> <li>• Credit risk</li> <li>• Market risk</li> <li>• Liquidity risk</li> <li>• Operational risk</li> <li>• Risk of money laundering, terrorism financing and financing the proliferation of weapons of mass destruction</li> <li>• Social and environmental risk</li> </ul> </li> <li>• Analysis of the banking group's solvency</li> <li>• Summary of the regulatory impact in areas where the banking group has a presence</li> <li>• Consolidated audited financial statements.</li> </ul> <p>Any changes that occur to the group's structure during the year must be notified to the SBP within five days. In addition, the SBP receives the following reports providing additional qualitative and quantitative data on banking groups:</p> <ul style="list-style-type: none"> <li>• BAN03 (Table of Economic Groups and Related Parties)</li> <li>• SBP-CF01 (Report of the Board of Directors on the Ownership of Banking Group Shares)</li> <li>• BAN21 Consolidated Balance Sheet and Profit and Loss Statement of Banks (Consolidation Sheet)</li> </ul> <p>The SBP off-site team assesses the documentation and reports in line with the consolidated off-site supervision process set out in Chapter X of MUSBER. Similarly qualitative</p>

<sup>33</sup> Please refer to footnote 19 under Principle 1.



	<p>assessment of the banking group's risks is undertaken through the consolidated on-site inspection process set out in Chapter X of MUSBER. There is no suggestion that the high level of vacancies in the SBP is having an adverse impact on its ability to conduct effective consolidated supervision.</p> <p>Reviews of supervisory files provided evidence of a detailed risk assessment by both on- and off-site supervisors and analysts of the organizational structure of banking groups and the wider risks they pose to the bank.</p>
<b>EC2</b>	<p>The supervisor imposes prudential standards and collects and analyzes financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, exposures to related parties, lending limits and group structure.</p>
Description and findings re EC2	<p>Article 14 of Rule 1-2015 sets out the consolidated capital adequacy requirements for banking groups. It states:</p> <p>"The capital adequacy index of a banking group will be calculated as the ratio of the capital funds on the consolidated balance sheet of the banking group to the risk-weighted assets obtained from the consolidated financial statements, using the consolidation perimeter defined in Article 12. At no time can this index be less than eight percent of the sum of the risk weighted assets."</p> <p>In addition, Article 14 of Regulation 7-14 sets out concentration limits for banking groups on two exposure levels:</p> <ol style="list-style-type: none"> <li>1. Of the banking group with a party not related to the banking group, including persons or legal entities that also constitute an economic group.</li> <li>2. Of the banking group with parties related to it. The calculation of the consolidated exposure concentration limits of the banking group shall be made according to the consolidated information thereof.</li> </ol> <p>Consolidated exposure limits include any funding, investment, derivatives and off-balance transactions that represent an irreversible contingency, among others. The application of consolidated exposure concentration limits of the banking group shall also be made even though the exposure or loan is not directly granted to the person classified as a member of or party related to the economic group, but to one or more entities, corporations or people that, in the SBP's judgment, have that classified person as a beneficial owner or ultimate beneficiary.</p> <p>Article 16 sets out the consolidated concentration limit for a single party. The banking group may not directly or indirectly maintain exposures with a single party, including those parties that form an economic group with that party, of more than twenty-five percent of the consolidated equity fund of the banking group.</p> <p>Article 18 sets out the consolidated concentration limits for parties related to the banking group. The banking group may not directly or indirectly maintain unsecured single related party exposures of more than five percent of the consolidated equity funds of the banking group. When the loan is backed by collateral other than deposits, the applicable limit shall be ten percent of the consolidated equity funds of the banking group. The banking group may not directly or indirectly maintain exposures with its related parties, including those making up an economic group with the banking group, of more than twenty-five percent of the consolidated equity fund of the banking group.</p>

	<p>Circular 200-2015 sets out the banking group's reporting requirements that relate to Regulation 7-2014. These are summarized below:</p> <ul style="list-style-type: none"> <li>• BAN03 (Table of Economic Groups and Related Parties)</li> <li>• BAN10 (Calculation of the Dynamic Provision)</li> <li>• SBP-CF01 (Report of the Board of Directors on the Ownership of Banking Group Shares).</li> <li>• BAN21 Consolidated Balance Sheet and Profit and Loss Statement of Banks (Consolidation Sheet)</li> </ul> <p>The SBP does not collect any data on the consolidated liquidity positions of banking groups – see BCPs 10 and 24. However, since August 2020, the liquidity of all regional financial groups has been monitored weekly at the Technical Liaison Committee level of the CCSBSO, both in local currency and in foreign currency.</p>
<b>EC3</b>	<p>The supervisor reviews whether the oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks' policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.</p>
Description and findings re EC3	<p>During an inspection of the home/host arrangements for an overseas branch of a Panamanian bank, the SBP verifies that the policies and procedures for integrated risk management are carried out in a consolidated and consistent manner. Likewise, the application of local regulations, corporate guidelines, and aspects of the home regulator's regulations is verified at the consolidated level. For this purpose, the SBP has the power to request documents and reports from any bank, any company of a banking group, the owner of bank shares, or nonbank affiliates, on their operations and activities. The SBP considers the effectiveness of the host country's supervisory regime before agreeing to the establishment of an overseas operation of a Panamanian bank.</p>
<b>EC4</b>	<p>The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.</p>
Description and findings re EC4	<p>Chapter IX.2 of MUSBER sets out the SBP's supervisory approach to cross-border on-site inspections. The frequency of inspections of overseas offices of Panamanian banks is determined by the level of risk posed by the operation to the wider group. The SBP always coordinates such visits with the host supervisor – see BCP13. Decisions on which overseas operations should be subject to inspection are determined in discussions with senior management as part of the SBP's annual supervisory planning process and are risk-based.</p>

<b>EC5</b>	The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group and takes appropriate supervisory action.
Description and findings re EC5	Section IX.1.2 of MUSBER sets out the SBP's approach to reviewing the activities of parent companies and its affiliates. It notes that a primary objective of consolidated supervision is to understand the ownership and organizational structure of the banking group. The supervisor must be able to reach the ultimate owner - Ultimate Beneficial Owner (UBO) - or at least have identified the economic group, family or group of people who exercise effective control of the banking group. This is initially evaluated through the information provided by the bank on its structure and followed up by on-site investigation or additional information requests if the ownership is unclear. As part of the consolidated supervisory process, the SBP visit the holding company or the parent bank to gain an understanding of its activities. If they are considered to present a threat to the safety and soundness of the banking group, appropriate supervisory action will be incorporated in the banking group's supervisory plan.
<b>EC6</b>	<p>The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it determines that:</p> <ul style="list-style-type: none"> <li>(a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed;</li> <li>(b) the supervision by other supervisors is not adequate relative to the risks the activities presented/or</li> <li>(c) the exercise of effective supervision on a consolidated basis is hindered</li> </ul>
Description and findings re EC6	Paragraph 2 of Article 16 of the Banking Law provides the SBP with the power to authorize the closure or transfer of establishments, as well as the opening abroad of branches or subsidiaries of Panamanian banks or foreign banks operating in Panama. The SBP may object to the establishment of branches or subsidiaries in territories where, in the SBP's opinion, the local supervisor does not guarantee proper levels of oversight. The SBP has exercised these powers in the past by closing the overseas operations of a bank.
<b>EC7</b>	In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group. <sup>34</sup>
Description and findings re EC7	The SBP sets separate prudential limits for individual banks within a wider banking group and supervises such entities in line with other banks which are not part of a consolidated banking group. The individual bank within the banking group is subject to the standard reporting requirements for banks and all other supervisory requirements.
<b>Assessment of Principle 12</b>	Compliant
Comments	The legal and regulatory framework for conducting consolidated supervision is robust and, through its supervisory processes and practice, the SBP has a good understanding of the

<sup>34</sup> Please refer to Principle 16, Additional Criterion 2.

	overall structure of banking groups and of their material activities (including non-banking activities), both domestic and cross-border. The SBP applies most prudential standards to consolidated entities, but does not collect any data on the consolidated liquidity positions of banking groups - See BCPs 10 and 24. However, since August 2020, the liquidity of all regional financial groups has been monitored weekly at the Technical Liaison Committee level of the CCSBSO, both in local currency and in foreign currency. This arrangement does not constitute effective consolidated supervision of banks' liquidity positions. The grading of BCP 24 reflects this issue.
<b>Principle 13</b>	<b>Home-host relationships.</b> Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.
<b>Essential criteria</b>	
<b>EC1</b>	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.
Description and findings re EC1	<p>As a home supervisor, the SBP organizes supervisory colleges in which the supervisors of the most significant overseas banks participate. Three supervisory colleges were convened in 2022 and four colleges in 2021. In all cases, overseas regulators who have a material presence in Panama have attended the colleges. Agendas for meetings are circulated and agreed in advance to ensure that the focus of the meeting is targeted on the bank-specific risks identified by respective attendees. A review of the papers confirmed this to be the case.</p> <p>In addition to bilateral and multilateral colleges, the SBP participates in bimonthly meetings of the Liaison Committee of the Central American Council of Superintendents of Banks, Insurance, and Other Financial Institutions (CCSBSO)<sup>35</sup>. The functions of the Liaison Committee are to:</p> <ul style="list-style-type: none"> <li>(a) Establish planning, identify material risks and coordinate annual consolidated and cross-border supervision for regional financial conglomerates, which must be submitted for approval by the Supervisory Authorities at the last regular meeting of the year preceding the consolidated and cross-border supervision program of regional financial conglomerates.</li> <li>(b) Share relevant information regarding material events or concerns regarding the operations of cross-border establishments, including changes in shareholder ownership, as applicable.</li> </ul>

<sup>35</sup> [Central American Council of Superintendents of Banks, Insurance and Other Financial Institutions \(ccsbsso.org\)](https://ccsbsso.org)

	<p>(c) Request, when deemed appropriate, from the respective supervisor of origin, a brief review of the performance of the financial conglomerate under its jurisdiction, including the main aspects of its administration and how they comply with the obligations and requirements of the supervisor and other aspects that the supervisor considers relevant.</p> <p>(d) Exchange information as soon as possible and to the extent possible on any event that has the potential to jeopardize the stability of cross-border establishments.</p>
<b>EC2</b>	Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and risk management practices of the banking group <sup>36</sup> and on the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential information.
Description and findings re EC2	The SBP has signed MoUs with 29 overseas regulators, covering all foreign-owned banks operating in Panama. Evidence was cited of the information shared in the various bilateral, multilateral college meetings and in the technical meetings of the CCSBSO, demonstrating a free and full sharing of risk assessments of banks between respective supervisors.
<b>EC3</b>	Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified to improve the effectiveness and efficiency of supervision of cross-border banking groups.
Description and findings re EC3	<p>Articles 3 and 4 of Resolution 1-2005 specify that the SBP will coordinate the information exchange and/or joint supervisions with the relevant foreign supervisors that perform the individual and/or sub consolidated supervision, to strengthen and make more effective the banking economic group supervision.</p> <p>Cross-border inspections are carefully planned with the home/host supervisor. Ahead of college meetings, an initial meeting between the relevant overseas supervisor(s) is convened to agree the topics to be considered. Findings and any subsequent supervisory actions arising from the meetings are agreed and coordinated between the relevant parties. The outcomes of any supervisory action are shared with the relevant supervisor.</p>
<b>EC4</b>	The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.
Description and findings re EC4	See EC3. In addition to agreeing findings and any necessary supervisory actions at college meetings, the respective supervisors coordinate closely on communication strategies with the relevant bank in terms of coordinating the supervisory action and any outcomes from it.

<sup>36</sup> See Illustrative example of information exchange in colleges of the October 2010 BCBS Good practice principles on supervisory colleges for further information on the extent of information sharing expected.

<b>EC5</b>	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.
Description and findings re EC5	The SBP does not currently require banks to draw up resolution plans. At the cross-border level, however, coordination on weak banks is carried out with other supervisory bodies through meetings of the Liaison and Resolution and Crisis Committees established under CCSBSO. The Resolution and Crisis Committee is in the process of developing a "Multilateral Memorandum of Understanding of Resolution". Although there is no formal resolution regime in Panama, the SBP has successfully wound down/closed two foreign banks since 2017 in an orderly fashion without loss to depositors or contagion to the wider banking system in Panama.
<b>EC6</b>	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings re EC6	See EC5.
<b>EC7</b>	The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings re EC7	The SBP's prudential regime and supervisory approach for foreign subsidiary banks is the same as applied to domestic banks. Foreign branches are not subject to capital adequacy or LCR requirements and large exposure limits do not apply as they have no dedicated capital in Panama. They are, however, subject to the home country's prudential rules and limits in these areas on a consolidated basis.
<b>EC8</b>	The home supervisor is given on-site access to local offices and subsidiaries of a banking group to facilitate their assessment of the group's safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC8	Article 64 of the Banking Law sets out the requirements on home supervisors conducting inspections of foreign banks licensed in Panama. The Article states: "Exclusively for supervisory purposes, foreign supervisory bodies may request information and carry out inspection visits in Panama to foreign banks over which they exercise home supervision. The information collected shall be subject to strict confidentiality and may not be disclosed by the foreign supervisory body or used for purposes other than banking supervision, without the prior authorization of the Superintendency, for which purpose the latter shall require sufficient guarantees of such confidentiality.

	<p>The foreign supervisory body shall provide the Superintendency with a copy of all reports and documents prepared in connection with the inspection.”</p> <p>Access by the overseas regulator to local branches and subsidiaries of which they are the home supervisor is granted in accordance with the conditions contained in the relevant MoU.</p>
<b>EC9</b>	The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
Description and findings re EC9	The SBP does not allow booking offices or shell banks to be established in Panama. All licensed banks must have a physical presence and undertake banking business as defined in Articles 2 and 3 of the Banking Law.
<b>EC10</b>	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.
Description and findings re EC10	The SBP confirmed that it would always consult with an overseas supervisor on any supervisory action it took in response to information received from that supervisor. The SBP cited examples of past such coordination, particularly in the case of branches of foreign banks that have been subject to intervention due to concerns raised with their parent company.
<b>Assessment of Principle 13</b>	Largely Compliant
Comments	The SBP has agreed bilateral MoUs with all foreign regulators of banking groups with cross-border activities and holds periodic colleges of regulators meetings with relevant host regulators to share information and cooperate. The SBP is also a key participant in multilateral college meetings under the umbrella of the CCSBSO. The CCSBSO provides an effective forum for sharing information and cooperation between the various authorities and the Liaison and Resolution and Crisis Committees established under the CCSBSO provide a useful channel for coordination on weak banks. However, these meetings do not specifically consider resolution plans for distressed banks,
<b>C. Prudential regulations and requirements</b>	
<b>Principle 14</b>	<b>Corporate governance.</b> The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks’ Boards and senior management, <sup>37</sup> and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.
<b>Essential criteria</b>	
<b>EC1</b>	Laws, regulations or the supervisor establish the responsibilities of a bank’s Board and senior management with respect to corporate governance to ensure there is effective

<sup>37</sup> Please refer to footnote 27 under Principle 5.

	control over the bank's entire business. The supervisor provides guidance to banks and banking groups on expectations for sound corporate governance.
Description and findings re EC1	<p>Article 55 of the Banking Law provides that: "Banks are required to comply with the Corporate Governance regulations issued by the Superintendency. In case of noncompliance, they will be penalized according to the provisions of this Decree Law." Regulation 5-2011 sets out the Corporate Governance requirements. Article 13 of this Regulation states that the board of directors shall have the following responsibilities and duties:</p> <ul style="list-style-type: none"> <li>(a) To promote the security and soundness of the bank.</li> <li>(b) To understand the regulatory framework and oversee that the bank has an effective relationship with its regulators.</li> <li>(c) To establish an effective corporate governance structure, including an internal control system that will contribute to the effective internal supervision of the bank and its subsidiaries.</li> <li>(d) To oversee that the overall working conditions are appropriate for the performance of the tasks assigned to each hierarchical level involved with the corporate governance structure.</li> <li>(e) To promote, together with top management, highly ethical and integrity standards.</li> <li>(f) To establish an organizational culture showing and remarking to all employees why the internal control process is important, the role of each one of them within the bank and to be fully integrated to such.</li> <li>(g) To approve and frequently review the business strategies and other important policies to the bank.</li> <li>(h) To learn and understand the main risks exposures of the Bank, setting reasonable limits and procedures for such risks and to ensure that top management adopts the measures required for their identification, assessment, supervision and control.</li> <li>(i) To keep the SBP informed about the situations, events, and problems affecting or that may affect the bank and the specific actions to face and/or correct the deficiencies identified.</li> <li>(j) To be duly informed and ensure its access to all the information required on the conditions and administrative policies for decision making, in the exercise of their executive and supervisory duties.</li> <li>(k) To approve the organizational structure and to ensure that the top management checks the effectiveness of the internal control system.</li> <li>(l) To choose and evaluate the general manager and the personnel responsible for the external audit duties, except when the shareholders' meeting attributes to itself said responsibility.</li> <li>(m) To choose and evaluate the general manager or person responsible for the internal audit duties.</li> <li>(n) To approve and review at least once (1) a year the objectives and procedures of the internal control system, as well as organizational and duties manuals, policies and procedures manuals, risk control manuals and other bank's manuals where these are stipulated, as well as the incentives, penalties and corrective measures</li> </ul>



	<p>encouraging the adequate execution of the internal control system and systematically check their compliance.</p> <p>(o) To approve internal and external audit programs, and to review bank's unaudited financial statements at least once (1) every three months.</p> <p>(p) To oversee compliance with the provisions set forth in Rules issued by this Superintendency in regards to accuracy, reliability and integrity of information contained within the financial statements.</p> <p>(q) To ensure the existence of systems that will ease compliance with Rules issued by this SBP in regards to transparency of information of bank's products and services.</p> <p>The SBP has also issued guidance on its website<sup>38</sup> on the responsibilities of the Board of Directors in the following areas:</p> <ul style="list-style-type: none"> <li>• No. 10-2000 Compliance officer</li> <li>• No. 1-2003 Guidelines for loans and credit facilities to related parties</li> <li>• No. 2-2003 Microfinance banks</li> <li>• No. 4-2008 Legal liquidity ratio</li> <li>• No. 3-2009 Foreclosed assets</li> <li>• No. 6-2009 Concentration of exposures to economic groups and related parties</li> <li>• No. 1-2010 Integrity and accuracy of the financial statements</li> <li>• No. 2-2010 Bank ratings</li> <li>• No. 4-2010 External audit of banks</li> <li>• No. 8-2010 Integrated risk management</li> <li>• No. 5-2011 Corporate governance</li> <li>• No. 6-2011 Electronic banking and related risk management</li> <li>• No. 2-2012 Nonbank correspondents</li> <li>• No. 3-2012 Information technology risk management</li> <li>• No. 6-2012 Technical accounting standards</li> <li>• No. 4-2013 Credit risk management</li> <li>• No. 7-2014 Standards for the consolidated supervision of banking groups</li> <li>• No. 10-2015 Prevention of the misuse of banking and trust services</li> <li>• No. 11-2017 Guidelines for operations with derivative financial instruments</li> <li>• No. 2-2018 Liquidity risk management and the short-term Liquidity Coverage Ratio</li> <li>• No. 3-2018 Capital requirements for financial instruments included in the trading book</li> <li>• No. 7-2018 Country risk management</li> <li>• No. 11-2018 Operational risk</li> <li>• No. 12-2019 Provisions on investments in securities</li> <li>• No. 6-2021 Parameters for provisions applicable to credits in the "special mention modified" category</li> <li>• No. 1-2022 on the establishment of special guidelines for the protection of personal data handled by banking institutions.</li> </ul>
<b>EC2</b>	The supervisor regularly assesses a bank's corporate governance policies and practices, and their implementation, and determines that the bank has robust corporate governance

<sup>38</sup> [Guides | Superintendency of Banks of Panama \(superbancos.gob.pa\)](https://superbancos.gob.pa/Guides)

	<p>policies and processes commensurate with its risk profile and systemic importance. The supervisor requires banks and banking groups to correct deficiencies in a timely manner.</p>
Description and findings re EC2	<p>The assessment of the effectiveness of a bank or banking group's corporate governance arrangements forms a key element of the SBP's supervisory process. Corporate governance is a key component (G) of the SBP's internal risk assessment methodology. The assessment aims to determine that banks and banking groups have effective executive structures (the Board of Directors), management structures (senior management), control structures (Audit Committee, Internal Audit and External Audit, Compliance Officer, Risk Management Unit, among others), and those corresponding to the owners (shareholders). The assessment also covers the effectiveness and comprehensiveness of policies and practices to conduct the day-to-day management, monitoring, and control of the business, within the framework of the applicable laws and regulations.</p> <p>The individual elements of the corporate governance component of the SBP's risk methodology, which are assessed in the supervisory process, are as follows:</p> <ul style="list-style-type: none"> <li>• Practices of the Board of Directors.</li> <li>• Senior management practice.</li> <li>• Quality of shareholders.</li> <li>• Risk control and management environment.</li> <li>• Compensation system.</li> <li>• Information and transparency.</li> <li>• Customer service.</li> </ul> <p>The findings, recommendations and actions arising from the analysis of each of the above components are recorded on the SBP's internal monitoring tool. The timeline for remedial action by a bank is determined by the materiality of the issue identified, with high materiality issues remediated in 3 months, medium materiality issues in 6 months, and low materiality issues in 9 months.</p>
<b>EC3</b>	<p>The supervisor determines that governance structures and processes for nominating and appointing Board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members</p>
Description and findings re EC3	<p>The SBP reviews the governance structures of banks, including an assessment of the experience of Board members, in their routine inspection program. The effectiveness of new Board members is assessed through the review of Board minutes to identify their contribution to the decision-making and challenge process.</p> <p>Regulation 5-2011 requires the composition of the Board of Directors of a bank to comprise a minimum of seven individuals with relevant knowledge or experience with respect to the operations and risks inherent in banking activities. The majority should be directors who do not participate in the administrative management of the bank (non-executive directors). The Board's composition should also include at least two independent directors. In addition, they are required to have an Audit Committee, a Compliance Committee, and a Risk Committee (the latter two by specific decision) and a Corporate Governance Committee is recommended.</p>

	Regardless of the above, the SBP may require the establishment of any other committee, depending in any case on the risk profile of the bank.
<b>EC4</b>	Board members are suitably qualified, effective and exercise their “duty of care” and “duty of loyalty”. <sup>39</sup>
Description and findings re EC 4	Board members require prior approval from the SBP before appointment. The assessment by the SBP considers the technical and professional knowledge and experience in the financial sector of the applicant, as well as any other background information deemed relevant to for the evaluation being carried out. As part of the on-site inspection process, the SBP assesses the performance (functions and responsibilities) of directors on the various committees in which they participate, the results of the assessment of the corporate governance performance of the Board of Directors, and the mechanisms applied to manage conflicts of interest of its members between their own activities and particular commitments with the bank's operations and/or with other organizations of the banking group are evaluated.
<b>EC5</b>	The supervisor determines that the bank's Board approves and oversees implementation of the bank's strategic direction, risk appetite <sup>40</sup> and strategy, and related policies, establishes and communicates corporate culture and values (e.g., through a code of conduct), and establishes conflicts of interest policies and a strong control environment.
Description and findings re EC5	Regulations 5-2011 (Article 13) and 7-2014 (Article 4) set out the responsibilities of Board members for solo banks and consolidated banking groups respectively. These include requirements to set the bank and banking group's strategic direction, risk appetite, strategy, corporate culture, policies on conflicts of interest and setting an appropriate risk management and internal control framework. In its supervisory process, the SBP verifies how the Board of Directors oversees the application and effectiveness of these requirements. This was demonstrated by file reviews of supervisory practice.
<b>EC6</b>	The supervisor determines that the bank's Board, except where required otherwise by laws or regulations, has established fit and proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management's execution of Board strategies, including monitoring senior management's performance against standards established for them.
Description and findings re EC6	Paragraph I of Article 13 of Regulation 5-2011 specifies that: “The bank shall establish ... the following:

<sup>39</sup> The OECD (OECD glossary of corporate governance-related terms in “Experiences from the Regional Corporate Governance Roundtables”, 2003, [www.oecd.org/dataoecd/19/26/23742340.pdf](http://www.oecd.org/dataoecd/19/26/23742340.pdf).) defines “duty of care” as “The duty of a board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the board member to approach the affairs of the company in the same way that a ‘prudent man’ would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgment rule.” The OECD defines “duty of loyalty” as “The duty of the board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders.”

<sup>40</sup> “Risk appetite” reflects the level of aggregate risk that the bank's Board is willing to assume and manage in the pursuit of the bank's business objectives. Risk appetite may include both quantitative and qualitative elements, as appropriate, and encompass a range of measures. For the purposes of this document, the terms “risk appetite” and “risk tolerance” are treated synonymously.

	<p>I. Choose and evaluate the general manager and the personnel responsible for the external audit duties, except when the shareholders' meeting attributes to itself said responsibility. The bank is required to ensure that the appointment is considered fit and proper.</p> <p>The supervision of banks and banking groups includes an assessment of how senior management, under the direction of the Board of Directors, ensures that the activities carried out by the bank are consistent with its business strategy, risk tolerance/appetite, and the policies approved by the Board of Directors.</p> <p>In addition, supervision includes confirmation of whether the Board of Directors has policies for reviewing and evaluating, at least once a year, the performance of the general manager (or equivalent position) with respect to the achievement of the objectives set by the Board.</p> <p>It also includes an assessment of how senior management provides the Board of Directors with the information it needs to perform its functions, supervise senior management, and evaluate the quality of its performance. In this regard, senior management must keep the Board regularly and adequately informed of the relevant issues.</p>
<b>EC7</b>	<p>The supervisor determines that the bank's Board actively oversees the design and operation of the bank's and banking group's compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies.</p>
Description and findings re EC7	<p>Section 111.111.10 of the MUSBER requires the SBP is required as part of its supervisory process to:</p> <ul style="list-style-type: none"> <li>• Evaluate that shareholders monitor the design and operation of the compensation system and the compensation system.</li> <li>• Evaluate that the Board of Directors actively monitors the design and operation of the compensation system, evaluates and reviews said system ensuring that it operates in the desired manner.</li> <li>• Assess that employee compensation is consistent with prudent risk-taking (adjusted for all types of risk; aligned to risks assumed; sensitive to the time horizon of risks; and that the mix of cash, equity and others is consistent with the risk assumed).</li> </ul> <p>In the supervision processes carried out with banks and banking groups, an assessment is made of how the Board of Directors has established appropriate incentives for the organization, for which purpose the long-term policies regarding the selection and remuneration of the members of the Board of Directors, senior management, executives, and other personnel are evaluated.</p> <p>In addition, supervision includes confirmation of how the Board of Directors maintains and discloses incentive, remuneration, and compensation policies and evaluates the following:</p> <ul style="list-style-type: none"> <li>• The type of shareholder oversight of the design and operation of the compensation system.</li> <li>• Whether the type of oversight by the Board of Directors of the design and operation of the compensation system evaluates and reviews the compensation system to ensure that it is functioning as intended.</li> <li>• Whether employee compensation is commensurate with prudent risk-taking (adjusted for all types of risk; aligned to the risks assumed; sensitive to the time</li> </ul>

	horizon of the risks; and the mix of cash, equity and other compensation is consistent with the risk assumed).
<b>EC8</b>	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (e.g., special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings re EC8	<p>There is no systemic approach in the SBP's supervisory framework for confirming that the Board and senior management understand a banking group's organizational structure, as regular meetings with the Board and senior management do not form part of the supervisory approach. However, Board members and/or senior management are engaged during each inspection when opportunities arise to challenge their knowledge of the structure and risks posed. During the supervision process when assessing the effectiveness of a group's governance arrangements, the SBP considers the structure of the bank and the banking group to determine whether the governance structure aligns with the nature, complexity, and inherent risks of its business. The organizational and functional structure of the internal control system and how senior management verifies its effectiveness is also considered. Supervision includes a determination of how the management structure established by senior management complies with the assigned roles and levels of responsibility.</p> <p>The SBP undertakes a review of impediments to consolidated supervision as part of the licensing process and as and when changes occur to the organizational structure. In cases where the bank or banking group intends to include or exclude banking or financial entities, they must first inform the SBP and obtain its approval in accordance with applicable regulations. In addition, for the purposes of effective consolidated supervision, the SBP may require the inclusion of other financial or nonfinancial entities. The SBP has powers to reject proposed structural changes which would hinder consolidated supervision and have used this power in the past.</p>
<b>EC9</b>	The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.
Description and findings re EC9	<p>Paragraph 9 of Article 16 of the Banking Law provides the SBP with the power to order a bank "to remove its directors, officers or executives if ... there is sufficient reason to do so". Article 107 provides that "any person who holds the position of director or officer or holds a management position in a bank, will cease his/her job and be disqualified from performing in those positions in any bank, if any of the following should occur:</p> <ol style="list-style-type: none"> <li>1. The person is declared bankrupt or involved in insolvency proceedings.</li> <li>2. The person is found guilty of crimes against property or the public trust.</li> <li>3. The person is found guilty of grievous mismanagement of the affairs of the bank, as determined by the Board of Directors of the Superintendency."</li> </ol> <p>The SBP has made use of these powers in practice. In one case, the SBP removed the President, certain Board members and the General Manager of a bank in distress and replaced them with other individuals to restore the bank's viability.</p>

<b>Assessment of Principle 14</b>	Largely Compliant
Comments	The SBP has a comprehensive regulation covering the corporate governance arrangements in banks and banking groups, and monitors compliance with the regulation through regular on- and off-site supervisory approaches. The supervisory assessment is tailored to the risk profile and systemic importance of the entity and covers, inter alia, Board and senior management recruitment, responsibilities and compensation, the effectiveness of the risk and internal control functions, and whether the organizational structure presents any hindrance to effective consolidated supervision. However, outside the on-site inspection, the SBP has limited engagement with Board members or senior management within a bank. This lack of dialogue constrains the authority's ability to maintain an ongoing understanding of the bank's strategic direction, group and organizational structure and control environment.
<b>Principle 15</b>	<b>Risk management process.</b> The supervisor determines that banks <sup>41</sup> have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate <sup>42</sup> all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor determines that banks have appropriate risk management strategies that have been approved by the banks' Boards and that the Boards set a suitable risk appetite to define the level of risk the banks are willing to assume or tolerate. The supervisor also determines that the Board ensures that: <ul style="list-style-type: none"> <li>(a) a sound risk management culture is established throughout the bank;</li> <li>(b) policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite;</li> <li>(c) uncertainties attached to risk measurement are recognized;</li> <li>(d) appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to relevant staff; and</li> <li>(e) senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.</li> </ul>
Description and findings re EC1	The SBP implemented a regulation (8-2010) which requires banks to implement a risk management framework. The regulation includes a definition of a comprehensive approach to risk management; the components of risk management; types of risks to be

<sup>41</sup> For the purposes of assessing risk management by banks in the context of Principles 15 to 25, a bank's risk management framework should take an integrated "bank-wide" perspective of the bank's risk exposure, encompassing the bank's individual business lines and business units. Where a bank is a member of a group of companies, the risk management framework should in addition cover the risk exposure across and within the "banking group" (see footnote 19 under Principle 1) and should also take account of risks posed to the bank or members of the banking group through other entities in the wider group.

<sup>42</sup> To some extent the precise requirements may vary from risk type to risk type (Principles 15 to 25) as reflected by the underlying reference documents.

	<p>covered; structure: responsibilities of the BoD; responsibilities of senior management; the need to implement a Board Risk Committee (BRC) and the duties of the BRC; the need to establish an independent risk management unit (line 2); and reporting.</p> <p>The risks to which the regulation pertain include both Pillar 1 risks and Pillar II, specifically:</p> <ul style="list-style-type: none"> <li>• Credit and counterparty risk;</li> <li>• Liquidity risk;</li> <li>• Market Risk (price risk, interest rate risk and exchange rate risk);</li> <li>• Operational risk;</li> <li>• Reputational risk;</li> <li>• Country risk;</li> <li>• Transfer risk;</li> <li>• Political risk; and</li> <li>• Sovereign risk.</li> </ul> <p>To assess the implementation of the requirements of the regulation, the SBP undertakes off-site and on-site activities (see also CPs 8 &amp; 9). Specifically in relation to the requirement of this EC:</p> <ol style="list-style-type: none"> <li>(a) Assess manuals, processes, procedures, supervision manual form – integrated risk management assessment form. The SBP assesses BRC minutes and reporting. The regulation refers to a risk management culture and to assess this the SBP interviews the three lines of defense. The regulations refer to a sound risk management culture being promoted across the banking group and discussions with management.</li> <li>(b) The regulations require banks to submit a report every three years for future capital needs. The banks must identify the risks they are exposed to in addition to capital. They assess this and ask the bank what has changed, in the different bank groups, indicators, limits. The SBP receive this annually and make an assessment.</li> <li>(c) risk measurement systems are evaluated on-site. Models are not used to calculate regulatory capital, but models are used for risk management. Model validation reports are assessed on-site.</li> <li>(d) Limits are assessed across all risks. SBP meets with all three lines of defense to assess the implementation of limits and the compliance framework.</li> <li>(e) The SBP interviews senior management during on-site examinations.</li> </ol> <p>The SBP assign a Director responsible for addressing findings from the on-site examinations. The SBP will also meet BoD directors during the course of the on-site examination. If there is a specific issue in terms of non-compliance with the regulations or the SBP has an issue that warrants the attention of the BoD, the SBP demonstrated an ability to meet with bank boards to communicate concerns.</p> <p>There is scope for more routine meeting with bank Boards and in particular with the Chair of the Audit Committee, Chair of the Risk Committee, and the Chair of the BoD. The processes in the supervisory manual to assess risk management include:</p> <ul style="list-style-type: none"> <li>• Chapter III. Banking Supervision Process <ul style="list-style-type: none"> <li>• III.10. Rating detail by individual GRENP component and subcomponent. <ul style="list-style-type: none"> <li>Section III.10.2 R – Risks</li> </ul> </li> </ul> </li> </ul>
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	<ul style="list-style-type: none"> <li>• III.11. Rating detail by consolidated GRENP component and subcomponent. Section III.11.2 R – Consolidated GRENP Risks</li> <li>• The following forms are used at the individual bank level: <ul style="list-style-type: none"> <li>• Form 7 FEGOB, Objectives 1, 2, 5, 6, 15, and 17–19</li> <li>• Form 8 FEGRI, Comprehensive Risk Management, Objectives 1–12</li> </ul> </li> <li>• The following forms are used at the banking group level: <ul style="list-style-type: none"> <li>• Form 20 FESCIG, Objectives 1, 3, 4, 7, 10, 11–14, and 18</li> </ul> </li> </ul>
<b>EC2</b>	<p>The supervisor requires banks to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate:</p> <ul style="list-style-type: none"> <li>(a) to provide a comprehensive “bank-wide” view of risk across all material risk types;</li> <li>(b) for the risk profile and systemic importance of the bank; and</li> <li>(c) to assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank’s risk management process.</li> </ul>
Description and findings re EC2	<p>The regulations require banks to implement a comprehensive risk management framework (see also EC1). The SBP undertakes an annual on-site examination program for D-SBs and higher risk banks while other banks will be assessed according to the GRENP rating but not less than once every two years. The supervisory manual contains guidance for supervisors to assess bank risk management frameworks for all material risks. In preparation for the on-site, banks are required to complete a self-assessment with materials to evidence which are assessed by the SBP. Weaknesses and high-risk areas are explored in detail during the on-site with interviews, file sampling, testing and review of reporting and policies.</p> <p>After assessing the risk management and control environment in general, a more in-depth evaluation will be conducted of the control environment specific to each risk to which they are exposed, and the business lines identified as relevant or most exposed to the risks. Their review will include:</p> <ul style="list-style-type: none"> <li>• The application of policies with respect to the acceptance levels of risks acceptable for the product, service, or business line (risk exposure limits);</li> <li>• The clear assignment of responsibilities at the various operational (approval and/or authorization) levels;</li> <li>• The methodology used to determine product and service prices.</li> </ul> <p>Specifically in relation to this EC:</p> <ul style="list-style-type: none"> <li>(a) Regulation 7-2014 pertaining to consolidated supervision refers to banks implementing a group-wide approach to risk management. The SBP assesses group-wide policies and includes on-site examinations to subsidiaries and offshore operations. Supervisory colleges are undertaken to understand business models of cross-border activities and regular communication with host supervisors.</li> <li>(b) The SBP recently implemented a D-SIB framework which raises the supervisory intensity for these banks. Expectations for risk management are commensurate with size, scale and complexity and risk profile.</li> </ul>



	<p>(c) The Financial Stability and Systemic Risk Division of the SBP undertakes assessment of macroeconomic factors and makes this available for the off-site analysis teams. . Analysis of assumptions in bank business plans is also undertaken.</p> <p>An area where there is scope to improve the assessment of all materials risks and capital strength is the ICAAP framework. The SBP plans to implement this process in the near-term future. The ICAAP would contribute to a structured approach to the assessment of all material risks on an individual bank basis including the results of stress testing which would inform the assessment of the adequacy of capital.</p>
<b>EC3</b>	<p>The supervisor determines that risk management strategies, policies, processes and limits are:</p> <ul style="list-style-type: none"> <li>(a) properly documented;</li> <li>(b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and</li> <li>(c) communicated within the bank</li> </ul> <p>The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank's Board where necessary.</p>
Description and findings re EC3	<p>During the review processes, it is determined whether the entity has established appropriate strategies, policies, processes, rules, and procedures to identify and limit risks inherent to its analyzed operations, services, and business lines. The specific procedures for the treatment of exceptions are also evaluated, as is the manner in which management will account for what had been done. These policies will be verified to make certain that they were approved by the Board and distributed to the corresponding staff. With regard to banking groups, a review is conducted of the mechanisms implemented by corporate senior management to submit relevant information on the banking group's business situation and risk management to the corporate Board in a timely manner.</p>
<b>EC4</b>	<p>The supervisor determines that the bank's Board and senior management obtain sufficient information on, and understand, the nature and level of risk being taken by the bank and how this risk relates to adequate levels of capital and liquidity. The supervisor also determines that the Board and senior management regularly review and understand the implications and limitations (including the risk measurement uncertainties) of the risk management information that they receive.</p>
Description and findings re EC4	<p>The SBP undertakes an annual on-site examination for higher risk banks and D-SIBs (see CPs 8 &amp; 9). The on-site will assess the adequacy of capital and liquidity to support the risks to which the banks are exposed. The SBP reviews the business plans and developments. The SBP undertakes an in-depth assessment of risk committees (both management and board) to assess reporting and governance. Supervision processes include reviews of Board meeting minutes and of whether discussions addressed topics related to the nature and level of risk assumed and the relationship between those risks and the bank's capital, liquidity, and provision levels. An assessment is also conducted of senior management's involvement in the implementation of policies and systems appropriate for comprehensive risk management, as directed by the Board and in accordance with the established strategic plan.</p>

	<p>An annual liquidity self-assessment process is not included in the regulation although extensive risk management requirements for liquidity are established (see CP24). While a differentiated approach to supervising D-SIBs has been implemented, the calibration against capital and liquidity is not explicitly mentioned in the regulations and it is not evidenced that D-SIBs are subject to higher capital and liquidity requirements reflecting their risk profile, size, scale, complexity and systemic importance.</p>
<b>EC5</b>	<p>The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.</p>
Description and findings re EC5	<p>Depending on the risk type, the regulations require banks to have a suitable process for managing their risks and assessing how those risks affect their capital and liquidity levels. There are currently no requirements in connection with the internal liquidity adequacy assessment process (ILAAP).</p> <p>With regard to the internal capital adequacy assessment process (ICAAP) specifically, a draft decision has been produced for its regulation. One of the responsibilities of the Risk Unit in regulated entities is to inform the Risk Committee, the Board, and senior management of the impact on capital adequacy of risk-taking by the bank or banking group, considering the sensitivity analyzes under various scenarios (stress testing), including external events.</p> <p>The review of the internal control system, consisting of policies, principles, rules, procedures, and prevention, verification, and evaluation mechanisms established by the Board and senior management, seeks to demonstrate how the regulated entity ensures that it is properly managing the risks to which it is exposed and their relationship with capital and liquidity. This is undertaken as part of the on-site examination.</p>
<b>EC6</b>	<p>Where banks use models to measure components of risk, the supervisor determines that:</p> <ul style="list-style-type: none"> <li>(a) banks comply with supervisory standards on their use;</li> <li>(b) the banks' Boards and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and</li> <li>(c) banks perform regular and independent validation and testing of the models</li> </ul> <p>The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.</p>
Description and findings re EC6	<p>Internal models cannot be used to calculate capital adequacy. However, banks use models for internal management and measurement of their risks, which are subject to assessment by the regulator. As per the regulation, the manager of an entity's Risk Management Unit must monitor the ongoing strengthening and development of continuous improvements in risk management systems and the corresponding policies, processes, quantitative models, and reports, as applicable, to ensure that risk management capacities are sufficiently robust and effective to fully support the strategic objectives and activities. The policies and procedures applied by the entity to measure its risks are reviewed during the management quality supervision processes carried out by the Supervision Directorate.</p>

<b>EC7</b>	The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing, and reporting on the size, composition and quality of exposures on a bank-wide basis across all risk types, products and counterparties. The supervisor also determines that these reports reflect the bank's risk profile and capital and liquidity needs and are provided on a timely basis to the bank's Board and senior management in a form suitable for their use.
Description and findings re EC7	<p>For comprehensive risk management, banks and banking groups must establish strategies, organization, policies, procedures, manuals, and information systems appropriate to the complexity and volume of operations, the diversity of operations they perform, and the risk level associated with each operation. They must also have a system for reviewing and monitoring compliance with these tolerance levels in the entire group.</p> <p>In reviewing the reports issued by the Risk Management Unit, the supervisor assesses whether the reports are prepared at least quarterly and verifies that the Risk Committee or the body responsible for risk management, the general manager, and the corresponding decision-making units have been informed of the effectiveness of mechanisms related to risk measurement, the degree of exposure, the limits, and risk management in accordance with the policies and procedures established by the entity.</p>
<b>EC8</b>	The supervisor determines that banks have adequate policies and processes to ensure that the banks' Boards and senior management understand the risks inherent in new products, <sup>43</sup> material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model and major acquisitions). The supervisor determines that the Boards and senior management are able to monitor and manage these risks on an ongoing basis. The supervisor also determines that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by their Board or a specific committee of the Board.
Description and findings re EC8	<p>The regulations require new products to be subject to appropriate internal due diligence by the three lines of defense and risk governance (see No6.2016). Article 3 states that regulated entities are required to apply the 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 the risk-based approach to new or developing technologies for new or pre-existing products. Based on the assessment, regulated entities must identify and assess the risks of money laundering, the financing of terrorism, and the financing of the proliferation of weapons of mass destruction that may arise, associated with:</p> <ol style="list-style-type: none"> <li>1. The development of new products and new commercial practices; and</li> <li>2. The use of new and developing technologies for new and pre-existing products.</li> </ol> <p>Banks and banking groups establish policies, principles, rules, and procedures conducive to maintaining adequate risk management at the banking group level and to knowing and understanding the risks to which they are exposed. As for new businesses, products, or services, the regulated entity must carry out a careful evaluation before entering a new</p>

<sup>43</sup> New products include those developed by the bank or by a third party and purchased or distributed by the bank.

	business to ensure that the risks of the new business for that party are known and properly controlled. 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. If a new product is launched that includes a technology application, the bank will need prior authorization of the SBP.
<b>EC9</b>	The supervisor determines that banks have risk management functions covering all material risks with sufficient resources, independence, authority and access to the banks' Boards to perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the Board and senior management. The supervisor also determines that the risk management function is subject to regular review by the internal audit function.
Description and findings re EC9	<p>The regulations stipulate risk management for all Pillar I risks which are integrated into the supervisory manual and on-site examination processes. Several Pillar II risks are also fully embedded such as legal and reputational risks which are included in operational risk assessments and credit concentration risks.</p> <p>Interviews with the three lines of defense assess independence of risk functions. Reporting to the BRC is also a key element of this assessment.</p> <p>Strategic and reputational risks are part of the risks defined in Article 4 of Decision No. 8-2010. The supervision process is outlined in Form 8 FEGRI on reputational risk. As for strategic risk, greater emphasis is placed on reviewing the strategy and the methodology for its preparation during the corporate governance management evaluation to ensure that the business plan approved by the Board takes into account the long-term strategy, its exposure to risk, and the ability to manage those risks effectively. To this end, the SBP:</p> <ul style="list-style-type: none"> <li>• Reviews that the quantitative and qualitative objectives and targets have been defined for each business line and that the parties responsible for their execution, control, and monitoring have been identified.</li> <li>• Analyzes the reasonableness of the business plan with the assumptions used.</li> <li>• Reviews that the customer segments to be served have been defined based on market studies.</li> <li>• Reviews that growth strategies (for current products, new products, new markets, new customers, the acquisition of new business units or lines, the expansion of the banking group, discontinuation of business/product lines, etc.) have been defined.</li> <li>• Verifies the application of the policies, procedures, and controls defined in the growth strategies where a monitoring committee exists, request minutes of its meetings.</li> </ul>
<b>EC10</b>	The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a Chief Risk Officer (CRO) or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the Board and generally should be disclosed publicly. The bank should also discuss the reasons for such removal with its supervisor.
Description and findings re EC10	The Risk Management Unit requirement is applied across all banks which states that a head of the unit needs to be applied. All regulated entities must have a unit for managing risk. Banking groups can have these functions filled by one of the current risk management

	<p>units within the group. However, for larger and/or more complex banking groups, the Superintendency may require a particular group to create a Risk Management Unit dedicated solely to the banking group that does not simultaneously perform functions for any subsidiaries. The CRO function reports to the BRC.</p> <p>There is no requirement for the removal of the CRO to be notified to the SBP but, in practice, this has taken place although CRO dismissals are not common. There is no requirement for public disclosure.</p>
<b>EC11</b>	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings re EC11	<p>The SBP has a developed regulatory framework. Below are the rules dealing with credit, market, liquidity, and interest rate risk in the bank portfolio as well as operational risk:</p> <ul style="list-style-type: none"> <li>• No. 4-2008 "Issuing new provisions for compliance with" the legal liquidity ratio"</li> <li>• No. 6-2009 "Establishing the rules for limits on risk concentration in economic "groups and related parties"</li> <li>• No. 8-2010 "Issuing provisions on comprehensive risk management"</li> <li>• No. 5-2011 "Issuing a new Decision to update the provisions on corporate governance"</li> <li>• No. 4-2013 "Establishing provisions on the management and administration of credit risk inherent to the credit portfolio and off-balance sheet operations"</li> <li>• No. 7-2014 "Establishing rules for the consolidated supervision of banking groups"</li> <li>• No. 11-2017 "Establishing guidelines for operations with derivative financial instruments"</li> <li>• No. 2-2018 "Establishing provisions on liquidity risk management and the short-term liquidity coverage ratio"</li> <li>• No. 3-2018 "Establishing the capital requirements for financial instruments registered in the trading portfolio"</li> <li>• No. 7-2018 "Establishing provisions on country risk management"</li> <li>• No. 11-2018 "Issuing new provisions on operational risk"</li> <li>• No. 12-2019 "Issuing provisions on investments in securities"</li> <li>• Banking book interest rate: Draft Decision, General Resolution No. 2-2000 on Interest Rate Risk Management</li> </ul>
<b>EC12</b>	<p>The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their risk management process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.</p>
Description and findings re EC12	<p>There is no integrated linkage between stress testing, contingency planning, and recovery planning. The requirements are often separate and based on individual risks. There is no resolution framework although the SBP is the resolution authority. Recovery and</p>

	<p>resolution planning has not been developed. Emphasis is placed on robust supervision to identify early weak banks and address weaknesses.</p> <p>Banks must include policies and contingencies in risk measurements for scenarios resulting from a backward-looking stress analysis and a forward-looking worst-case scenario analysis. The supervision process comprises an evaluation of the policies, processes, procedures, and requirements for carrying out stress tests and mechanisms to address deviations that may arise, according to the established scenarios. There is no explicit requirement for banks to undertake recovery planning which is a deficiency.</p>
<b>EC13</b>	<p>The supervisor requires banks to have forward-looking stress testing programs, commensurate with their risk profile and systemic importance, as an integral part of their risk management process. The supervisor regularly assesses a bank's stress testing program and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision-making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing program:</p> <ul style="list-style-type: none"> <li>(a) promotes risk identification and control, on a bank-wide basis</li> <li>(b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks;</li> <li>(c) benefits from the active involvement of the Board and senior management; and</li> <li>(d) is appropriately documented and regularly maintained and updated.</li> </ul> <p>The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing program or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process</p>
Description and findings re EC13	<p>There is no regulation which stipulates a comprehensive approach to stress testing where all risks are considered against an assessment of capital and liquidity. The individual risk areas include requirements for stress testing, though scope for improvement exists.</p> <p>The SBP released a guide aimed at regulated entities to assist them in developing the content and thus help them to strengthen internal processes for self-assessment of the capital adequacy they establish. Therefore, forward-looking stress tests do not currently have to be carried out, according to their risk profile and their systemic importance, as an integral part of the risk management process. During the supervision processes, the practice used by the entities is evaluated and the respective recommendations are made. This EC is not met.</p>
<b>EC14</b>	<p>The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement and new product approval process for all significant business activities.</p>
Description and findings re EC14	<p>The supervision processes for the selected relevant business lines assesses whether the financial entity has established appropriate strategies, policies, processes, rules, and procedures to identify and limit risks inherent to its analyzed business line. Banks recognize and consider the strong links between liquidity risk and other types of risk to which they are exposed in connection with significant products, services, and business lines that can affect their liquidity profile. Under normal business conditions, forward-looking measurements help to identify needs that could arise from the relationship</p>

	between projected cash outflows and current sources of financing. In stress situations, forward-looking measurements will have to enable the identification of liquidity mismatches for various horizons and in turn serve as a basis for establishing liquidity risk limits and early warning indicators. The bank's senior management must adapt liquidity risk measurement and analysis to the entity's business model, complexity, and risk profile.
<b>Additional criteria</b>	
<b>AC1</b>	The supervisor requires banks to have appropriate policies and processes for assessing other material risks not directly addressed in the subsequent Principles, such as reputational and strategic risks.
Description and findings re AC1	
<b>Assessment of Principle 15</b>	Materially Non-compliant
Comments	<p>The regulations require banks to implement a comprehensive risk management framework. The SBP undertakes an annual on-site examination program for D-SBs and higher risk banks while other banks will be assessed according to the GRENP rating but not less than once every two years. The supervisory manual is extensive and contains guidance for supervisors to assess bank risk management frameworks for all material risks. In preparation for the on-site, banks are required to complete a self-assessment with materials to evidence which are assessed by the SBP. Weaknesses and high-risk areas are explored in detail during the on-site with interviews, file sampling, testing and review of reporting and policies.</p> <p>While the regulations are generally comprehensive, there are several areas that need to be developed:</p> <ul style="list-style-type: none"> <li>• There is no regulation which stipulates a comprehensive approach to stress testing where all risks are considered against an assessment of capital and liquidity. The individual risk areas include requirements for stress testing, though scope for improvement exists.</li> <li>• There is no regulation for banks to undertake recovery planning.</li> <li>• There is no explicit provision in the regulation for a bank to notify the SBP if the CRO is removed (EC10).</li> </ul> <p>An area where there is scope to improve the assessment of all material risks and capital strength is the ICAAP framework. The SBP plans to implement this process in the near-term future. The ICAAP would contribute to a structured approach to the assessment of all material risks on an individual bank basis including the results of stress testing which would inform the assessment of the adequacy of capital. In terms of supervisory practice, there is a lack of routine contact with the Board. Implementation of an ICAAP and ILAAP would help structure an assessment of all material risks. Weaknesses in stress testing are evident in other Principles (e.g., market risk - CP22 and IRRBB - CP23). We have consolidated the grading into CP 15 to avoid double counting. While a differentiated approach to supervising D-SIBs has been implemented, the calibration against capital and liquidity is not explicitly mentioned in the regulations and it is not evidenced that D-SIBs are subject to higher capital and liquidity requirements reflecting their risk profile, size,</p>

	scale, complexity and systemic importance. Reflecting these material weaknesses, an MNC rating is appropriate.
<b>Principle 16</b>	<b>Capital adequacy.</b> <sup>44</sup> The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
<b>Essential criteria</b>	
<b>EC 1</b>	Laws, regulations, or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations, or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and findings re EC1	<p>Regulations for capital adequacy include:</p> <ul style="list-style-type: none"> <li>• Banking Law, Article 67 (Capital Composition) and Article 70 (Capital Adequacy Ratios)</li> <li>• Decision No. 1-2015 "Establishing the capital adequacy rules applicable to banks and banking groups"</li> <li>• Decision No. 3-2016 "Establishing the rules for determining assets weighted by credit risk and counterparty risk"</li> <li>• Decision No. 3-2018 "Establishing the capital requirements for financial instruments registered in the trading portfolio"</li> <li>• Decision No. 11-2018 "Issuing new "provisions on operational risk" (Chapter VI on capital and reporting requirements, Articles 26 and 27)</li> </ul> <p>Article 67 of the Banking Law stipulates that all banks shall have the capital funds required by the Banking Law and the rules governing it and that banks' capital funds shall consist of primary, and secondary capital. Pursuant to Article 70 of the Banking Law, all banks with a general or international license whose home office supervisor is the Superintendency shall maintain capital funds equivalent to at least eight percent of their total assets and off-balance sheet operations representing a contingency, weighted based on their risks, as well as primary capital equivalent to not less than four percent of their assets and off-balance sheet operations representing a contingency, weighted according to their risks. Article 11 of the regulations set the limits and composition of bank's capital base; "Common tier 1 capital cannot be less than four and a half percent (4.5 percent) of its risk-weighted assets, and tier 1 capital cannot be less than six percent (6 percent) of its risk-weighted assets."</p>

<sup>44</sup> The Core Principles do not require a jurisdiction to comply with the capital adequacy regimes of Basel I, Basel II and/or Basel III. The Committee does not consider implementation of the Basel-based framework a prerequisite for compliance with the Core Principles, and compliance with one of the regimes is only required of those jurisdictions that have declared that they have voluntarily implemented it.



	<p>Article 67 stipulates the composition of regulatory capital consisting of primary (CET1) and secondary (Tier 2). Article 68 stipulates the minimum paid up capital. Article 68 provides that a reduction in capital can only be executed by the SBP permission. Under Article 70, the SBP may apply higher minimum capital requirements for banks on an individual basis. Definition of capital is contained in Article 4 of the regulations. It states that common tier 1 capital is composed of the following elements:</p> <ul style="list-style-type: none"> <li>• Capital Stock, including stock from the capitalization of retained earnings.</li> <li>• Share premiums resulting from instruments included in common tier 1 capital (capital overpayments).</li> <li>• Declared reserves, i.e., those reserves classified by the regulated entity as Capital Reserves to reinforce its financial situation and coming from earnings retained on their books and subject to the provisions of Article 69 of the Banking Law.</li> <li>• Non-distributed retained earnings from the current and previous periods. The regulated entity may include the earnings for the current period in the common tier 1 capital before it has adopted a formal decision confirming the results, as long as it ensures that all foreseeable expenses, interests and dividends have been deducted from these earnings. The regulated entity may include the earnings from previous periods in the common tier 1 capital as long as its accounts were verified by external auditors to ensure all foreseeable expenses, interests and dividends have been deducted from these earnings.</li> <li>• Holdings representing minority interests, held in capital accounts of consolidating subsidiaries and complying with the criteria for inclusion in common tier 1 capital.</li> <li>• Other accrued items in comprehensive (total) income, specifically, unrealized net profits or losses from the assets available for sale portfolio.</li> <li>• Other reserves authorized by the Superintendency.</li> </ul> <p>The regulation also prescribes the characteristics of CET1 (see Article 4) i.e., permanent, commitment of capital that represent the most loss absorbing of equity. The SBP's definition of CET1 was based on the Basel III framework. Definitions of AT1 and Tier 2 are stipulated in the regulations and also closely align with the Basel III capital framework i.e., T2 capital is reduced on a straight-line depreciation of 20 percent per year. Adjustments to capital are outlined in detail.</p> <p>The SBP sets a leverage ratio of 3 percent measured against the common tier 1 capital to the total exposure to the non-risk-weighted assets in and off-balance sheet established by the Superintendency. To determine off-balance sheet operations exposure, the criteria for credit risk and counterparty risk will be used. Derivative exposure will be the reasonable value registered on the entity's books. At no time can the leverage ratio be less than 3 percent.</p> <p>The SBP sets guidance for banks to calculate risk-weighted assets in Regulation 3-2016. The regulation sets out ten categories of loans with a prescribed percentage as follows: [0, 10, 20, 35, 50, 100, 125, 150, 200, 250] percent. The risk-weights align closely with the Basel III text. Corporate exposures is the largest portfolio of banks' loan portfolios followed by mortgages. Mortgages attract a 35 percent risk-weight based on fulfilling certain conditions:</p>
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	<ul style="list-style-type: none"> <li>• Mortgages on a main residence granted to the final acquirer of such property, as long as the loan amount does not exceed 80 percent of the lowest appraised value in the appraisal report. Banks may not include loans considered consumption loans linked to a mortgage in this category.</li> <li>• To be considered within this category, the bank must have a property appraisal conducted by independent professionals within the past three years.</li> <li>• Interest receivable for these assets (repayment is based on principal and interest).</li> </ul> <p>There is no formal buffer framework as envisaged by the Basel III capital framework such as the capital conservation buffer and countercyclical buffer. The average capital adequacy ratio of the sector is approximately 15 percent.</p>
<b>EC2</b>	At least for internationally active banks, <sup>45</sup> the definition of capital, the risk coverage, the method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.
Description and findings re EC2	<p>The definition of capital implemented by the SBP largely aligns with the Basel III capital framework. The capital framework calculates risk-weighted assets for Pillar I risks (credit, market and operational risk). The standardized approaches are applied for credit and market risk-weights and for operational risks banks use the Basic Indicator approach. Panama is the home supervisor for regionally active banks. The minimum thresholds for capital adequacy and the composition of capital are aligned with Basel, although there is no formal buffer framework. As a result, minimum capital requirements are 8 percent rather than the Basel III minimum of 10.5 percent (8 percent minimum plus the 2.5 percent capital conservation buffer).</p> <p>The SBP has developed and implemented a D-SIB framework where enhanced supervision is applied to this cohort of banks, however, a systemic risk buffer has not been implemented such that all banks are subject to uniform minimum capital of 8 percent for total capital.</p>
<b>EC3</b>	The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not to have been adequately transferred or mitigated through transactions (e.g., securitization transactions) <sup>46</sup> entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.
Description and findings re EC3	The SBP has the power to impose higher capital requirements on an individual bank and system-wide basis (see also Principle 1). Meetings with the SBP and evidence sighted during a sample of supervisory files demonstrated the exercise of those powers. In the majority of cases, however, the SBP uses moral suasion as a way to persuade banks to hold higher minimum capital. In terms of powers, Article 70 of the regulation provides the SBP

<sup>45</sup> The Basel Capital Accord was designed to apply to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the Basel II and Basel III capital adequacy frameworks would apply such ratios on a fully consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalized on a stand-alone basis.

<sup>46</sup> Reference documents: Enhancements to the Basel II framework, July 2009 and: International convergence of capital measurement and capital standards: a revised framework, comprehensive version, June 2006.

	the power to modify the minimum capital requirements for banks in terms of adjusting the minimum 8 percent ratio higher and the composition of capital. The Pillar II process is undertaken annually considering on-site and off-site outputs. Currently the industry average capitalization is approximately 15 percent.
<b>EC4</b>	The prescribed capital requirements reflect the risk profile and systemic importance of banks <sup>47</sup> in the context of the markets and macroeconomic conditions in which they operate and constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.
Description and findings re EC4	<p>The Superintendent may, by reasoned decision, either temporarily or permanently require a higher ratio for a specific bank when advisable based on the bank's risk profile. The SBP assesses a report submitted by banks on an annual basis. The report pertains to the 'future capital needs' which is essentially a capital management plan (Article 16 of Decision No. 1-2015). The plan aligns capital needs with banks' business models. If any changes take place throughout the year, the bank must update the plan.</p> <p>There is scope to deepen the assessment of capital adequacy to include a broader range of risks (as envisaged in this EC). A comprehensive assessment of capital and all material risks was not evidenced such as: (i) the potential loss absorbency of the instruments included in the bank's capital base, (ii) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (iii) the adequacy of provisions and reserves to cover loss expected on its exposures, and (iv) the quality of its risk management and controls.</p>
<b>EC5</b>	<p>The use of banks' internal assessments of risk as inputs to the calculation of regulatory capital is approved by the supervisor. If the supervisor approves such use:</p> <ul style="list-style-type: none"> <li>(a) such assessments adhere to rigorous qualifying standards;</li> <li>(b) any cessation of such use, or any material modification of the bank's processes and models for producing such internal assessments, are subject to the approval of the supervisor;</li> <li>(c) the supervisor has the capacity to evaluate a bank's internal assessment process to determine that the relevant qualifying standards are met and that the bank's internal assessments can be relied upon as a reasonable reflection of the risks undertaken;</li> <li>(d) the supervisor has the power to impose conditions on its approvals if the supervisor considers it prudent to do so; and</li> <li>(e) if a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.</li> </ul>
Description and findings re EC5	Banks are not approved to utilize internal models to calculate regulatory capital. Banks apply prescribed risk-weights and definitions for capital to calculate regulatory capital.

<sup>47</sup> In assessing the adequacy of a bank's capital levels in light of its risk profile, the supervisor critically focuses, among other things, on (a) the potential loss absorbency of the instruments included in the bank's capital base, (b) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (c) the adequacy of provisions and reserves to cover loss expected on its exposures and (d) the quality of its risk management and controls. Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support the risks it is running and the risks it poses.

	Banks assess their capital needs in the future capital report. Banks may use economic models for risk management.
<b>EC6</b>	<p>The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing).<sup>48</sup> The supervisor has the power to require banks:</p> <ul style="list-style-type: none"> <li>(a) to set capital levels and manage available capital in anticipation of possible events or changes in market conditions that could have an adverse effect; and</li> <li>(b) to have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.</li> </ul>
Description and findings re EC6	<p>The SBP has the power to require banks to maintain capital levels commensurate with their risk profile, business model and strategic plans. The regulations (Circular 72-2016 (Report on future capital requirements) require banks to submit an annual statement of capital needs of the bank and banking group. It states: "The aforementioned report, with projections of future capital requirements, shall be replaced whenever significant changes occur in its conceptualization that cause it to shift from the original projections. To that end, the bank shall measure its effectiveness, inform this Superintendency of the differences, and submit a replacement report. We [the SBP] have estimated that differences of 25 percent will be considered material and will be subject to a change or restatement of the report." The report is assessed by the SBP.</p> <p>The annual capital plans are assessed by the SBP using inputs from macroeconomic/financial stability to assess the macro-financial environment. Based on the capital management plans, the SBP meets the bank and questions the veracity of the plans testing the reasonableness of assumptions. Formal stress tests are not undertaken as part of the assessment on a routine basis and minimum standards for stress testing are not prescribed.</p> <p>The SBP's regulatory roadmap includes a plan to implement ICAAP including a role for stress testing.</p>
<b>AC1</b>	For non-internationally active banks, capital requirements, including the definition of capital, the risk coverage, the method of calculation, the scope of application and the capital required, are broadly consistent with the principles of the applicable Basel standards relevant to internationally active banks.
Description and findings re AC1	
<b>AC2</b>	The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks. <sup>49</sup>
Description and findings re AC2	

<sup>48</sup> "Stress testing" comprises a range of activities from simple sensitivity analyses to more complex scenario analyses and reverse stress testing.

<sup>49</sup> Please refer to Principle 12, Essential Criterion 7.

<b>Assessment of Principle 16</b>	Materially Non-compliant
Comments	<p>The capital framework is largely aligned with the Basel III Accord. Definitions of capital, thresholds, calibration of risk-weighted assets and deductions are equivalent to the Basel standards. While the SBP has developed and implemented a differentiated approach to supervising D-SIBs, the capital framework has not been changed, e.g., a systemic risk buffer has not been implemented. A further deviation from the Basel Capital Framework is that no formal buffer framework (as envisaged by Basel III such as the capital conservation buffer and countercyclical buffer) has been implemented. The average capital adequacy ratio of the sector is approximately 15 percent. The addition of a formal buffer framework is warranted to allow a structured process to standardize responses to capital deterioration. In this regard, internationally active banks are not meeting the Basel capital standards (EC2) which is a material deviation from the requirements of this Principle.</p> <p>There is scope to deepen the assessment of capital adequacy to include a broader range of risks (as envisaged in EC4). A comprehensive assessment of capital and all material risks was not evidenced such as: (i) the potential loss absorbency of the instruments included in the bank's capital base, (ii) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (iii) the adequacy of provisions and reserves to cover loss expected on its exposures, and (iv) the quality of its risk management and controls. The implementation of the ICAAP will help support the annual assessment of all material risks across banks and of integrated risk management across the entire bank with qualitative and quantitative inputs and the use of stress testing.</p>
<b>Principle 17</b>	<b>Credit risk.</b> <sup>50</sup> The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk <sup>51</sup> (including counterparty credit risk) <sup>52</sup> on a timely basis. The full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.
<b>Essential criteria</b>	
<b>EC1</b>	Laws, regulations or the supervisor require banks to have appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank, take into

<sup>50</sup> Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

<sup>51</sup> Credit risk may result from the following: on-balance sheet and off-balance sheet exposures, including loans and advances, investments, inter-bank lending, derivative transactions, securities financing transactions and trading activities.

<sup>52</sup> Counterparty credit risk includes credit risk exposures arising from OTC derivative and other financial instruments.

	account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.
Description and findings re EC1	<p>Decision No. 4-2013 "Establishing provisions on the management and administration of credit risk inherent to the credit portfolio and off-balance sheet operations" is the main regulation dedicated to the management of credit risk. The regulation is a detailed set of requirements for the management of credit risk. According to the Regulation, banks are required to implement credit risk management processes bank-wide. Approach to supervision includes all subsidiaries and credit portfolios. Policies are assessed on an annual basis for compliance with the regulations.</p> <p>A credit risk review is undertaken for higher risk banks and D-SIBs annually. When the SBP reviews loans they sample a range of files, looking at greatest concentration in portfolio, restructured loans, loans of high risk that could have a negative impact on collection. After selecting the sample, they review the credit folder, align credit management with the approval limits, assessing how credit risk is managed. Delegations are reviewed, governance and minutes of the credit committee. They check the folders of legal approvals, collaterals, operational aspects, also check performance of the loan, performance to cut off date, evolution, and whole payment. The SBP contrasts payments with the contribution, loan classification and appropriately classified. The SBP meets with senior management and reviews minutes of credit committees and risk committees. The SBP utilizes credit risk specialists to assess loans providing industry benchmarking.</p> <p>Off-site analysis is undertaken using data reported on a monthly and quarterly basis. The ATOM has 73 fields which allows the SBP to monitor trends, analysis of data to align with strategic plan and business plans, exceptional growth in a portfolio, and signs of credit deterioration. Data on loan-to-values for portfolios is assessed. The following data points are submitted to the SBP for analysis (see General Resolution No. SBP-RG-0001-2022 of July 6, 2022):</p> <ul style="list-style-type: none"> <li>• Loan data record (AT03)</li> <li>• Data record on procured goods (AT04)</li> <li>• Liquidity data record (AT10), installments of obligations payable in Panama</li> <li>• Guarantee data record (AT12)</li> <li>• Investment data record (AT15)</li> <li>• Accounting data record (AT21)</li> <li>• Table of Economic Groups and Related Parties (BAN03)</li> <li>• Credit Risk Capital Requirement Table (BAN05)</li> <li>• Table of Off-Balance Sheet Operations (BAN06)</li> <li>• Assets Acquired from the Bank and Subsidiaries (BAN07)</li> <li>• Dynamic Provisioning (BAN10)</li> <li>• Capital Adequacy Table (BAN16)</li> <li>• Asset and Liability Maturity Structure (EVAP)</li> <li>• Form A (SB-CAP-A) Report on the loan portfolio maturity profile according to loan type and activity and payment compliance</li> <li>• Form B (SB-CAP-B) Report on the current loan portfolio maturity profile according to remaining contractual period</li> <li>• Form C (SB-CAP-C) Report on the age of the past due portfolio</li> </ul>

	<ul style="list-style-type: none"><li>Form D (SB-CAP-D) Report on the loan portfolio by type, activity, and classification category</li><li>Form E (SB-CAP-E) Report on provision details, according to loan portfolio type and classification category</li><li>Form F (SB-CAP-F) Control of written-off loans</li></ul> <p>To augment the regulatory reporting, SBP’s Financial Stability Department produces macro analysis and data to help support supervisors, specifically the off-site analysis team. At a banking sector level, corporate loans comprise the majority of system loan portfolios at approximately 63 percent with mortgages second. Household debt (defined as the total home mortgage and consumer loans granted by bank credit establishments) in Panama represents an important share of the banking loan portfolio. As of June 2022, home mortgage and consumer loans reached 58 percent of loans to the private sector. Personal loans break down as follows (source SBP as at June 2022):</p> <table><tr><th>Type of loan</th><th>Banking System (Millions of USD)</th><th>Banking System (Quantity)</th><th>Average Debt (USD)</th></tr><tr><td>Mortgages</td><td>19,204</td><td>281,767</td><td>68,155</td></tr><tr><td>Personal Car loans</td><td>1,755</td><td>153,342</td><td>11,446</td></tr><tr><td>Personal loans</td><td>8,985</td><td>694,758</td><td>12,933</td></tr><tr><td>Credit Cards</td><td>2,235</td><td>607,590</td><td>3,678</td></tr><tr><td>Total</td><td>32,179</td><td>1,737,457</td><td>18,521</td></tr></table>	Type of loan	Banking System (Millions of USD)	Banking System (Quantity)	Average Debt (USD)	Mortgages	19,204	281,767	68,155	Personal Car loans	1,755	153,342	11,446	Personal loans	8,985	694,758	12,933	Credit Cards	2,235	607,590	3,678	Total	32,179	1,737,457	18,521
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EC2	<p>The supervisor determines that a bank’s Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming, <sup>53</sup> identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.</p>																								
Description and findings re EC2	<p>Article 5 of the regulation sets out the responsibilities of the BoD to be involved in the oversight and governance of credit risk. The regulation states that the BoD is responsible for ensuring the bank has an appropriate, effective, feasible and fully documented framework for credit risk management and loan administration. This framework shall contain policies, manuals, and procedures and will be known as the structured and integrated risk and loan administration system. For compliance with this provision, the BoD will have the following responsibilities:</p> <ul style="list-style-type: none"><li>To approve credit strategies, policies and practices, and review them at least once a year or every time there are important events or situations linked to this risk. These policies must consider the credit risk assumed in all operations, both individually and as aggregated credit portfolios for economic groups, products, economic sectors or any other classification relevant to the target markets and client profiles defined and approved within the strategy.</li></ul>																								

<sup>53</sup> "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.

	<ul style="list-style-type: none"> <li>• To approve credit risk exposure tolerance, providing credit limits for clients, market segments and products.</li> <li>• To approve an organizational structure appropriate for its size and business sophistication, clearly setting the responsibilities, as well as the levels of authority and interrelationship of each area involved in credit risk management.</li> <li>• To ensure that top management is trained to manage the credit risk operations of the bank and that these transactions are made following the strategy, policies and approved level of tolerance of risk.</li> <li>• To ensure that the staff incentive policy is aligned with the bank's credit risk strategy and does not weaken the credit processes.</li> <li>• To supervise the credit risk level assumed by the bank, ensuring it is proportional to capital funds.</li> <li>• To approve the introduction of new products, segments or activities in the credit portfolio and off-balance sheet transactions generating credit risk.</li> <li>• To follow-up on exposures with related parties and economic groups and ensure that internal auditing reviews that information.</li> <li>• To approve exceptions to internal policies and established limits proposed by top management and/or the person having been delegated that responsibility.</li> <li>• To request and approve corrective strategies when the Risk Committee, the Credit Committee or Internal Auditing submit information warning of real or potential damages to credit portfolio quality.</li> <li>• To ensure that the bank correctly applies the accounting and regulatory standards regarding credit risk management.</li> <li>• To establish a system for the delegation of authority for approving credit transactions and the authority necessary for their monitoring, recovery and collection.</li> <li>• To create a credit committee within the corporate governance system, pursuant to the provisions of this Rule.</li> </ul> <p>The regulations also require banks to establish a credit committee to (i) approve those transactions falling within the level assigned to it by the BoD; and (ii) Proposing to the BoD improvements in policies, processes, and procedures for credit approval.</p> <p>The SBP assesses minutes of the credit committee, BRC and BoD. Analysis of credit files evaluates the delegation approvals, oversight of loans that are reported to the credit committee and BoD.</p>
<b>EC3</b>	<p>The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including:</p> <ul style="list-style-type: none"> <li>(a) a well-documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments;</li> <li>(b) well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing exposures, and identifying the appropriate approval authority for the size and complexity of the exposures;</li> </ul>



	<p>(c) effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification system;</p> <p>(d) effective information systems for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank's Board and senior management on an ongoing basis;</p> <p>(e) prudent and appropriate credit limits, consistent with the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff;</p> <p>(f) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board where necessary; and</p> <p>(g) effective controls (including in respect of the quality, reliability, and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.</p>
Description and findings re EC3	<p>The rules and processes that cover what is requested in paragraphs "a" through "g" are the following in Decision No.3-2013:</p> <ul style="list-style-type: none"> <li>• Article 11-Minimum Components of the Structured and Comprehensive System for Credit Risk Management and Credit Administration;</li> <li>• Article 12-Target Market Definition;</li> <li>• Article 14-Organizational Structures and Support Committees;</li> <li>• Article 15-Exposure Limits;</li> <li>• Article 17-Bank Credit Risk Monitoring and Follow-up Mechanisms;</li> <li>• Article 22-Credit Administration Process;</li> <li>• Article 23-Origination Process Criteria; Article 24-Guarantee Policies)</li> </ul> <p>The SBP undertakes a thorough analysis of the implementation of risk management. In relation to the sub criteria:</p> <p>(a) Banks are required to have a well-documented credit risk management strategy as per Decision 3-2013. Policies are reviewed as part of the on-site examination and verified through loan sampling. The loan file reviews assess the extent to which banks perform an assessment of creditworthiness, loan serviceability, valuation of collaterals etc. without excessive reliance on external credit ratings.</p> <p>(b) SBP loan file reviews sample new lending to verify that underwriting policies have been applied prudently. The loan life cycle is assessed for segregation of duties, hind sighting and periodic facility review. Delegations are verified and larger more complex exposures are typically subject to additional governance such as credit committee approvals.</p> <p>(c) An assessment of credit administration is an integral aspect of the on-site examination. SBP evaluates banks' assessment of serviceability and collateral management processes to align with the bank's internal policies and for compliance with prudential standards.</p>

	<p>(d) Bank MIS reports on credit risk exposures are assessed on-site and off-site. Banks are expected to have a comprehensive system for reporting individual credits and for portfolio reporting. The timeliness and accuracy of reporting is assessed from business units to the BoD.</p> <p>(e) Banks are expected to have credit limits in place and a process for reporting adherence to the limits. The process for credit approvals is verified and assessed to ensure limits are adhered to (see also CP19 for large exposures). The regulations require credit risk tolerances to be implemented at the Board level and cascaded throughout the bank to credit departments. Reporting is then produced to the Board mainly via the BRC. EXCO has a credit committee which adds to the governance of credit risk limits and appetite. Calibration of risk appetite and capital strength is undertaken mainly at the CRO level in connection with the Board.</p> <p>(f) Banks are expected to have processes in place for exception tracking which is verified by the SBP during onsite activities.</p> <p>(g) Internal models are used typically for assessing loans but not for calculating regulatory capital. Accuracy of credit risk ratings (ratings matrices) are undertaken annually with back testing and jump to default hind-sighting.</p>
<b>EC4</b>	The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged foreign exchange risk.
Description and findings re EC4	<p>The regulations require banks to assess loans using total indebtedness when calculating debt serviceability ratios. The requirements are included in the following sections of Decision No. 4-2013:</p> <ul style="list-style-type: none"> <li>• Article 17–Bank Credit Risk Monitoring and Follow-up Mechanisms;</li> <li>• Article 11-Minimum Components of the Structured and Comprehensive System for Credit Risk Management and Credit Administration;</li> <li>• Article 25-Follow-up and Control Processes).</li> </ul> <p>Banks have access to a credit registry which contains loan details that banks access when originating loans.</p>
<b>EC5</b>	The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm's length basis.
Description and findings re EC5	The regulations clearly stipulate that credit decisions need to be undertaken free of conflicts. The SBP reviews files to ensure related party transactions are administered appropriately (see also CP21).
<b>EC6</b>	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's Board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings re EC6	The regulation for the management of large exposures is set out in the Banking Law and Decision No. 6-2009 (see also CP19 for the regulatory framework pertaining to large exposures). According to the regulations, large exposures are defined as exposures greater than 10 percent with a maximum limit of 25 percent measured against total regulatory capital.

<b>EC7</b>	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling, and reporting on credit risk.
Description and findings re EC7	The Banking Law and regulations give the SBP full access to bank records, reporting systems, staff and board committees to assess and evaluate credit risk management. Analysis of supervisory files demonstrated access to the necessary information to evaluate bank credit risk management, minutes of meetings with senior management and BoD.
<b>EC8</b>	The supervisor requires banks to include their credit risk exposures into their stress testing programs for risk management purposes.
Description and findings re EC8	Regulation (4-2013) requires banks' independent risk units to develop and maintain a stress testing methodology. The risk management guidelines for banks also require risk management systems to measure and monitor exposures using different scenarios.
<b>Assessment of Principle 17</b>	Compliant
Comment	The SBP has a strong focus on credit risk management. The off-site analysis occurs on a frequent basis using a comprehensive suite of indicators and data points. Banks report detailed credit information relating to the counterparty, valuations of collateral, loan-to-value ratios, details regarding serviceability, vintage, loan type, region, geography etc. Using this information, the SBP is able to undertake analysis on an individual bank basis and across the sector to identify early vulnerabilities, build up in credit risks and outliers. The on-site examination samples files from a range of portfolios and loan files are tested and verified for compliance with banks' internal policies and the SBP's regulations. The regulations consist of a detailed suite of risk management for risk governance and risk management. The regulations emphasize, amongst other things: segregation of duties, governance, delegations, the three lines of defense, hind sighting, appropriate due diligence to assess serviceability and collateral management.
<b>Principle 18</b>	<b>Problem assets, provisions and reserves.</b> <sup>54</sup> The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves. <sup>55</sup>
<b>Essential criteria</b>	
<b>EC1</b>	Laws, regulations, or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations, or the supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings re EC1	The regulations (Decision No. 4-2013) stipulate banks' obligations to implement a structured and integrated credit risk and loan administration system. The regulation requires all banks to have a structured and integrated credit risk system that will enable it

<sup>54</sup> Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

<sup>55</sup> Reserves for the purposes of this Principle are "below the line" non-distributable appropriations of profit required by a supervisor in addition to provisions ("above the line" charges to profit).

	<p>to appropriately identify, monitor, control, mitigate and report credit risk in all stages of the credit process or cycle. This system must also include loan administration, which consists of planning, granting, monitoring, and recovering credit, as well as its classification and provisions requirement. The system must contain the applicable policies, processes and procedures for each one of the stages. To achieve this, it must have the staff, tools, systems and documentation guaranteeing its efficiency. The system must be appropriately documented in manuals that must be approved by the BoD. The manuals must be available to internal auditors, external auditors and the SBP at all times.</p> <p>In terms of regular review of problem assets, the regulation requires banks to implement a credit scoring system which is under the direction of the risk management unit, the bank must design credit scoring systems consistent with the segmentation of the loan portfolio and the sophistication of transactions. The credit scoring system must be a basic pillar of the approval and tracking functions, as well as a tool to help determine risk premiums and comprehensive credit portfolio management. The credit scoring system must be fully documented in the relevant manuals (see Article 16).</p> <p>In addition, the regulation requires banks to have mechanisms for monitoring and tracking bank credit risk. The bank must continuously monitor and track the payment behavior of debtors and all exogenous and endogenous conditions that affect the probability of on-time compliance or that have the potential for increasing the possibility of noncompliance. To comply with the above, the bank must have tools and clear policies for tracking the portfolio. This responsibility will belong to the risk management unit called for in the Rule on Comprehensive Risk Management and related regulations See Article 17).</p> <p>According to the regulation, banks need to classify all of their obligations using five prescribed categories of: Normal, Special Mention, Substandard, doubtful, and unrecoverable. The loan classifications are applied across the portfolio in accordance with definitions (see Article 18). The treatment of write-offs is prescribed in Article 27 which states that each bank will write off all loans classified as unrecoverable within no more than a year from the date in which they were classified within this category.</p> <p>Guidance for the treatment of loan loss provisioning is contained in the regulation Articles 33-38. Broadly, banks are required to consider two types of provisions: specific and dynamic. Specific provisions are defined as those that must be created due to a credit classification under the special mention, substandard, doubtful, or unrecoverable risk categories. They apply to both individual loans and loan portfolios. In the case of loan portfolios, the reserves apply when there is evidence of impairment in the quality of credit, even though the identification of the impairment of individual loans within the portfolio is not yet possible. Dynamic provisions are established according to the prudential criteria on all loans lacking a specific reserve, i.e., on the loans classified as normal (see Article 33).</p> <p>IFRS are the accounting standards applied by regulated entities, which are issued by the International Accounting Standards Board. Through the General Resolution of the Board of Directors SBP-GJD-0003-2013 of July 9, 2013, the SBP established the accounting treatment of the differences between the Prudential Standards it issues and the IFRS in accordance with the provisions of Article 3 of Agreement 6-2012. IFRS is analyzed by the SBP to determine its impacts on the Prudential Standards issued, and thus be able to define the accounting treatments on the differences that may arise, since Article 3 of</p>
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	<p>Agreement 6-2012 states that the prudential standards issued by the SBP applicable to banks, subsidiaries, and affiliates, which present specific accounting aspects additional to those required by IFRS, will prevail over the latter. In this way, banks calculate two sets of provisions, one based on the requirements issued by the SBP and described above, and the other using IFRS (see also CP27). IFRS9 was implemented in 2018. Through the implementation process, two areas of difference in the calculation of regulatory provisions between the two approaches: (i) calculation of credit loss for performing loans which; and (ii) broader consideration of collateral types used under IFRS. Some challenges exist in implementing IFRS9 including access to historical data, modeling skills and expertise etc. Article 34 states that if under IFRS there is a surplus in the specific reserve, it will be registered in a regulatory reserve of capital (credited to the retained earnings account). The regulatory reserve will not be considered regulatory capital funds for the purpose of the capital adequacy index, concentration limits for a sole borrower or related parties, or any other prudential relationship.</p> <p>The SBP establish the accounting treatment of the differences that arise between the two standards. Regulated entities make the respective adjustments and/or reclassifications related to these prudential standards, so that the consolidated financial statements are presented exclusively on the basis of IFRS. In each Audited Financial Statement issued by the banks, they disclose in their respective notes the differences between IFRS and the Prudential Standards issued by the SBP, indicating the adjustments made.</p> <p>To assess banks' compliance with the regulations, the SBP undertake on-site and off-site supervision. The process commences with analysis of off-site data. SBP reporting guidance (see General Resolution No. SBP-RG-0001-2022 of July 6, 2022,) obliges banks to submit granular data regarding a breakdown of the loan portfolio on a monthly basis, a breakdown of calculations generating dynamic provisions on a quarterly basis. Full balance sheet data and profit and loss are also submitted on a quarterly basis. In addition, banks submit a report on the age of the past due portfolio and control of written-off loans. Banks submit annual reports and semi-annual audited financial reports. Loan classifications re submitted on a quarterly basis and breakdown of loan portfolio provisions by type and classification category. The data is analyzed and monitored by the SBP off-site team. Trends, irregularities and issues are addressed to bank staff for explanation. Annual self-assessment questionnaires are submitted by banks to evidence compliance with the prudential regulations and banks submit corroborating evidence such as policies and process documents that are assessed by the SBP.</p> <p>On-site examinations focus on loan life cycle evaluating banks' compliance with credit risk management and loan administration. Loan classification processes are assessed as well as collaterals and provisioning rates. The SBP supervisory manual has a structured approach for supervisors to follow on-site and consistently apply.</p>
<b>EC2</b>	<p>The supervisor determines the adequacy of a bank's policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor's opinion may be conducted by external experts, with the supervisor reviewing the work of the external experts to determine the adequacy of the bank's policies and processes</p>

Description and findings re EC2	<p>SBP assesses banks policies and processes on an annual basis via the self-assessment questionnaire process. The on-site examination is the main activity that will verify the effective implementation of bank policies in accordance with the regulations. Specifically, SBP evaluates appropriateness of the loan classification and provisioning rates. The file review will include an assessment of the types of collaterals and valuation processes for the secured portfolios (see also EC1).</p> <p>The SBP engages with the internal audit function during on-site examinations to assess the third line of defense and effectiveness of internal controls such as segregation of independent review. Minutes of the Board Audit Committee (BAC) are reviewed and associated reports. On an annual basis, banks share the audit opinion providing additional input into the SBP's assessment of the implementation of a bank's policies and processes for grading its assets and establishing provisions levels. Interviews with the SBP provided examples where the output of the internal auditor and external auditor is reviewed.</p>
<b>EC3</b>	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures. <sup>56</sup>
Description and findings re EC3	Banks are required to include off-balance sheet exposures in their provisioning. The on-site examination takes into account the total exposure of the obligor which includes direct loan exposures as well as facilities such as letters of credit and guarantees. The SBP samples the entire client file to ensure loan classification and provisioning to undertaken for on- and off-balance sheet exposures. Definition 21 of the regulation defines off-balance sheet transactions as those transactions representing the irrevocable commitment of the bank to granting or assuming the risk of payment by a debtor.
<b>EC4</b>	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.
Description and findings re EC4	<p>The regulation requires banks to have policies and processes for write-offs. Article 27 states that each bank will write-off all loans classified as unrecoverable within no more than a year from the date in which they were classified within this category. Unrecoverable can be aged up to 360 days and then another 365 maximum 2 years. See proviso 2 under Article 19. There is no recognition in the regulations for the market and macroeconomic conditions to be taken into account when writing-off loans. The one year write off requirement is appropriate.</p> <p>The regulations require the loan administration system to continuously monitor and update the loan classification and collateral valuations. There is a general requirement in the regulation (see article 32) for banks to keep their loan files up to date and their assessment and loan classification, including reserves needed to cover potential losses. In the event the SBP determines the need to create greater reserves than those calculated by the bank, the bank must create those reserves within a period of time acceptable to the Superintendency. In any case, the bank must proceed to the immediate reclassification of</p>

<sup>56</sup> It is recognized that there are two different types of off-balance sheet exposures: those that can be unilaterally cancelled by the bank (based on contractual arrangements and therefore may not be subject to provisioning), and those that cannot be unilaterally cancelled.

	the debtors in question. Interviews with the SBP evidenced examples where it had directed banks to regrade exposures and contribute additional provisions.
<b>EC5</b>	The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g., 30, 60, 90 days). The supervisor tests banks' treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards (e.g., rescheduling, refinancing or reclassification of loans).
Description and findings re EC5	<p>The regulations stipulate the requirement for the risk management unit to undertake the following in relation to identification of deteriorating assets (see Article 7):</p> <ul style="list-style-type: none"> <li>• Develop and submit credit risk management policies through the risk committee for the approval of the board of directors, simultaneously reporting these to the general manager or his/her equivalent.</li> <li>• To track compliance with the credit risk exposure limits approved by the board of directors.</li> <li>• To develop and submit for the approval of the risk committee the credit risk management methodology. Specifically, develop credit classifications for grantees and submit them for the approval of the risk committee.</li> <li>• To submit to the board of directors, through the risk committee, a suitable structure for credit risk management.</li> <li>• To implement the credit risk management methodology.</li> <li>• To prepare opinions on possible credit risks related to new credit products, services or promotions prior to their launch.</li> <li>• To develop and submit for the consideration of the risk committee an information system based on objective and timely reports that will indicate credit risk exposure levels and compliance with set limits.</li> <li>• To develop and maintain stress testing methodology.</li> <li>• To develop and maintain methodologies to show shortfalls, forecast future portfolio recovery cash flows and establish current values for periodic comparison of the market values obtained with the book value.</li> </ul> <p>The self-assessment questionnaire evidence policies and processes in relation to loan classification and provisioning which is assessed by the SBP. When on-site, the SBP evaluates the implementation of the policies and processes and the adequacy of provisions. In terms of governance arrangements, in addition to the stipulation for an independent risk management unit, the regulations stipulate the role of senior management in regard to loan classification and to establish a credit committee. The SBP reviews the reporting and minutes of the credit committee as well as the BRC.</p>
<b>EC6</b>	The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.

Description and findings re EC6	<p>Banks are required to report a range of data across monthly, quarterly, semi-annual, and annual basis. General Resolution No. SBP-RG-0001-2022 of July 6, 2022 require banks to submit the following reports:</p> <ul style="list-style-type: none"> <li>• Loan data record (AT03)</li> <li>• Accounting data record (AT21)</li> <li>• Table of Economic Groups and Related Parties (BAN03)</li> <li>• Credit Risk Capital Requirement Table (BAN05)</li> <li>• Table of Off-Balance Sheet Operations (BAN06)</li> <li>• Capital Adequacy Table (BAN16)</li> <li>• Form D (SB-CAP-D) Report on the loan portfolio by type, activity, and classification category</li> <li>• Form E (SB-CAP-E) Report on provision details, according to loan portfolio type and classification category</li> <li>• Form F (SB-CAP-F) Control of written-off loans</li> </ul> <p>The data is verified by the SBP during on-site and off-site processes (see also EC1).</p>
<b>EC7</b>	<p>The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g., if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.</p>
Description and findings re EC7	<p>Data submitted to the SBP monitors the changes and trends in loan classification on both a monthly and quarterly basis. The SBP undertakes an in-depth assessment of loan classification and provisioning during the on-site through file sampling and testing. Semi-annual and annual accounts provide additional inputs into the assessment. The regulations provide the SBP the power to amend provisioning rates if they deem necessary (Article 32). Discussions with the SBP confirm examples where this power has been exercised in practice.</p> <p>The SBP has implemented dynamic reserves (see Articles 36 and 37). Dynamic reserves are established on a quarterly basis, based on the data from the last day of the quarter. The amount of the dynamic reserves is obtained by calculating the following components:</p> <ol style="list-style-type: none"> <li>1. Component #1: The amount obtained by multiplying the balance of risk-weighted assets for loans classified under the normal category by the Alpha coefficient of 1.5 percent.</li> <li>2. Component #2: The amount obtained by multiplying the quarterly variation in risk-weighted assets for loans classified under the normal category, if positive, by the Beta coefficient 5 percent. If the variation is negative, the amount is zero.</li> <li>3. Component #3: The amount of the variation in the balance of specific reserves during the quarter.</li> </ol> <p>The amount of dynamic reserves that must be maintained at the end of the quarter is the sum of the two components obtained in numbers 1 and 2 above minus the third component, taking its mathematical sign into account, i.e., if the third component is</p>



	<p>negative, it must be added. The following restrictions apply to the amount of the dynamic reserve:</p> <ol style="list-style-type: none"> <li>1. It cannot be greater than 2.5 percent of the risk-weighted assets of the loans classified under the normal category.</li> <li>2. It cannot be less than 1.25 percent of the risk-weighted assets on the loans classified under the normal category.</li> <li>3. It cannot be less than the amount established in the previous quarter unless the decrease is the result of a conversion to specific provisions. The Superintendency of Banks will establish the criteria for the above conversion.</li> </ol> <p>The reserve called "global minimum" will be considered part of the dynamic reserve for the purpose of meeting the required reserve on the date in which the dynamic reserves are calculated.</p>
<b>EC8</b>	<p>The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.</p>
Description and findings re EC8	<p>Article 24 of the regulations require each bank to have a clear policy on what collateral is acceptable, for what type of client, business line or product and the maximum credit to grant based on the value of the collateral. The policy on collateral will include, as a minimum, the following:</p> <ul style="list-style-type: none"> <li>• A formal evaluation of the support and reliability of the collateral.</li> <li>• An assessment of the coverage and liquidity of the collateral, establishing its current value based on a current appraisal and taking into consideration the scenarios for its liquidation and the inherent time, cost and expense of doing so. This assessment must include the risk rating that the bank will establish for the debtor. <ul style="list-style-type: none"> <li>• The criteria and requirements that evaluation experts must have to be acceptable to the bank.</li> </ul> </li> <li>• The methodology for assessing intangible collateral and payment sources represented by the cession of economic rights.</li> <li>• The risk assessment criteria for counterparts such as trust agents, custodians, issuers and originators of assets granted as collateral.</li> </ul> <p>The regulations also specify valid collateral for the purposes of provisioning. As per the regulations, the following assets are considered valid collateral to calculate specific provisions:</p> <ul style="list-style-type: none"> <li>• Pledged deposits in the same bank or in other banks.</li> <li>• Fixed and variable income securities traded in an active market.</li> <li>• Panamanian sovereign debt.</li> <li>• Fixed and variable income securities lacking an active market but whose estimated market value is feasible.</li> <li>• Sovereign debt traded in an active market.</li> <li>• Standby letters of credit, pledges, bonds, warranties, and irrevocable export/import credit letters issued by banks.</li> <li>• Promissory notes with a discount code from the Social Security Fund.</li> <li>• Residential properties.</li> </ul>

- Commercial properties.
- Land.
- Land restricted to agricultural use.
- Automobiles.
- Cattle
- Agricultural products that can be fully identified by the bank.

In this way, the SBP ensures a minimum level of eligibility of collateral types to offset the exposure amount. The regulations go into more detail that all collateral eligible as risk mitigators must be legally established and validated by the bank granting the loan. When applicable, the collateral must have current insurance policies issued or endorsed to the bank, guaranteeing that the insurance company will promptly pay for any casualty. Collateral eligible as risk mitigators must permit the creditor bank to directly execute legal action for payment to the bank in case of noncompliance.

For the calculation of the specific reserves under IFRS and the principles of prudential valuation, it is necessary to take into consideration the time value of money and the uncertainty of the actual cash value of liquidated collateral, as well as recovery costs. In this regard, and for the purposes of calculation the reserves established in Article 34, the current values established in the chart below must be applied:

<b>Pledge</b>	<b>Current Value</b>
Deposits in the bank itself or in other banks, be they pledged or given as trust funds.	100%
Fixed or variable income securities traded in active markets.	70%
Panamanian sovereign debt.	90%
Fixed or variable income securities lacking an active market.	50%
Sovereign debt traded in an active market.	70%
Standby letters of credit, warranties, sureties, endorsements and irrevocable export/import letters of credit issued by banks.	90%
Cession of promissory notes with a discount code from the Social Security Fund.	85%
Residential real property.	70%
Commercial real property.	60%
Land.	50%
Land used exclusively to agricultural purposes.	50%
Personal property (mortgages on private automobiles).	50%

	Cattle.	75%										
	Agricultural products properly identified by the bank.	40%										
	<p>1. Article 42 states that, for the calculation of specific provisions under IFRS and the principles of valuation prudence, it is necessary to take into account the time value of money and uncertainty about the cash realization value of guarantees, as well as the costs of recovery activity. For the 15 types of guarantees indicated in Article 34 (see above) the present values established must be applied.</p> <p>2. Article 41 stipulates the various frequency at which collateral needs to be revalued which typically reflect good practice. What is not in place is the need to have an independent appraisal of collateral as an additional external validation of collateral values.</p> <p>Article 44 – Appraisal companies - Banks must establish and apply policies and procedures that ensure adequate knowledge of the appraisal companies they contract, and the methods used by them when establishing the value of the real and personal property being used as collateral.</p>											
EC9	<p>Laws, regulations, or the supervisor establish criteria for assets to be:</p> <p>(a) identified as a problem asset (e.g., a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and</p> <p>(b) reclassified as performing (e.g., a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).</p>											
Description and findings re EC9	<p>The regulations (see Article 18) stipulate the loan classifications for three types of loans: (i) corporate and other loans; (ii) personal consumption loans; and (iii) personal mortgage loans.</p> <p>Article 34 states the bank must calculate and maintain, as a minimum, the specific reserves determined by the following criteria at all times:</p> <p>1. The basis for reserve calculation is the difference between the amount of the loan classified in any of the categories subject to reserve, and the amount of the collateral mitigating any possible loss. If the difference above is negative, the basis for calculation is zero. Values for collateral are further described in Article 42.</p> <p>2. The reserve is calculated by multiplying the weight established in the table below for each risk category, by the calculation basis.</p> <p>Reserve Calculation Weight Chart</p> <table><tr><td>Category</td><td></td></tr><tr><td>Special mention</td><td>20%</td></tr><tr><td>Substandard</td><td>50%</td></tr><tr><td>Doubtful</td><td>80%</td></tr><tr><td>Unrecoverable</td><td>100%</td></tr></table> <p>The regulations state that regardless of whether the loans are corporate, consumer, or mortgages, the number of days elapsed since full or partial payment was due will be</p>		Category		Special mention	20%	Substandard	50%	Doubtful	80%	Unrecoverable	100%
Category												
Special mention	20%											
Substandard	50%											
Doubtful	80%											
Unrecoverable	100%											

	<p>sufficient reason for their classification in any of the categories previously provided, with the provision that corporate loans must be classified in the appropriate category when one or more of the circumstances provided pertains, regardless of the number of days elapsed since the last payment.</p> <p>Article 18 develops the criteria for classifying credit risks of the portfolio considering the days of arrears, the financial situation, the debtor's ability to pay, among other aspects. Regarding Article 21, it establishes the additional general criteria for the classification of the portfolio, in which the days foreseen in each category of portfolio classification indicated in article 18 above, will be a sufficient objective condition for all its obligations and there will be a presumption of deterioration of the capacity to pay, when:</p> <ul style="list-style-type: none"> <li>i. The payment behavior of natural persons in the financial market deteriorates with respect to that they had at the time of the origination of their loans with the bank.</li> <li>ii. Legal entities present impairments in their recent financial information that could affect their ability to pay, especially in the following indicators: Free Operating Cash Flow, Operating Profit, Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA), Total Indebtedness and EBITDA Interest Coverage.</li> </ul> <p>Specifically in relation to the EC:</p> <ul style="list-style-type: none"> <li>(a) The regulations fulfil the criteria to identify as a problem loan, e.g., a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement);</li> <li>(b) Local practice is for banks to offer their customers the alternative of restructuring their debts, making changes in the originally agreed conditions that may include changes in interest rates, extending the maturity date of the loan, requirement of additional guarantees, partial forgiveness according to a certain amount of payments in a certain term, among others. The guideline is that there should be prospective financial viability. Agreement 4-2013, in its Article 19, indicates the conditions and the term of cure so that a restructured loan can be reclassified to a category of lower risk. In the case of non-compliance with its new established conditions, a higher risk category must be classified. The loan is reclassified as performing only when all arrears have been cleared and the loan has been brought fully current.</li> </ul>
<b>EC10</b>	<p>The supervisor determines that the bank's Board obtains timely and appropriate information on the condition of the bank's asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.</p>
Description and findings re EC10	<p>The regulations clearly establish governance requirements in relation to loan classification and provisioning. Article 5 -Board Responsibilities describes their role for ensuring the bank has an appropriate, effective, feasible and fully documented framework for credit risk management and loan administration. This framework shall contain policies, manuals, and</p>

	procedures and will be known as the structured and integrated risk and loan administration system. The Article sets out meaningful responsibilities that ensures the BoD is involved in oversighting the classification system and provisioning rates. The on-site process assesses the role of the BoD, the credit committee and senior management as well as the risk units.
<b>EC11</b>	The supervisor requires that valuation, classification, and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.
Description and findings re EC11	The regulations do not specify a threshold for exposures to be classified on an individual basis. In the absence of this requirement, banks are permitted to set their own thresholds.
<b>EC12</b>	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment.
Description and findings re EC12	Regulatory reporting is reviewed and assessed monthly and quarterly. Regulatory reporting is assessed on an individual bank basis as well as for the system. Results of the analysis is integrated into the SBP's supervision processes and system-wide trends are published on the SBP's website. Data is periodically evaluated using the information sent by banks through the ITBank system. This information serves as a basis for the preparation of the economic report, statistics, and financial indicators of the banking center.
<b>Assessment of Principle 18</b>	Compliant
Comments	The regulations are generally sound and require banks to classify all on- and off-balance sheet exposures using a prescribed framework. Guidance for loan classification is extensive and reporting to the supervisor is extensive and frequent. On-site, the SBP focuses on the appropriate classification of loans, handling of problem assets and the calculation of provisioning. Guidance surrounding collateral valuation is extensive and there is a prescribed set of eligible collateral types for provisioning.
<b>Principle 19</b>	Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties. <sup>57</sup>
<b>Essential criteria</b>	

<sup>57</sup> Connected counterparties may include natural persons as well as a group of companies related financially or by common ownership, management, or any combination thereof.

<b>EC1</b>	Laws, regulations, or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk. <sup>58</sup> Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Description and findings re EC1	<p>The regulatory framework for concentration risk and large exposures consists of the following:</p> <ul style="list-style-type: none"> <li>• Banking Law, Article 95 (Concentration in a Single Person), Article 96 (Concentration in Related Parties), and Article 98 (Economic Groups)</li> <li>• Decision No. 4-2013 "Establishing provisions on the management and administration of credit risk inherent to the credit portfolio and off-balance sheet operations" (Article 15-Exposure Limits)</li> <li>• Decision No. 6-2009 "Establishing the rules for limits on risk concentration in economic groups and related parties" (Article 3-Concentration Risk Management)</li> <li>• Decision No. 7-2014 "Establishing rules for the consolidated supervision of banking groups" (Articles 14 and 16).</li> </ul> <p>Article 3 of the Regulation (Decision No.4 2013) requires banks to have policies and processes to manage concentration risk management and states that the bank must have policies, procedures and internal controls that mitigate the material exposure risk that may derive in losses that affect the main business of the bank or its banking group in an important or significant manner. Furthermore, the regulation states that the bank must observe at all times the quantitative concentration limits set by Articles 95 and 96 of the Banking Law. Similarly, they must develop a healthy banking management conducive to monitoring the concentration risk, including specific exposures in: (i) economic sectors; (ii) industries; (iii) geographic regions; and (iv) products or services.</p> <p>Article 95 of the Banking Law states that banks and owners of bank shares in which the banking group is consolidated are prohibited from granting, directly or indirectly, to a single natural or legal person, including those who form an economic group with it, loans or credit facilities or any guarantees, or from incurring any other obligation in favor of said person, whose total at any time individually or jointly exceeds twenty-five percent of the bank's capital funds.</p> <p>For the application of the prohibitions set forth in Articles 95 and 96 of this Decree Law, consideration shall be given to page 30 of Executive Decree No. 52 of April 30, 2008, on economic groups. However, a bank shall not be deemed to have violated the provisions of said articles if the existence of the economic group is supervening, that is, it did not exist at the time that the obligations were contracted. In such case, the Superintendency shall give the bank a timeframe within which to remedy the excess within the applicable limits. If it is found that the economic group existed at the time that the obligation was generated, the Superintendency shall impose a fine on the bank in question, in accordance</p>

<sup>58</sup> This includes credit concentrations through exposure to: single counterparties and groups of connected counterparties both direct and indirect (such as through exposure to collateral or to credit protection provided by a single counterparty), counterparties in the same industry, economic sector or geographic region and counterparties whose financial performance is dependent on the same activity or commodity as well as off-balance sheet exposures (including guarantees and other commitments) and also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

	<p>with this Decree Law, and shall order that the fault be remedied within a peremptory period.</p> <p>The bank shall establish, based on its strategic definitions, maximum and minimum limit policies by business line, economic sector, geographic region, and client. The foregoing without prejudice to compliance with the limits established in the concentration rules with economic groups and related parties. Such limits shall be defined by the Risk Management Unit, the Risk Committee, and the Board. The bank shall have clearly identified and consolidated the economic groups and related parties with which credit risk exposure exists. (See Decision No. 4-2013, Article 14).</p> <p>To achieve a comprehensive bank-wide view of significant sources of concentration risk, the SBP implemented Decision No. 7-2014, in which Article 14 states that "Consolidated concentration shall be managed at two exposure levels: 1. Banking group with a party not related to this banking group, including natural and legal persons that in turn form an economic group. 2. Banking group with parties related to it. The banking group's consolidated exposure concentration shall be calculated based on its consolidated information. Exposure concentration limits include all financing, investments, derivatives, and off-balance sheet operations representing an irrevocable contingency, among others. The banking group may not directly or indirectly maintain exposures with a single person, including those forming an economic group with it, for more than twenty-five percent (25 percent) of the banking group's consolidated capital fund. (Decision 7-2014, Article 16). The credit exposure limit to a single name or group of connected borrowers is 25%. This is the only limit in the framework. No other exposure limits exist. Taken together, the regulatory framework achieves a comprehensive bank-wide view of significant sources of concentration risk.</p> <p>The concentration limit for a single counterparty is prescribed in the regulation (Article 7) and states that "The concentration limit on a single person, individually or jointly, is twenty-five percent (25 percent) of the capital stock stipulated by Article 95 of the Banking Law. The measurement of the limit set will be based on the consolidated capital stock." The capital stock is total capital (that is the sum of Tier 1 and Tier 2). There are three exceptions to Article 7 however:</p> <ol style="list-style-type: none"> <li>1. When the credit facility is duly secured by pledging deposits in the same bank for up to the secured amount;</li> <li>2. When the credit facility is granted to the Panamanian State or is secured by the same;</li> <li>3. When the credit facility is granted to a Foreign State or is secured by the same, as long as the same has investment grade international risk rating.</li> </ol> <p>The definition of connected counterparties is described in Article 6 which states "The following persons will be deemed to form an economic group with a credit facility HOLDER:</p> <ol style="list-style-type: none"> <li>1. Any legal person over whom the HOLDER exerts control.</li> <li>2. Any natural or legal person that exerts control on the HOLDER.</li> <li>3. Any legal person with whom the HOLDER has a common controller.</li> <li>4. Any legal person who is the bank's main debtor in another credit facility wherein the HOLDER is also a co-debtor or guarantor.</li> </ol>
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	5. The HOLDER'S spouse. "
<b>EC2</b>	The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure <sup>59</sup> to single counterparties or groups of connected counterparties.
Description and findings re EC2	<p>The SBP requires a comprehensive suite of routine reporting for off-site analysis (see also CPs 10 and 17). The off-site analysis verifies the accuracy and timeliness of data reporting. When the SBP undertakes an on-site examination, it evaluates bank credit management systems and aggregation rules. As per the regulation (Article 25 of No 4-2013) each bank must have clear policies and methodologies that, as a minimum, determine:</p> <ol style="list-style-type: none"> <li>1. Statistical information related to the historic behavior of portfolios and loans.</li> <li>2. Updated information on the characteristics of the debtors, their loans and collateral.</li> <li>3. Information on the debtor's credit behavior with other entities, if known.</li> <li>4. Updated information that will permit the bank to evaluate the debtors' financial condition and payment capacity at all times.</li> </ol> <p>The regulation also requires that annually the risk committee will submit to the BoD a report on the portfolio classification in accordance with the debtors' inherent risk, including a segment analysis by portfolio, business line, product and any other segmentation indicated in the bank strategy.</p> <p>The verification of the counterparty is carried out through the information sent by the regulated through the ITBank system. General Resolution SBP-RG-0002-2021 "By means of which the information requirements are established for banks, banking groups and owners of bank shares over which the Superintendence exercises the supervision of origin," establishes in its article 5 "Quality of Information" that the information sent by banks to this Superintendence through Atoms, BAN tables, printed or technological media, must be duly verified and endorsed by the manager of the operational area as appropriate. Therefore, it is the responsibility of the bank to ensure that there are no inconsistencies or errors between the information they maintain in their records and that provided, in relation to compliance with each of the parameters established in the rules governing the structuring and sending of the same to this Superintendence.</p> <p>The supervisory manual has guidelines for on-site examinations to evaluate bank information systems and they sample connected borrowers and compare against the data submitted by banks across the sector.</p>
<b>EC3</b>	The supervisor determines that a bank's risk management policies and processes establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the bank's policies and processes

<sup>59</sup> The measure of credit exposure, in the context of large exposures to single counterparties and groups of connected counterparties, should reflect the maximum possible loss from their failure (i.e., it should encompass actual claims and potential claims as well as contingent liabilities). The risk weighting concept adopted in the Basel capital standards should not be used in measuring credit exposure for this purpose as the relevant risk weights were devised as a measure of credit risk on a basket basis and their use for measuring credit concentrations could significantly underestimate potential losses (see *"Measuring and controlling large credit exposures"*, January 1991).



	require all material concentrations to be regularly reviewed and reported to the bank's Board.
Description and findings re EC3	<p>The regulation sets out the responsibility of the BoD and for credit risk concentrations (see Dec No-8-2010 Article 4). Article 4 stipulates the Board's role in implementing a framework for managing concentration risk and states that "It is a responsibility of the Board of Directors of each bank subject to this Rule to adopt policies, controls and procedure manuals to ascertain that:</p> <ol style="list-style-type: none"> <li>1. The material concentration exposures on a single person, or on someone that forms an economic group with that person, as well as concentrations on related parties of the bank, on and off-balance sheet, are adequately monitored and controlled by Management.</li> <li>2. The Board of Directors of the bank periodically reviews the material exposures on a single person and on related parties.</li> <li>3. The transactions with related parties of the bank that exceed the levels authorized by management due to their high amounts will be sent to the Board of Directors for their approval or rejection; this process will not have the participation of any member that, due to the transaction, has a conflict of interests.</li> <li>4. The entity has systems that allow it to obtain the information needed to identify, measure and monitor the concentration risk.</li> </ol> <p>Article 10 of Decision No. 8-2010 states that the Risk Committee's functions include endorsing limits, strategies, and policies that contribute to effective risk management and defining the scenarios and time horizon in which exceedances of the limits or exceptions to the policies can be accepted, upon approval by the Board, in addition to the possible courses of action or mechanisms for resolving the situation. The provisions in the regulations ensure that concentration risks are escalated to the BRC and Board as part of the governance process. SBP undertakes on-site examinations with an emphasis on sampling credit files including a sample for large exposures and concentration risks in the credit portfolio. When assessing an exposure, SBP will examine the total counterparty exposure which includes off-balance sheet exposures (such as credit lines, guarantees etc.) and derivatives or other instruments. The intention is to assess the total exposure of the counterparty and adherence to policies and processes including limits for concentration.</p>
<b>EC4</b>	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.
Description and findings re EC4	Concentrations by sector, activity, and geographic area (the reported currency is US Dollar) are assessed monthly based on information received from banks, with requests for further information. A report is also received on a quarterly basis from economic groups and related parties (of the bank, bank and subsidiaries, and banking group) on consolidated capital funds. In on-site reviews, verifications are carried out of the facility conditions granted so that, in the event of any exceedance in the allowable limits, the entity makes immediate adjustments to reduce the respective degree of exposure. Banks also submit annual reports to the SBP which are examined which includes data on concentration risk by single names, connected counterparties, sectors, geography and currency.
<b>EC5</b>	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to

	define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case-by-case basis.
Description and findings re EC5	<p>The regulations give the SBP the power to define connected counterparties. Decision No. 6-2009 "Establishing the rules for limits on risk concentration in economic groups and related parties" (Article 6-Economic Group. "Economic group" is defined). The following persons shall be deemed to form an economic group with the HOLDER of a credit facility:</p> <ol style="list-style-type: none"> <li>1. Any legal person over which the HOLDER exercises control.</li> <li>2. Any natural or legal person who exercises control over the HOLDER.</li> <li>3. Any legal person with which the HOLDER has a common controller.</li> <li>4. Any legal person as principal debtor of the bank in another credit facility of which the HOLDER is in turn co-debtor or guarantor.</li> <li>5. The HOLDER's spouse.</li> </ol>
<b>EC6</b>	Laws, regulations or the supervisor set prudent and appropriate <sup>60</sup> requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. "Exposures" for this purpose include all claims and transactions (including those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.
Description and findings re EC6	<p>The regulation (Decision No. 6-2009) Article 7 sets the concentration limit for a single person, individually or jointly, is twenty-five percent (25 percent) of the capital funds established under Article 95 of the Banking Law. The established limit is measured based on the consolidated capital funds. The regulation defines a material exposure as 10 percent of capital. This means credit facilities whose balance exceeds 10 percent of the capital funds of the entities subject to this Decision. Article 2 of Decision No. 6-2009 on "Definitions" states the following: "Means loans, investments in fixed-income securities, or off-balance sheet transactions that represent an irrevocable contingency as well as any other instrumentation or documentation modality through which a bank assumes a credit risk."</p> <p>The definition of exposures for inclusion in the calculation of LE is stipulated in Decision No. 6-2009 and include traditional credit-based exposures on-balance sheet as well as off-balance sheet exposures such as lines of credit and guarantees etc. The more material off-balance sheet exposures are associated with counterparties with import-export businesses which the SBP evaluate during onsite examinations.</p> <p>The regulations set out a range of risk management requirements for credit risk. It states that the bank has internal controls, policies, and procedures to mitigate the risk of material exposures potentially involving losses having significant or substantial effects on the main business of the bank or its banking group. To that end, it is verified that credit approval limits have been established by amounts and levels for the Board, the Credit Committee, and Bank Management. In addition, the information that is presented to the control and decision-making bodies is requested and evaluated with regard to compliance with the</p>

<sup>60</sup> Such requirements should, at least for internationally active banks, reflect the applicable Basel standards. As of September 2012, a new Basel standard on large exposures is still under consideration.

	internal and regulatory limits at the individual bank, bank and subsidiaries, and consolidated levels.
<b>EC7</b>	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programs for risk management purposes.
Description and findings re EC7	<p>The requirement to include risk concentrations is not stipulated explicitly in the regulations. Since the pandemic, the SBP has undertaken additional evaluations of concentration risk. For example, impact of exposures to the tourism sector. During inspections the SBP conduct analysis of how these portfolios will perform under different scenarios. determine how this is managed.</p> <p>The regulations (8-2010) require that the Risk Management Unit perform the following functions: Fully identify, assess, and control all risks relevant for the entity. For that purpose, it may: (i) Use risk measurement systems and models consistent with the degree of complexity and volume of its operations, accurately reflecting the value of the positions and their sensitivity to various risk factors; and (ii) Present at least quarterly to the Risk Committee or the body responsible, for its consideration, tools and techniques for identifying and analyzing risks and methodologies, models, and parameters to measure and control various types of risks to which the bank is exposed.</p>
<b>Additional criteria</b>	
<b>AC1</b>	<p>In respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following:</p> <ul style="list-style-type: none"> <li>(a) ten per cent or more of a bank's capital is defined as a large exposure; and</li> <li>(b) twenty-five per cent of a bank's capital is the limit for an individual large exposure to a private sector non-bank counterparty or a group of connected counterparties.</li> </ul> <p>Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.</p>
Description and findings re AC1	
<b>Assessment of Principle 19</b>	Largely Compliant
Comments	<p>The SBP has implemented a framework for credit concentration risk and large exposure limits. The regulations require that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of credit risk on a timely basis, reported on a monthly and quarterly basis. The SBP sets prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties of 25 percent total capital. The SBP undertakes extensive analysis to assess concentration risk based on detailed reporting.</p> <p>The regulations for concentration risk are focused predominantly on management of credit-related exposures. However, this Principle envisages a comprehensive view of significant sources of concentration risk (such as market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies - see EC1). Analysis undertaken by supervisors is detailed in respect of large exposures and credit concentration risks, however a broader definition is needed together</p>

	with data and supervisory processes. There is no formal requirement for stress testing concentration risks which would augment risk management (EC7).
<b>Principle 20</b>	<b>Transactions with related parties.</b> To prevent abuses arising in transactions with related parties <sup>61</sup> and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties <sup>62</sup> on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.
<b>Essential criteria</b>	
<b>EC1</b>	Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of "related parties". This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case-by-case basis.
Description and findings re EC1	<p>Banking Law, Article 96 (Credit to parties related to the bank) establishes a range of prohibitions on related party exposures:</p> <ul style="list-style-type: none"> <li>• Granting unsecured loans or unsecured credits to any of their employees in an amount greater than the salaries, wages, and other annual emoluments for that employee.</li> <li>• Granting loans or credits under more favorable conditions of cost and maturity than are usual in the market for that particular type of operation to their managers, officers and employees, or any person or legal entity that owns five percent of the stock of the bank or its holding company or anyone who forms an economic group with these persons.</li> <li>• Directly or indirectly granting unsecured credits that exceed five percent of their capital funds or loans secured with real collateral other than deposits that exceed ten percent of their capital funds, in favor of: (i) One or more directors or any person or legal entity that, directly or indirectly, jointly or severally, owns five percent or more of the stock of the bank or its holding company; and (ii) Any legal entity in which one or more directors are directors or officers of the bank or guarantors of the loan or credit.</li> </ul> <p>The Banking Law also places a maximum limit of related party exposures to 25 percent of total capital. The Law states "The aggregate of unsecured loans and loans secured with real collateral other than deposits granted by the bank and other firms that make up a banking group to related parties mentioned in this article, may not in any case exceed the</p>

<sup>61</sup> Related parties can include, among other things, the bank's subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, Board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

<sup>62</sup> Related party transactions include on-balance sheet and off-balance sheet credit exposures and claims, as well as, dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs. The term transaction should be interpreted broadly to incorporate not only transactions that are entered into with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

	<p>percentage of capital funds established periodically by the Superintendency, which will, in no case, exceed 25 percent of the capital funds of the bank."</p> <p>The Banking Law defines economic groups as "any group of persons or legal entities of any nationality or jurisdiction, whose interests are interrelated such that, in the opinion of the Superintendency, they should be considered as one entity." The regulations (Decision No. 6-2009 "Establishing the rules for limits on risk concentration in economic groups and related parties") expands the definition of related parties (see Article 9). The definitions are extensive capturing a wide range of potential associations between natural persons and legal entities to be treated as an economic group. This definition is comprehensive.</p> <p>Furthermore, the regulation permits the SBP discretion in determining associations to form an economic group. (See Article 10 "Assumed Related Parties). It states that: The Superintendency of Banks may require from the entities subject to this Rule any additional information that, in its judgment, is considered necessary so as to clarify if the holder or beneficiary of the credit facility is the Entity's related party. In the case when the entity refuses to provide the information or when the latter is insufficient, the Superintendency reserves the right to consider the holder or beneficiary an assumed related party and consequently will apply the limits set by Article 96 of the Banking Law, until it receives the pertinent information that in the Superintendency's judgment proves the contrary." The current regulation indicates and defines the related parties. Under the regulations, the supervisor also has criteria to apply at its discretion if a debtor is a party related to the bank under the "presumed" category.</p>
<b>EC2</b>	<p>Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favorable terms (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties.<sup>63</sup></p>
Description and findings re EC2	<p>Banking Law, Article 96 (Concentration in Related Parties, paragraph 2) places prohibitions on related party transactions (see EC1). Specifically, the Law states that banks are not permitted to: "Grant loans or credit facilities under more favorable cost and term conditions than those which are typical in the market for the corresponding type of operation to own managers, officials, and employees or any natural or legal person who holds five percent of the bank shares or the owner of bank shares in which the banking group is consolidated as well as any party that forms an economic group with them."</p> <p>The policies and conditions established for granting credits to related parties are verified to ensure that they are not more favorable in terms of amount, term, interest, and/or guarantee than those granted to other debtors.</p> <p>The regulation defines an exposure mainly as credit facilities. It defines a credit facility as "loans, investments in fixed revenue securities or off- balance sheet operations that represent an irrevocable contingency, as well as any other instrumentation or documentation modality whereby a bank assumes a credit risk."</p>
<b>EC3</b>	<p>The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject</p>

<sup>63</sup> An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g., staff receiving credit at favorable rates).

	to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.
Description and findings re EC3	The regulation (Decision No. 6-2009 "Establishing the rules for limits on risk concentration in economic groups and related parties") requires the BoD to approve related party transactions above a certain threshold set internally by the bank (see Article 4, paragraph 3). The regulation also requires the BoD to approve exposures where there is a conflict of interest and for Board members not to participate in the event of a conflict. The review of Board minutes verifies the discussion of topics related to accounting recognition of losses of credits granted to related parties and their approval. Collection and recovery procedures for this credit portfolio are also checked. Furthermore, verifications are performed to ensure that the related party does not take part in approving credits recognized as a loss.
<b>EC4</b>	The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.
Description and findings re EC4	The supervisory manual includes analysis of policies and processes in preparation for the on-site examination. Banks submit their policies and processes which are assessed by the SBP along with a self-assessment questionnaire. Examinations have a strong focus on credit risk sampling files and assessing compliance with banks' internal policies and the regulations. SBP processes sample loans during the on-site examination to ensure that a bank's policies prevent persons from benefiting from transactions and there is an appropriate governance structure for approving related party exposures.
<b>EC5</b>	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.
Description and findings re EC5	The applicable regulation establishes the prudential limits for granting facilities to related parties. The review of facilities that have been granted also assesses the level of exposure relative to the bank's consolidated capital. The nature and extent of transactions with related parties and parties in the bank's economic group are also examined. The regulations are not sufficiently specific in relation to setting specific limits or deducting from capital. The credit risk regulation (4-2013) is comprehensive in terms of the SBPs powers to apply greater reserves for an exposure if it deems necessary (see Article 32). Furthermore, the SBP has broad powers that it has used in the case of related party transactions.  In terms of the limit framework, the regulations require a maximum exposure of 25 percent of regulatory capital which aligns with the concentration limit for single counterparties or connected groups.
<b>EC6</b>	The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with related parties as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The supervisor determines that exceptions to policies, processes and limits are reported

	to the appropriate level of the bank's senior management and, if necessary, to the Board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
Description and findings re EC6	<p>Banks are required to have policies and processes to identify individual exposures with related parties. Credit exposures are subject to independent review by risk units and by internal audit. SBP on-site examinations assess the coverage and due diligence of risk management to independently verify the treatment of related party exposures according to policies and processes. The SBP assesses board minutes and risk committee minutes and reports to ensure related party exposures are monitored and applied appropriate risk governance.</p> <p>SBP's supervisory manual verifies the bank has policies, procedures, and internal controls to mitigate the risk of material exposures potentially involving losses having significant or substantial effects on the main business of the bank or its banking group. Equally that the bank has sound banking management conducive to monitoring concentration risk, including specific exposures in economic sectors, industries, geographic regions, and products or services, of which the Board have knowledge for its approval and corresponding monitoring</p>
<b>EC7</b>	The supervisor obtains and reviews information on aggregate exposures to related parties.
Description and findings re EC7	The SBP receives a comprehensive suite of regulatory reporting by banks. Full balance sheet data is submitted on a quarterly basis and detailed credit information is also submitted. Article 14 states that "Entities subject to this Decision shall submit to the Superintendency, in the manner, at the frequency, and with the content established, a report with the credit facilities granted to a single person, or whoever forms an economic group with it, and to related parties." The reporting allows the SBP to monitor related party exposures. Bank's credit data records include the economic groups and their related parties, which is verified against the information in the quarterly report and the bank's internal details during the inspection.
<b>Assessment of Principle 20</b>	Largely compliant
Comments	<p>The SBP receives a comprehensive suite of regulatory reporting pertaining to related party exposures. Banks are required to have policies and processes to identify individual exposures with related parties with an expansive definition of related parties. SBP's supervisory manual verifies the bank has policies, procedures, and internal controls to mitigate the risk of related party exposures. The regulation contains several prohibitions to ensure banks enter into related party exposures on an arms' length basis. The Banking Law also places a maximum limit of related party exposures to 25 percent of total capital. Furthermore, the SBP has the discretion to classify an exposure as a related party if it deems necessary.</p> <p>The regulations are not sufficiently comprehensive in terms of the following:</p> <ul style="list-style-type: none"> <li>• The requirement for material related party exposures to be monitored and reported to the Board;</li> </ul>

	<ul style="list-style-type: none"> <li>• Expansion of the definition of exposures to be more than credit-related (such as service contracts);</li> <li>• Need for Board approval to write-off.</li> <li>• Notification to the SBP when a material related party exposure has been entered into.</li> </ul> <p>The regulations allow banks discretion to set thresholds for board approval of a related party transaction (EC5). While there is a maximum exposure limit of 25 percent, a more dynamic limit framework is warranted and governance requirements.</p>
<b>Principle 21</b>	<b>Country and transfer risks.</b> The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk <sup>64</sup> and transfer risk <sup>65</sup> in their international lending and investment activities on a timely basis.
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance, and risk appetite of the bank, take into account market and macroeconomic conditions and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored, and managed on a regional and an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	<p>The regulations for country and transfer risk are comprehensive and detailed (see Decision No. 7-2018 Country Risk Management Policies). This is a dedicated risk management standard to manage and mitigate country risk. In addition, the more general risk management standard is also relevant for establishing minimum requirements for country and transfer risks (see also CP15 that evaluates Decision No. 8-2010 "Issuing provisions on comprehensive risk management"). As per the regulation, banks are required to develop and implement policies and processes to manage country and transfer risk. The SBP receives the policies as part of the on-site examination and assesses based on knowledge of the bank's risk profile, business model and systemic importance.</p> <p>Included in this assessment is the bank's strategic plans which sets out plans for lending such as cross-border exposures and risk appetite for countries. Country risk limits are required to be established and types of exposures. Banks are required to monitor regional</p>

<sup>64</sup> Country risk is the risk of exposure to loss caused by events in a foreign country. The concept is broader than sovereign risk as all forms of lending or investment activity whether to/with individuals, corporate, banks or governments are covered.

<sup>65</sup> Transfer risk is the risk that a borrower will not be able to convert local currency into foreign exchange and so will be unable to make debt service payments in foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower's country. (Reference document: *IMF paper on External Debt Statistics – Guide for compilers and users*, 2003.)



	developments. Interviews with the SBP and market participants confirmed rigorous processes to be aware of regional developments.
<b>EC2</b>	The supervisor determines that bank' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	Article 4 of the regulation clearly stipulates the responsibility of the BoD to develop and implement a policy framework for the management of country and transfer risk. The SBP reviews BoD minutes as part of the on-site examination including minutes for the Board Risk Committee. The review evaluates the quality of the policy framework, reporting obligations and limit framework commensurate with the bank's risk profile.
<b>EC3</b>	The supervisor determines that banks have information systems, risk management systems and internal control systems that accurately aggregate, monitor and report country exposures on a timely basis; and ensure adherence to established country exposure limits.
Description and findings re EC3	Article 7 of the Regulation requires the need for banks to establish and implement appropriate information systems to identify and aggregate country risk exposures. The SBP evaluates the effectiveness of those systems as part of the on-site examination.
<b>EC4</b>	There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include: <ul style="list-style-type: none"> <li>(a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate.</li> <li>(b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate.</li> <li>(c) The bank itself (or some other body such as the national bankers association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.</li> </ul>
Description and findings re EC4	The external auditors set percentage ranges for provisions in relation to country risks. The SBP communicates with the audit profession and the banks to ensure prudent valuations are taken into consideration. The SBP has past experiences of the need to strike provisioning rates associated with country risks, e.g., Venezuela.
<b>EC5</b>	The supervisor requires banks to include appropriate scenarios into their stress testing programs to reflect country and transfer risk analysis for risk management purposes.
Description and findings re EC5	Stress testing is not prescribed by the SBP for country risk. Experience is mixed in terms of quality of risk management.

<b>EC6</b>	The supervisor regularly obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g., in crisis situations).
Description and findings re EC6	The SBP receives information through the ITBank system on the exposures by country that the regulated entity maintains in the course of its operations. The regulatory reports provide a view of country risk exposures that the SBP monitors on a regular basis.
<b>Assessment of Principle 21</b>	Compliant
Comments	The regulatory framework is comprehensive, except for the absence of stress testing (see EC5). A compliant rating has been given and stress testing deficiencies have been graded in CP15. All other ECs are fully met.
<b>Principle 22</b>	<b>Market risk.</b> The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
<b>Essential criteria</b>	
<b>EC1</b>	Laws, regulations or the supervisor require banks to have appropriate market risk management processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank; take into account market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.
Description and findings re EC1	<p>The main regulation specifically dedicated to traded market risk is Decision No. 3-2018 "Establishing the capital requirements for financial instruments registered in the trading portfolio" (Chapter II-Market Risk and Trading Portfolio Management and Administration). The regulation clearly stipulates the need for banks to establish an appropriate market risk management process and governance arrangements that are applied bank-wide (see Article 4). In addition to the above regulation, Decision No. 12-2019 "Issuing provisions on investments in securities" (Chapter II-Management of Investments in Securities) is also relevant.</p> <ol style="list-style-type: none"> <li>Trading activity is relatively limited across the sector. With respect to what is part of the regulatory trading book, the most common instruments traded are: <ul style="list-style-type: none"> <li>Fixed income instruments (73 percent): agency bonds, corporate bonds, sovereign bonds and public company bonds.</li> <li>Equity instruments (16 percent): shares, shares in investment funds, ETFs.</li> <li>Trading derivatives (10 percent)</li> </ul> </li> <li>Majority of banks' securities investment portfolio is not held under a trading model, but is held to obtain their contractual flows of capital and interest. This is reflected because, from an accounting point of view, the majority of the center's portfolio is classified at "fair value with changes in other comprehensive income"</li> </ol>

	<p>or "amortized cost". The distribution of the accounting classification of securities investment portfolios (before provisions) as of June 2022 (Working paper 191.2) is presented below:</p> <ul style="list-style-type: none"> <li>• 59 percent Fair value investments with changes in other comprehensive income</li> <li>• 36 percent Investments at amortized cost</li> <li>• 5 percent Fair value investments with changes in profit and loss</li> </ul> <p>According to the SBP, the main sources of market risk are the following:</p> <ol style="list-style-type: none"> <li>1. Interest Rate Risk</li> <li>2. Stock price risk</li> <li>3. Credit risk</li> <li>4. Exchange rate risk</li> </ol> <p>The information presented corresponds to the definition of market risk of the regulatory trading book. However, it is important to mention that there is a portfolio classified at fair value with changes in another comprehensive income, which is part of the bank book, which is not part of the trading book. This portfolio is made up mostly of fixed income instruments issued in US dollars, so the biggest risks to which it is exposed are Interest rate risk and credit risk. Market risk of the trading book, in terms of capital requirements, is measured at three levels:</p> <ul style="list-style-type: none"> <li>• Individual Bank</li> <li>• Bank and Subsidiaries of a financial nature</li> <li>• Banking Group</li> </ul> <p>The regulation (3-2018) sets out a comprehensive set of requirements for the monitoring, measurement and risk governance of traded market risk. The trading book is defined (see Article 2) and the SBP has the power to direct assets to be included in the traded portfolio. The regulation also addresses boundary issues between the traded book and banking book (see Article 5).</p> <p>The regulation sets out minimum standards for market risk management (see Article 4) and the necessary policies and processes. Article 6 states the responsibilities of the BoD: The bank must identify and appropriately manage the market risks they face. In this sense, it will be the primary responsibility of the BoD and top management to establish policies and procedures to identify and appropriately manage these risks. This responsibility includes meeting the provisions herein and, particularly, the approval, in its case, of the internal models and limitation policies proposed by the risk unit.</p> <p>The measurement and management tools most commonly used by banks in the market are: concentration limits, loss limits, Value at Risk (VaR), VaR limits, rating limits, sensitivities to movements in interest rates. This information is reported by the banks' Risk Units at the meetings of the Risk Committee and Board of Directors.</p> <p>The SBP undertakes a risk-based on-site examination. For D-SIBs on-site examinations are undertaken on an annual basis. The supervisory manual (MUSBER) has extensive procedures for the assessment of risk management. In terms of assessing the role of the BoD developing and approving policies and processes for market risk the SBP receives policies on an annual basis and makes an assessment. For lower risk bank, an examination at least every two years. Board minutes are also assessed to assess risk governance.</p>
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<b>EC2</b>	The supervisor determines that bank' strategies, policies and processes for the management of market risk have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	<p>In terms of governance requirements for market risk management, the SBP has both general and specific guidelines. The general requirements are outlined in Decision No. 8-2010 "Issuing provisions on comprehensive risk management" (Articles 6 and 7). The specific requirements are set out in Article 6 of Decision No. 3-2018 which states "The bank must identify and appropriately manage the market risks they face. In this sense, it will be the primary responsibility of the board of directors and top management to establish policies and procedures to identify and appropriately manage these risks. This responsibility includes meeting the provisions herein and, particularly, the approval, in its case, of the internal models and limitation policies proposed by the risk unit."</p> <p>In terms of supervisory activities, MUSBER provides the framework for assessing the governance arrangements and risk management frameworks, including:</p> <ul style="list-style-type: none"> <li>• Off-site – minutes Board approved policies</li> <li>• On-site – meetings with senior management and ALCO</li> <li>• On-site – minutes of BRC</li> </ul> <p>Currently, the Risk Directorate is preparing a project to request weekly information from banks on aggregate losses of investment portfolios (fair value with changes in other comprehensive income, amortized cost, and fair value with changes in loss and gain).</p>
<b>EC3</b>	<p>The supervisor determines that the bank's policies and processes establish an appropriate and properly controlled market risk environment including:</p> <ul style="list-style-type: none"> <li>(a) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk exposure to the bank's Board and senior management;</li> <li>(b) appropriate market risk limits consistent with the bank's risk appetite, risk profile and capital strength, and with the management's ability to manage market risk and which are understood by, and regularly communicated to, relevant staff;</li> <li>(c) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board, where necessary;</li> <li>(d) effective controls around the use of models to identify and measure market risk, and set limits; and</li> <li>(e) sound policies and processes for allocation of exposures to the trading book.</li> </ul>
Description and findings re EC3	<p>The regulations clearly establish the specific requirements for banks to have in place policies and processes to properly control market risk. Articles 7, 10, 11, and 13 of the regulations (Decision No. 3-2018) are explicit for banks for the market risk management framework to consist of at least the following:</p> <ul style="list-style-type: none"> <li>1. Organization, duties and delimited and segregated responsibilities;</li> <li>2. Policies and procedures manuals;</li> <li>3. Suitable employees and professionals;</li> <li>4. Documentation, reports and reporting;</li> </ul>

	<ol style="list-style-type: none"> <li>5. Methods for the identification, prevention, measurement, analysis and valuation of market risks;</li> <li>6. Trading book fair value daily registry;</li> <li>7. Controls and limits for market risk exposure;</li> <li>8. Appropriate computer systems;</li> <li>9. Allocation of equity pursuant to the provisions herein;</li> <li>10. Disclosing in the financial statements, at least, the policies, composition and changes to the trading book, capital requirements, and the profits and losses resulting from the trading book.</li> </ol> <p>For the trading book, banks report quarterly data on positions by asset class (see IT Bank tables BAN 17 and BAN 18). Off-site analysis is undertaken to monitor movements in capital requirements for market risk. Likewise, the atom of investments in securities (AT15) is received on a monthly basis, in which it is possible to identify which are the securities that are part of the regulatory trading portfolio, and thus monitor the volume of this portfolio. In the accounting regulatory return (atom AT21) that is reported on a monthly basis, the SBP identifies and tracks the profits and losses of the investment portfolios that have gone through the results of the period. This information is available to supervisors through the following securities profit and loss accounts:</p> <ul style="list-style-type: none"> <li>• Profit/Loss on Buying and Selling Securities</li> <li>• Gain/Loss on Financial Instruments at fair value with changes in profit or loss</li> <li>• Gain/Loss on Financial Instruments at fair value with changes in other comprehensive income</li> <li>• Profit/Loss on Marketable Derivatives</li> </ul> <p>This information is analyzed by the Risk Directorate during on-site inspections and is part of the specialized reports. Apart from the trading portfolio, through the investment atom banks must report monthly the unrealized loss/gain of the fair value portfolio with changes in another comprehensive income; information that is also reviewed during inspections of banks.</p> <ol style="list-style-type: none"> <li>(a) Specifically in relation to this EC: "The bank will have appropriate computer systems to conduct and support the identification, monitoring and management of the market risks the bank faces. The bank should also have appropriate mechanisms to ensure the security and physical and functional contingency plans, including data and processes integrity, of these systems."</li> <li>(b) Article 12 - Pursuant to its own market risks characteristics, the bank will establish internal operating and administrative controls for these market risks, including authorized activities and individual, cumulative and overall internal limits for every segment of the managed trading book. These limits must consider, among others, cumulative realized and unrealized losses in designated period of time.</li> <li>(c) Exception tracking is evaluated when SBP reviews risk committee reports and minutes, reports from risk units and from IA.</li> <li>(d) model validation and governance are mentioned in Article 4. SBP assesses the governance of models used for valuations and the inputs.</li> <li>(e) Article 5 prescribes rules regarding the separation of the banking and trading books. Specifically, it states that "There are strict limitations on the ability of banks</li> </ol>
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	to move instruments between the trading book and the categorized portfolios in the banking book on their own after the instrument's initial designation. The Superintendency of Banks will only permit the transfers in extraordinary circumstances, at the substantiated request of top management and with the requirement to make the transfer public. Market events, changes in the liquidity of a financial instrument, or a change of trading intent alone are not valid reasons for re-designating an instrument to a different book."
<b>EC4</b>	The supervisor determines that there are systems and controls to ensure that banks' marked-to-market positions are revalued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.
Description and findings re EC4	Article 12 of the regulation (3-2018) sets out guidelines for controls and limits for market risk exposures where banks are expected to design and implement a framework commensurate with the trading strategy. The regulation states – "The limits will also include stop-loss instructions, concentration limits by issuer, instrument, market, geographical location and economic sector, and limits on the entry into new markets and new financial instruments. A continuous assessment of the adequacy and performance of controls and limits must be conducted." During on-site examinations, supervisors meet with representatives from the three lines of defense to assess the quality and effectiveness of the control environment, reporting of limits and management of market risks. Market risk management systems are subject to IA. Regulations Article 14 of Agreement 3-2018 establish that "The internal audit function will evaluate compliance with the policies and procedures established by banks for carrying out operations subject to market risks, and with the policies and procedures established for the identification and administration thereof, as well as with the provisions of this Agreement. Such evaluations shall be included in the ongoing activities of the annual internal audit plan and shall be documented by written reports containing the recommendations arising therefrom." The SBP undertakes an assessment of valuations in compliance with the regulations (see also EC1 and 2).
<b>EC5</b>	The supervisor determines that banks hold appropriate levels of capital against unexpected losses and make appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities.
Description and findings re EC5	The SBP confirms the value of capital is calculated correctly, in the case of adjustments it is rare and not significant. The majority of instruments are valued using publicly available prices and rates (e.g., Bloomberg etc.). Mark-to-model valuations are not regularly used. The regulations require the trading book to be valued daily with oversight by an

	independent risk unit (see Article 7). Market risk capital for the system is approximately 1.7 percent RWAs which is lower than many systems.
<b>EC6</b>	The supervisor requires banks to include market risk exposure into their stress testing programs for risk management purposes.
Description and findings re EC6	There is no explicit stipulation in the regulations for banks to perform stress testing. There are general requirements for risk management (see EC1 and 2). The SBP recommends banks implement stress testing as part of an integrated approach to market risk management. The absence of formal guidance by the SBP places emphasis on the SBP on-site examination process. Standards are at different stages.
<b>Assessment of Principle 22</b>	Compliant
Comments	<p>The regulation sets out minimum standards for market risk management and the necessary policies and processes. Banks must identify and appropriately manage the market risks they face and the BoD has primary responsibility to establish policies and procedures and identify these risks. The measurement and management tools most commonly used by banks in the market are: concentration limits, loss limits, Value at Risk (VaR), VaR limits, rating limits, sensitivities to movements in interest rates. This information is reported by the banks' Risk Units at the meetings of the Risk Committee and Board of Directors. Exposure to market risk is <i>de minimis</i> in terms of proportion of total income derived from trading and in terms of market risk weighted assets.</p> <p>The SBP undertakes a risk-based on-site examination. For D-SIBs, on-site examinations are undertaken on an annual basis. The supervisory manual (MUSBER) has extensive procedures for the assessment of risk management. In terms of assessing the role of the BoD developing and approving policies and processes for market risk the SBP receives policies on an annual basis and makes an assessment. For lower risk banks, an examination is undertaken at least every two years. Board minutes are also assessed to assess risk governance. There are no explicit requirements for stress testing which needs to be rectified. A compliant rating has been given and stress testing deficiencies have been graded in CP15.</p>
<b>Principle 23</b>	<b>Interest rate risk in the banking book.</b> The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk <sup>66</sup> in the banking book on a timely basis. These systems take into account the bank's risk appetite, risk profile and market and macroeconomic conditions.
<b>Essential criteria</b>	
<b>EC1</b>	Laws, regulations or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The supervisor determines that the bank's strategy, policies and processes are

<sup>66</sup> Wherever "interest rate risk" is used in this Principle the term refers to interest rate risk in the banking book. Interest rate risk in the trading book is covered under Principle 22.

	consistent with the risk appetite, risk profile and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank's changing risk profile and market developments.
Description and findings re EC1	<p>There is no dedicated regulation for IRRBB that is updated to align with the Basel standards (April 2016). Decision No. 8-2010 is a general risk management standard that includes the requirement for banks to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The relevant articles include:</p> <ul style="list-style-type: none"> <li>• Article 2 - It is understood as comprehensive risk management the process in which the Bank identifies, measures, monitors, controls, mitigates and reports to the operating areas of the bank, the different kinds of risks to which it is exposed to according to the size and complexity of its operations, products, and services.</li> <li>• Article 4 – defines Interest Rate Risk as “the possibility that economic loss has occurred due to adverse movements in interest rates.”</li> </ul> <p>However, the SBP has developed a draft Agreement for the IRRBB that is aligned with the Basel standard (Working paper 194.2. - AGREEMENT ON THE MANAGEMENT OF INTEREST RATE RISK OF THE BANK BOOK VERSION 1 01_01_2019). Although the draft agreement has not entered into force, inspections carried out by the SBP's Risk Directorate take into consideration the guidelines established, as well as the principles of the Basel standard (Interest Rate Risk in the Banking Book / April 2016). This draft agreement contemplates criteria for the management of the interest rate risk of the bank book, as well as the metrics that banks must perform to measure this risk. Draft Agreement on Interest Rate Risk in the Banking Book (IRRBB): Articles 5, 6, 7, 8, 9, 10, and 11.</p> <p>MUSBER considers a series of procedures for the evaluation of this risk, both from a management point of view, as well as the metrics that banks must use and report for their measurement. At the system level, the Risk Directorate does not regularly measure IRRBB, however, it has the power to carry out surveys of all the banks in the system when deemed necessary, to collect information on this risk. As proof of this, in 2019 a survey was conducted with several banks on the management of the interest rate risk of the bank book. (Working paper 195.1) In addition, work is currently underway on a template that will be sent to banks, to request information that will be used by the Risk Directorate, to measure interest rate risk in the banking book. This project is part of the objectives of the Market Risk Management.</p> <p>The SBP receives reports through the ITBank system, which are used as part of the inspection process to evaluate the IRRBB. Among the reports used are the following:</p> <ul style="list-style-type: none"> <li>• Accounting Atom (AT21): contains information on interest income and expenses. This information is used during the inspection process to the banks to analyze the behavior of the financial margin and its trend. This report is received monthly.</li> <li>• Interest Rate Atom (AT09): through this structure, banks report monthly interest rates on their assets and liabilities.</li> </ul> <p>Additionally, during the inspection processes, the Risk Management Department asks banks to analyze and calculate the sensitivity of net interest income, as well as the sensitivity of the economic value of the assets. Both metrics are reviewed by the regulator.</p>



	<p>The reasonableness of the models is evaluated and that they are aligned with the Basel standard, being a common cause of findings during the inspection processes.</p> <p>The SBP does not receive routine reporting on IRRBB. The on-site examination is the opportunity for the SBP to review this risk in depth. The lack of a dedicated reporting format inhibits the off-site analysis process and consideration for impacts on the business model and capital adequacy.</p>
<b>EC2</b>	The supervisor determines that a bank's strategy, policies and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank's Board. The supervisor also determines that senior management ensures that the strategy, policies and processes are developed and implemented effectively.
Description and findings re EC2	<p>The measures and limits used by banks for the management and measurement of this risk are reported to the SBP during the inspection processes. During the inspection, the management framework for interest rate risk, including policies and procedures and a cap structure, is reviewed and approved by the Board of Directors. With respect to the limits, it is verified that they are frequently monitored and reported to the responsible bodies, and that there are guidelines and action plans for management in case of exceptions. Requests for information sent to banks for comprehensive inspection processes generally include specific requirements on the policies and measurement files employed by banks for bank ledger interest rate risk (See extract of request for information submitted in question 195).</p> <p>The regulations are relatively general although the draft regulations are more specific.</p> <ul style="list-style-type: none"> <li>• Decision No. 8-2010.</li> <li>• Decision No. 5-2011 "Issuing a new Decision to update the provisions on corporate governance" (Article 13)</li> <li>• IRRBB Draft Agreement (Articles 13, 14, and 16)</li> </ul>
<b>EC3</b>	<p>The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including:</p> <ul style="list-style-type: none"> <li>(a) comprehensive and appropriate interest rate risk measurement systems;</li> <li>(b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions);</li> <li>(c) appropriate limits, approved by the banks' Boards and senior management, that reflect the banks' risk appetite, risk profile and capital strength, and are understood by, and regularly communicated to, relevant staff;</li> <li>(d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks' senior management or Boards where necessary; and</li> <li>(e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks' Boards and senior management.</li> </ul>
Description and findings re EC3	The regulatory framework has not been formalized; however draft guidelines cover the specifics in this EC as well as the risk management requirements which capture IRRBB. In this way, the SBP has engaged with banks in terms of developing risk management

	<p>systems for this risk. Internal processes have been developed along these lines and are incorporated into the supervisory manual.</p> <p>Banks have implemented internal processes to manage IRRBB which the mission understand are implemented in practice. Analysis of supervisory files also evidenced the inclusion of IRRBB in on-site examinations.</p>
<b>EC4</b>	The supervisor requires banks to include appropriate scenarios into their stress testing programs to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC4	<p>There are no detailed specific stress test guidelines that incorporate interest rate risk from the bank ledger. However, the draft Agreement establishes in Article 19 "Stress Tests" the following:</p> <p>"Banks shall carry out at least once a year, and when required by the Superintendency of Banks, stress tests of the interest rate risk of the bank book to which it is exposed. To do this, the bank must properly document the work done. Stress tests will be performed for both economic value and profits. One of the results of the tests should be to explain the additional capital requirements needed in stress scenarios." Given the above, once the draft agreement is published and enters into force, this will be an aspect that will be part of the reviews during the inspections.</p> <p>The absence of a formal regulation is problematic in terms of enforcing a robust approach to risk management including stress testing. The steepening of the yield curve in 2022 has necessitated additional attention to risk management of IRRBB.</p> <p>More frequent attention to stress testing outcomes is needed as an input into the assessment of bank exposure to IRRBB.</p>
<b>Additional criteria</b>	
<b>AC1</b>	
Description and findings re AC1	
<b>AC2</b>	The supervisor assesses whether the internal capital measurement systems of banks adequately capture interest rate risk in the banking book.
Description and findings re AC2	
<b>Assessment of Principle 23</b>	Materially non-compliant
Comments	<p>The regulatory framework has not been updated to include IRRBB, instead guidance remains in draft form. The draft guidance is closely aligned with the BCBS frameworks (2016) and the SBP plans to formalize the draft in due course. There are other aspects that can be strengthened:</p> <ul style="list-style-type: none"> <li>• There is a reliance on on-site examinations to assess exposure to IRRBB. Off-site reporting is not adequate and therefore problematic in terms of ongoing surveillance for risks to NII and capital.</li> <li>• There are no specific stress testing requirements. The SBP does not receive routine reporting on IRRBB. The on-site examination is the opportunity for the SBP to review</li> </ul>

	<p>this risk in depth. The lack of a dedicated reporting format inhibits the off-site analysis process and consideration for impacts on the business model and capital adequacy.</p> <p>During the on-site examination, banks submit to the SBP results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book. The SBP does not assess bank's internal capital management systems in terms of IRRBB.</p>
<b>Principle 24</b>	<p><b>Liquidity risk.</b> The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.</p>
<b>Essential criteria</b>	
<b>EC1</b>	<p>Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than, those prescribed in the applicable Basel standards.</p>
<b>Description and findings re EC1</b>	<p>Banks are required to meet two prudential liquidity ratios: (i) the Legal liquidity index and the (ii) Liquidity Coverage Ratio (LCR). To manage short-term liquidity risks, banks are required to limit maturity mismatches and subject to supervision of estimated future cash flows, which are implemented through the LCR which establishes a minimum daily limit for hedging high-quality liquid assets on net cash outflows within 30 days. The Legal Liquidity Index (LLI) sets a minimum weekly limit of Coverage of eligible liquid assets on net computable deposits within 186 days.</p> <p>In terms of the legal basis for the liquidity ratios, Article 4 of Decision No. 4-2008 stipulates that the minimum LLI that General License and International License Banks must keep is 30 percent. Nevertheless, said index will be 20 percent for banking entities that keep an interbank deposit quarterly average greater than 80 percent of their total deposits. The calculation of the LLI is contained within Article 4 in terms of eligible assets (numerator) and liabilities (denominator). Articles 30, 37, and 40 of Decision No. 2-2018 "Establishing provisions on liquidity risk management and the short-term liquidity coverage ratio" is a revised regulation for liquidity which is comprehensive covering quantitative and qualitative requirements.</p> <p>The Short-term LCR complements the LLI as the second quantitative liquidity requirement that banks need to meet. The regulations are prescriptive in terms of eligible assets to meet the LCR and the run-off assumptions for liabilities. Rule No. 2-2018 is a comprehensive suite of risk management standards.</p>

	<p>In terms of long-term liability mismatch, there is currently no prudential requirement, the NSFR has not been implemented. However, Article 76 of the Banking Law establishes that banks must maintain a maturity structure for assets and liabilities that favors adequate financial liquidity. By virtue of this, Circular No. 060-2008 establishes the obligation to send to this Superintendence the table of Maturity Structure of Assets and Liabilities (EVAP – Working Paper 199.3), in addition to the information provided weekly through the liquidity atom (AT10), with the objective of evaluating, measuring and monitoring the maturities of the assets and liabilities that make up the liquidity basket. The frequency of sending the EVAP is weekly, at the close of every Friday with a deadline to report until Sunday (General Resolution SBP-RG-0001-2022).</p> <p>The regulations are relatively comprehensive in terms of the qualitative risk management standards to manage, monitor, mitigate and report liquidity risks. The standards are closely aligned with the BCBS Sound Principles for Liquidity Risk Management. The relevant sections of the regulations are as follows:</p> <ul style="list-style-type: none"> <li>• Article 3 provides that the liquidity position of banks must be commensurate with the scale of their funding gaps.</li> <li>• Article 4 provides that the liquidity risk management strategy should include specific policies on the normal liquidity needs and liquidity implications of periods characterized by liquidity stresses, the origin of which may lie in the institution itself, in the market as a whole and/or in both.</li> <li>• Article 9 states that the Board of Directors must be informed about the increase in the liquidity deficit.</li> <li>• Article 21 requires banks to have an information system that, among other components, should enable them to effectively manage and monitor their net financing needs.</li> <li>• Article 13 requires banks to identify, measure, monitor and control their liquidity risk positions resulting from future cash flows of assets and liabilities; and the sources of demand for contingent liquidity and their corresponding inducers associated with off-balance-sheet positions.</li> <li>• Article 15 states that in order to estimate the cash flows to which it is exposed, the bank must have a robust liquidity risk management framework, which provides dynamic future forecasts of cash flows and includes a scenario analysis; realistic assumptions about their future short- and long-term liquidity needs; Analysis of the quality of assets that could be used as collateral.</li> <li>• In addition, for the estimation of cash flows from its liabilities, the bank must evaluate aspects such as: the "persistence" of its sources of financing; the likelihood of renewal of financing lines and the possible maintenance of the conduct of funders in situations of stress, thus contemplating the possibility of a disappearance of guaranteed financing (repos) and unsecured in periods of stress; that for financing secured with a maturity of one day, it should not presume its automatic renewal; the availability of financial assistance through term financing facilities and the circumstances in which it may be sought; and consider factors influencing the "persistence" of retail deposits, such as volume, interest rate sensitivity, depositors' geographic location, and fundraising channel.</li> </ul>
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	<ul style="list-style-type: none"> <li>Article 16 requires the bank to identify, measure, monitor and control potential cash flows from irrevocable off-balance sheet commitments and other contingent liabilities. To this end, it should have a robust framework for projecting the possible consequences of triggering previously inactive commitments, taking into account the nature of the commitment, the creditworthiness of the counterparty and exposures to economic sectors and geographical areas, because counterparties in the same sectors and areas could simultaneously be affected by stresses.</li> <li>Article 18 states that the bank must use indicators that project cash flows and future liquidity positions, taking into account off-balance sheet risks, which must incorporate existing vulnerabilities, both under normal business conditions and in stressful situations, for various time horizons.</li> <li>Under normal business conditions, needs that might arise from the relationship between projected cash outflows and current sources of financing should be identified; and in situations of stress, they should make it possible to identify liquidity gaps for different horizons and in turn serve as a basis for establishing limits on liquidity risk and early warning indicators.</li> </ul>
<b>EC2</b>	The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.
Description and findings re EC2	<p>Article 3 of Decision No. 2-2018 sets out a comprehensive set of principles for liquidity risk management. It states that liquidity risk management principles aim to ensure, with a high level of trust, that a bank is equipped to meet its liquidity obligations, both intraday and during a major liquidity stress scenario affecting funding, whether originating in the bank itself or in the market. For such purposes, in addition to maintaining good corporate governance and sound liquidity risk management practices, the bank must ensure that it complies with the following requirements:</p> <ol style="list-style-type: none"> <li>1. To maintain sufficient liquidity, composed of assets easily tradable in the market, putting it in a position to survive periods of liquidity stress;</li> <li>2. To achieve a liquidity position matching the complexity of its on- and off-balance sheet operations, its assets and liabilities liquidity, the scale of financing gaps, the diversity of its business model and its funding strategy;</li> <li>3. To use sufficiently conservative assumptions on the possibility of trading the assets making up its liquidity position in the market and on its access to funding during stress scenarios;</li> <li>4. To not allow competition-related stress to compromise the integrity of the bank's management, control functions and liquidity risk limitation systems, nor its liquidity position.</li> </ol> <p>The prescribed liquidity requirements (mainly the LCR) are risk sensitive in the calibration of run-off assumptions for liabilities. The absence of a central bank in Panama means banks do not have access to a lender of last resort and emergency liquidity assistance. As a result, the calibration of the two liquidity ratios is conservative. For example, the run-off rates are more conservative than the BCBS framework (e.g., the minimum run off rate is 10 percent (compared with a 3 percent run-off rate under Basel). Equally, the definition of HQLA is closely aligned with the BCBS definitions with one major exception that accounts</p>

	for the absence of a central bank: deposits with the Banco Nacional Panama (BNP) are included as Level 1 assets. The ratios are a reflection of market conditions and macroeconomic factors.
<b>EC3</b>	The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks' Boards. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance
Description and findings re EC3	<p>The regulations (Banking Law, Chapter VI (Bank Liquidity), Article 73 (Liquidity Requirements) Articles 3, 4, and 5 of Decision No. 4-2008) require banks to implement a liquidity risk management strategy commensurate with the size, scale and complexity of the bank and banking group. They state that the liquidity strategy must match the nature, scale and complexity of the bank's operations. When designing this strategy, the bank must take into consideration the legal structures, its main business lines, the scale and diversity of markets, products and jurisdictions where it has operations and the regulatory framework of the home and host countries. Articles 6 &amp; 7 require senior management to be responsible for developing and implementing the liquidity risk management framework and communicating through the organization.</p> <p>The regulations require BoDs to be responsible for developing and implementing a liquidity risk management framework including the strategy, funding plans, risk limits, measurement tools, reporting obligations and policies and processes. The SBP assesses bank's liquidity risk management frameworks in depth during the on-site examination. The SBP assesses liquidity policies taking into consideration systemic importance and a bank's liquidity risk profile.</p>
<b>EC4</b>	<p>The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including:</p> <ul style="list-style-type: none"> <li>(a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks' Boards;</li> <li>(b) sound day-to-day, and where appropriate intraday, liquidity risk management practices;</li> <li>(c) effective information systems to enable active identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide;</li> <li>(d) adequate oversight by the banks' Boards in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite; and</li> <li>(e) regular review by the banks' Boards (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.</li> </ul>

Description and findings re EC4	<p>The on-site supervision processes aligned with this EC can be found in Form 19 – FEN – Technical Relations – Objective 2. The SBP undertakes on-site and off-site analysis of bank policies and processes which fully align with this EC. The rules and processes that cover this EC are:</p> <ul style="list-style-type: none"> <li>(a) Article 6, <b>MUSBER:</b> FEGRI, Liquidity Risk, Objective 2, Procedures 3 and 4</li> <li>(b) Chapter II; Articles 23 and 24, <b>MUSBER:</b> FEGRI, Liquidity Risk, Objective 2, Procedures 3 and 5</li> <li>(c) Article 21, <b>MUSBER:</b> FEGRI, Liquidity Risk, Objective 3, Procedure 9</li> <li>(d) Articles 6 and 9, <b>MUSBER:</b> FEGRI, Liquidity Risk, Objective 2, Procedures 2, 3, and 5</li> <li>(e) Article 4, <b>MUSBER:</b> FEGRI, Liquidity Risk, Objective 2, Procedures 3 and 4</li> </ul>
<b>EC5</b>	<p>The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g., credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy, and include:</p> <ul style="list-style-type: none"> <li>(a) an analysis of funding requirements under alternative scenarios;</li> <li>(b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress;</li> <li>(c) diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits;</li> <li>(d) regular efforts to establish and maintain relationships with liability holders; and</li> <li>(e) regular assessment of the capacity to sell assets.</li> </ul>
Description and findings re EC5	<p>The regulations (Decision No. 2-2018) address liquidity and funding obligations of banks (See Articles 11 and 14). Article 11 states – “The bank must consider the interaction between funding liquidity risk and market liquidity risk exposures. The bank allocating liquidity in capital markets must be aware that these sources might be more volatile than the traditional retail deposits. The bank must not assume that financial markets will function perfectly and retain their liquidity, given that assets and funding markets can disappear in stress scenarios. The lack of market liquidity may put the bank in a complicated position in obtaining funds by the sales of assets, increasing the need for maintaining fund liquidity.”</p> <p>The guidelines for contingency funding plans are extensive (see Article 27). The guidelines stipulate that the CFP must be consistent with the bank's complexity, risk profile and scale of operations, as well as its role in the financial systems in which it has operations. The guidelines go into detail on what the CFP must contain.</p> <p>Banks submit funding plans annually in addition to the strategic business plan where the plans are assessed under normal and stressed circumstances. The SBP evaluates the veracity of assumptions and economic and market context for the plans as well as the reasonableness of the plans and the reliability of the sources of funds under different market stresses. When on-site the SBP reviews the ALCO minutes, BRC minutes and reporting. Through interviews and discussion with Treasury staff, the SBP makes an assessment of funding plans.</p>

<b>EC6</b>	The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the bank's contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.
Description and findings re EC6	<p>The rules and processes that cover this EC include Articles 4, 9, and 27 of Decision No. 2-2018. Article 27 is the most comprehensive articulation of the SBP's expectations for banks to establish contingency plans. Specifically, that the bank must implement a contingency funding plan (CFP) that will cover the compilation of policies, regulations, procedures and action plans to respond to severe disruptions of the bank's capacity to fund all or part of its operations in a timely manner and at a reasonable cost. The contingency funding plan (CFP) must be consistent with the bank's complexity, risk profile and scale of operations, as well as its role in the financial systems in which it has operations. This contingency funding plan must contain:</p> <ol style="list-style-type: none"> <li>1. A clear description of a diversified set of potential contingent funding measures that are viable, easy to make and flexible, oriented towards maintaining liquidity and eliminating treasury deficits under different adverse situations;</li> <li>2. Identification of the potentially available contingent funding sources and the volume of funds that the bank believes could be available from these sources;</li> <li>3. Clear reinforcement and prioritization procedures describing when and how any of the measures could and should be activated, as well as the necessary time period for obtaining additional funds from each of the contingent sources;</li> <li>4. A very flexible framework that permits the bank to react rapidly in very diverse situations.</li> </ol> <p>The SBP evaluates the CFPs' design, plans and procedures are implemented and closely connected with the continuous liquidity risk analysis process of the bank and with the results of the scenarios and assumptions used in stress-testing. To this end, the plan must be operative for a series of different temporary horizons, including intraday.</p>
<b>EC7</b>	The supervisor requires banks to include a variety of short-term and protracted bank-specific and market-wide liquidity stress scenarios (individually and in combination), using conservative and regularly reviewed assumptions, into their stress testing programs for risk management purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity risk management strategies, policies and positions and to develop effective contingency funding plans.
Description and findings re EC7	Articles 25, 26, and 27 of Decision No. 2-2018 address the risks associated with short-term and protracted liquidity stress events and the need for risk management tools to assess the bank's exposure. Article 25 sets out specific requirements for liquidity risk stress testing to be undertaken against the consolidated banking group, using scenarios for different temporary horizons including intraday. The survival horizon for the LLI is 186 days which



	<p>is significantly longer than the LCR at 30 days providing banks with buffers that should provide access to liquidity for a significant period.</p> <p>The guidelines are extensive. The SBP undertakes analysis of the scenarios and outcomes of stress testing results.</p>
<b>EC8</b>	<p>The supervisor identifies those banks carrying out significant foreign currency liquidity transformation. Where a bank's foreign currency business is significant, or the bank has significant exposure in a given currency, the supervisor requires the bank to undertake separate analysis of its strategy and monitor its liquidity needs separately for each such significant currency. This includes the use of stress testing to determine the appropriateness of mismatches in that currency and, where appropriate, the setting and regular review of limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant currency individually. In such cases, the supervisor also monitors the bank's liquidity needs in each significant currency, and evaluates the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal entities.</p>
Description and findings re EC8	<p>Regulations require banks to evaluate liquidity risk in foreign currency, the bank must undertake the following:</p> <ol style="list-style-type: none"> <li>1. Evaluate the added liquidity requirements in the foreign currency and determine the collateral exposure for acceptable currencies;</li> <li>2. Perform a separate analysis of the bank's strategy for each currency in which it has a significant stake, including the potential restrictions in stress scenarios. The scale of collateral exposure for the currency must take into account: <ul style="list-style-type: none"> <li>• The bank's capacity to capture funds in currency markets;</li> <li>• The ability to acquire financial terms backed by foreign currency in one's own national market;</li> <li>• The ability to transfer liquidity surpluses of one currency to another, as well as between jurisdictions and legal entities;</li> <li>• The possible convertibility scenarios for currencies in which the bank has operations, including the possibility of deterioration or total closure of currency swaps markets for certain currency pairs.</li> </ul> </li> <li>3. Understand and be capable of managing exposures coming from using deposits and short-term lines of credit denominated in a foreign currency to fund assets in the national currency, as well as those resulting from funding assets in foreign currency with national currency;</li> <li>4. Take into account sudden risk fluctuations in exchange or market liquidity rates, or both, given their potential to sharply expand the liquidity gaps and alter the efficiency of currency coverage and coverage strategies;</li> <li>5. Evaluate the possibility of losing access to currency markets, as well as the possible convertibility of currencies in which the bank trades.</li> </ol> <p>If the bank has significant exposures to liquidity risk in a given currency, the bank must negotiate backup liquidity terms in that currency or develop a contingency strategy.</p>
<b>Additional criteria</b>	
<b>AC1</b>	

Description and findings re AC1	
<b>Assessment of Principle 24</b>	Materially non-compliant
Comments	<p>The liquidity regulations are generally comprehensive consisting of risk management standards which closely reflect the BSBC Principles for Sound Liquidity Risk Management. In terms of quantitative requirements, banks need to meet two prudential ratios to manage short term liquidity and funding risk – the LLI and LCR. Regulations are prescriptive in terms of (i) inclusion of HQLA and eligibility criteria; and (ii) calibration of run-off assumptions. Banks need to establish and update regularly funding plans that take into account disruptions to liquidity and funding conditions. The plans are regularly stress tested and contingency funding plans are developed taking account of changes in market conditions (both idiosyncratic and market-wide). The BoD takes responsibility for developing and implementing the liquidity risk management framework. Supervisory assessments on-site and off-site include: Analysis of liquidity returns; Analysis of funding plans; Analysis of stress testing and scenario analysis; Assessment of policies, processes and strategies; Analysis of policies and reporting to BoD; and, Discussion with ALCO and Treasury staff.</p> <p>The LCR is calculated and reported on a Level 1 basis and not Level 2 (or group-wide). As a result, material subsidiaries are omitted from the calculation. In relation to offshore bank operations, the SBP places reliance on the host supervisor to set liquidity limits and to ensure compliance with liquidity requirements and risk management standards. In relation to domestic non-bank subsidiaries, the liquidity needs of these group entities are not captured in LCR reporting. As a result, a consolidated view of group-wide liquidity is not achieved. The absence of a central bank where the lender of last resort facility is available makes ex ante liquidity risk management vital to the stability of the system and individual banks. The absence of a consolidated view of liquidity is therefore seen as material for this assessment.</p> <p>The lack of a consolidated approach impairs both liquidity supervision and the effectiveness of consolidated supervision but the issue is only reflected in the grade of CP 24 to avoid double jeopardy.</p>
<b>Principle 25</b>	<b>Operational risk.</b> The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk <sup>67</sup> on a timely basis.
<b>Essential criteria</b>	

<sup>67</sup> The Committee has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

<b>EC1</b>	Law, regulations or the supervisor require banks to have appropriate operational risk management strategies, policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the bank's risk profile, systemic importance, risk appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the bank on a bank-wide basis (including periods when operational risk could increase).
Description and findings re EC1	<p>Decision No. 11-2018 "Issuing new provisions on operational risk" sets out the requirements for operational risk management. This regulation is a comprehensive set of requirements for the measurement, management and reporting of operational risk. The specific sections of the regulatory framework relevant to this EC include:</p> <ul style="list-style-type: none"> <li>• Article 4 – organizational structure with an independent risk management unit;</li> <li>• Article 5 – strategy for operational risk management that is approved on an annual basis by the BoD;</li> <li>• Article 6 – policies and processes that address a complete set of measurement, monitoring and management tools (e.g., risk matrices, limits, indicators, databases etc.);</li> <li>• Article 19 – Risk management unit</li> <li>• Article 27 – operational risk capital requirements.</li> </ul> <p>The SBP employs a set of internal procedures to assess the effectiveness of a bank's operational risk management set out in MUSBER: Appendix 8-Operational Risk Objective 1, Procedures 3–4, 8. Capital requirements for operational risk are set out in regulation Article 25-27, specifically:</p> <ul style="list-style-type: none"> <li>• ARTICLE 25. Bank up for potential losses. The Superintendency may establish capital requirements to cover operational risk, based on international standards and according to the situation in the banking center or of a particular bank.</li> <li>• ARTICLE 26. Determining operational risk-weighted assets. Operational risk-weighted assets are determined by multiplying the Business Index (IN, for its acronym in Spanish) amount, as defined in the Technical Appendix of this Rule, by 0.75.</li> <li>• ARTICLE 27. Operational risk capital requirements. Minimum operational risk capital requirements are determined by multiplying the operational risk-weighted assets established above by the capital coefficient for the due date. The calculation should be made on a quarterly basis following the operational rules established by the Superintendency.</li> </ul> <p>To calculate capital for operational risk, banks use the basic indicator approach. The Business Index (IN) is defined as follows: <math>IN = CIAD + CS + CF</math>. CIAD is the interest, leasing and dividend component, CS is the service component and CF is the financial component. To determine that banks' operational risk management framework (ORMF) is commensurate with its complexity, risk profile, systemic importance and capital strength the SBP performs a range of assessments. The principal activity is the on-site examination to make this assessment which includes, amongst other things:</p> <ul style="list-style-type: none"> <li>• Assessment of management and board committee minutes;</li> </ul>

	<ul style="list-style-type: none"> <li>• Interviews with senior management responsible for operational risk management;</li> <li>• An assessment of policies and processes together with sample testing;</li> <li>• Assessment of control and risk self-assessments (CRSAs);</li> <li>• Evaluation of risk appetite and limit frameworks;</li> <li>• Interviews with banks staff from the three lines of defense;</li> <li>• Evaluation of loss data measured against</li> <li>• Assessment of staff training;</li> <li>• Assessment of calculations to estimate capital adequacy for operational risk;</li> <li>• Analysis of scenario analysis; and</li> <li>• Analysis of business environment and internal control factors.</li> </ul> <p>An assessment of supervisory files demonstrated these assessments are undertaken on-site.</p>
<b>EC2</b>	<p>The supervisor requires banks' strategies, policies and processes for the management of operational risk (including the banks' risk appetite for operational risk) to be approved and regularly reviewed by the banks' Boards. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.</p>
Description and findings re EC2	<p>Article 16 of the operational risk regulations (Decision No. 11-2018 "Issuing new provisions on operational risk"), sets out the expectations of the BoD responsible for guaranteeing an appropriate environment for operational risk management, as well as fostering an internal environment that facilitates its development. Among their specific responsibilities are:</p> <ul style="list-style-type: none"> <li>• Approve the operational risk management policies and the relevant methodology;</li> <li>• Approve business continuity plans that permit the entity to react effectively to adverse situations;</li> <li>• Approve the necessary resources for the development of an appropriate operational risk management process, to have the necessary infrastructure, methodology and staff;</li> <li>• Ensure that the risk committee complies with the operational risk duties assigned to it;</li> <li>• Know the exposures and the main operational risk principles taken by the bank;</li> <li>• Know the required regulatory capital for operational risk and its effect within the bank;</li> <li>• Ensure that the bank has an effective operational risk management and that it is within the established tolerance limits;</li> <li>• Require periodic reports from the risk committee on operational risk exposure levels, their implications and mitigation plans;</li> <li>• Ensure that the matters discussed and the decisions made on operational risk management are fully documented in the board of directors meeting minutes.</li> </ul> <p>The regulations require banks to establish a risk committee with responsibility for operational risk, typically the Board Risk Committee (Article 17). The SBP reviews the operational risk management framework on an annual basis for systemic banks and for smaller and lower risk banks every two years (see MUSBER: Appendix 8, Objective 1,</p>

	Procedures 1–4). The SBP pays attention to the role of senior management and Board committees to implement the ORMF.
<b>EC3</b>	The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the bank's overall risk management process.
Description and findings re EC3	<p>The regulations clearly stipulate the requirements for banks to implement policies and processes for the management of operational risk. The policies are required to be implemented enterprise-wide (see Articles 16, 17, 18, 19, and 20). The regulations meet the requirements in this EC. In particular, Article 10 states that the financial institution must evaluate events and incidents continuously through the use of the following tools:</p> <ul style="list-style-type: none"> <li>• Risk maps.</li> <li>• Global limit and specific limits.</li> <li>• Operational Risk Indicators (IROs)</li> <li>• Operational risk databases.</li> </ul> <p>Article 22 also establishes that banks shall carry out at least once (1) a year, self-assessments that detect the strengths and weaknesses of the control environment in operations and service activities in the banking business, according to the list of potential operational risks identified to which it is exposed. The SBP includes within its supervision processes, the procedures to verify that financial institutions have implemented tools that allow measuring the behavior of losses (incidents) and events that could cause losses (events) against the established limits. The procedures applied are described in Appendix F8, objective No. 5 of the MUSBER. The SBP meets with bank staff responsible for operational risk, and produces on-site examinations, reports and off-site analysis of policies on an annual basis. MUSBER: Appendix 8, Objective 8, 18 sets out the framework for supervisors to conduct an assessment of policies and processes for operational risk.</p>
<b>EC4</b>	The supervisor reviews the quality and comprehensiveness of the bank's disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.
Description and findings re EC4	<p>Article 21 sets out the SBP's expectations for business continuity planning and disaster recovery (DR) requiring that as part of an appropriate operational risk management, banks must implement a business continuity plan aimed principally at providing effective responses ensuring service and banking business continuity in situations that might cause an interruption or instability in their operations. This business continuity plan must be tested once a year, as a minimum. The plan must be included in the operational risk manual. Regarding operational resilience, the regulations stipulate that Banks must also have an information security management system, oriented towards ensuring the integrity, confidentiality and availability of information.</p> <p>According to Article 22, banks are required to undertake a self-assessment to detect strengths and weaknesses in their control of banking operations and services, using the list of identified operational risks to which the bank is potentially exposed. To this end, the</p>

	<p>bank must document the self-assessment conducted. This is a more general requirement that also captures DR and continuity planning into the integrated approach to risk management. The self-assessment is a principal input into the SBPs assessment of operational risks, including adequacy of DR and business continuity planning. In addition to Article 21 and 22 of the regulations, the following are standards that reinforce risk management of operational risk and contingency planning:</p> <ul style="list-style-type: none"> <li>• Decision No. 8-2010 "Issuing provisions on comprehensive risk management"</li> <li>• Decision No. 6-2011 "Establishing guidelines on electronic banking and the management of related risks"</li> <li>• Decision No. 03-2012 "Establishing guidelines for the management of information technology risk"</li> <li>• General Resolution SBP-RG-0192-2019 "Expanding the reporting requirement established in Article 28 of Decision No. 011-2018"</li> </ul> <p>The supervisory assessment of DR and business continuity planning is set out in MUSBER: Appendix 8, Objective 4, Procedure 12.</p> <p>In terms of banks' technology infrastructure, there is a mix of on-site data centers and third-party service providers. At this stage, banks do not use cloud service providers for critical systems (such as core banking), though cloud is used for some applications such as platform development. The SBP undertakes on-site assessments of DR and continuity plans. Article 21 of the regulation requires banks to undertake a test of the DR plan annually. Banks submit the results of the DR tests and the SBP assesses the results. Based on the results, the SBP will decide whether further follow-up is needed. Supervisors have access to operational risk experts in the Risk Bureau of the SBP who are able to compare and contrast industry benchmarks to identify areas for improvement across the sector.</p>
<b>EC5</b>	<p>The supervisor determines that banks have established appropriate information technology policies and processes to identify, assess, monitor and manage technology risks. The supervisor also determines that banks have appropriate and sound information technology infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security and availability and supports integrated and comprehensive risk management.</p>
Description and findings re EC5	<p>Article 21 of the regulation stipulates that banks must have an information security management system, oriented towards ensuring the integrity, confidentiality and availability of information. To evaluate the Technological Risk the SBP assesses banks against the requirements within Agreement 3-2012, which establishes the guidelines for the risk management of information technology including: Information Technology Governance; Information Technology Risk Management; Information technology or "IT"; Information Security. This regulation is relatively comprehensive in terms of setting out the requirements for banks to establish appropriate governance and risk management standards for IT security risk.</p> <p>As part of the inspection planning, the scope is established and the procedures to be executed are selected. According to the type of comprehensive inspection, special information security – cybersecurity, special electronic banking, special legal department,</p>

	<p>SAC case inspection, specialized report, special electronic banking report, special report of the Legal Department and SAC case, respectively. In the case of inspections of Legal Management and SAC case, the resulting report is for internal use and only the general conclusions of the case are shared with the Legal Department and the Customer Service Management.</p> <p>In the last two years, IT Governance and Risk Management inspections have been carried out and those based on cybersecurity risk, special inspections, comprehensive monitoring, fraud through electronic channels. The following describe supervisory activities that have a focus on technology:</p> <ul style="list-style-type: none"> <li>• Comprehensive inspections (SB_I): this is the most general and in-depth monitoring measure provided for in MUSBER. It is broad enough to draw conclusions regarding banks' GRENP assessment and rating methodology. In the case of Technology Risk, IT Governance, IT Organizational Infrastructure, Policies and Procedures are evaluated.</li> <li>• Follow-up inspections (SB_S): is a supervisory action with a specific and limited scope, which generally focuses on the aspects where weaknesses or deficiencies were detected in previous actions or in the follow-up of the recommendations made</li> <li>• Special Follow-up Inspections (SB_SE): They focus on a certain product, area or risk, and the relevant points found in the previous inspection will be verified. In the case of Technological Risk, issues of Cybersecurity, Electronic Channels are reviewed.</li> <li>• Special Technology Risk Inspections (RT-E): They cover topics of IT Governance, Cybersecurity, Management with Suppliers among others.</li> <li>• Continuous Supervision Inspections Electronic Banking and Digitalization (GRT_SCBED): The controls and processes in the authorizations of the electronic channels are reviewed.</li> <li>• Electronic Banking Inspections Claims Service Case (BE_CSAC): customer complaints about unrecognized transactions and security controls applied to electronic channels are addressed.</li> </ul>
<b>EC6</b>	<p>The supervisor determines that banks have appropriate and effective information systems to:</p> <ul style="list-style-type: none"> <li>(a) monitor operational risk;</li> <li>(b) compile and analyze operational risk data; and</li> <li>(c) facilitate appropriate reporting mechanisms at the banks' Boards, senior management and business line levels that support proactive management of operational risk.</li> </ul>
Description and findings re EC6	<p>The relevant sections of the regulations relating to appropriate and effective information systems to monitor operational risk include Articles 8, 9, 10, 13, 16–19, and 23. Article 23 is exhaustive in terms of describing the expectations for banks to establish a database to capture operational risk loss data. Article 23 states that it is necessary for banks to design and implement centralized and high-quality databases to record, order, classify, and have available, information on the events and incidents, in addition to guaranteeing the staff involved in these processes is trained. Databases must meet the following criteria: Operational risk (events or incidents) originated anywhere in the bank must be recorded,</p>

	<p>and policies and procedures must be developed for their capture and communication. As a minimum, the following information about each event and/or incident must be recorded:</p> <ul style="list-style-type: none"> <li>• Category: event or incident;</li> <li>• Type of occurrence;</li> <li>• Identification code (assigned by the bank);</li> <li>• Business line, according to Appendix 2 of this Rule;</li> <li>• Another business line, according to Appendix 2 of this Rule;</li> <li>• Origin;</li> <li>• Affected product;</li> <li>• Process or area to which it belongs;</li> <li>• Type of risk (according to level one of Appendix 1 of this Rule);</li> <li>• Risk cause (according to level two of Appendix 1 of this Rule);</li> <li>• Description of the event.</li> </ul> <p>In terms of the supervisory processes, MUSBER: Appendix 8, Objective 8, Procedure 18. This verification involves evaluating the existence and content of manuals, policies and procedures for the collection of loss data, analysis to determine the causes that allowed the materialization of such losses and that corrective actions have been implemented to strengthen control to reduce the possibility of similar events in the future. The SBP includes within its supervision processes, the procedures to verify that financial institutions have implemented tools that allow measuring the behavior of losses (incidents) and events that could cause losses (events) against the established limits. The procedures applied are described in Appendix F8, objective No. 5 of the Single Manual for Risk-Based Supervision (MUSBER).</p>
<b>EC7</b>	<p>The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.</p>
Description and findings re EC7	<p>In terms of the notification requirements of developments affecting operational risk, the two most relevant sections of the regulations are Articles 28 and 29 which state the following:</p> <ul style="list-style-type: none"> <li>• ARTICLE 28. REPORTING REQUIREMENTS. Banks shall submit an annual report containing the main issues and results of the operational risk management program, electronically and in the format the Superintendency provides, by January 31 of each year.</li> <li>• ARTICLE 29. ADDITIONAL REQUIREMENTS. Banks will make available to the Superintendency any information, database, policies, processes, procedures, management systems, strategies, plans, and others mentioned in this Rule, as well as reviews by auditors and the parent company if the parent company is abroad.</li> </ul> <p>These requirements are relatively broad but do not necessarily capture the requirement to apprise the SBP, especially an immediate notification in the event of an operational risk event.</p>
<b>EC8</b>	<p>The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program covers:</p> <p>(a) conducting appropriate due diligence for selecting potential service providers;</p>



	<p>(b) structuring the outsourcing arrangement;</p> <p>(c) managing and monitoring the risks associated with the outsourcing arrangement;</p> <p>(d) ensuring an effective control environment; and</p> <p>(e) establishing viable contingency planning.</p> <p>Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.</p>
Description and findings re EC8	<p>The majority of Panamanian banks are adopting digitalization strategies that make use of outsourced service providers. As a result, the SBP has increased its focus on outsourcing arrangements, especially for technology service providers. In terms of the regulations dedicated to outsourcing, Decision No. 9-2005 "Developing outsourcing" Articles 3–8 relate to outsourcing. Article 3 stipulates the activities that do not require SBP approval (e.g., administrative activities, general services, transportation etc.). Article 4 stipulates that except for the activities mentioned in the previous article, all outsourcing contracts will need to be authorized by the Superintendency of Banks. The analysis of the authorization request will be done in a term not greater than thirty (30) business days, and until the banking entity has been notified of the decision made, it cannot carry out the requested outsourcing. Article 5 is relatively comprehensive in terms of setting out the minimum requirements, including:</p> <ul style="list-style-type: none"> <li>• Setting detailed policies or specific criteria for the assessments and decision- making related to outsourcing;</li> <li>• Analyzing and assessing its feasibility;</li> <li>• Developing, implementing and supervising effective programs for the continuous and adequate management of all risks inherent to outsourcing the activity or process;</li> <li>• Not decreasing or lessening their capacity to completely fulfill the obligations to their customers and the regulatory authority;</li> <li>• Satisfying the obligations with the Superintendency of Banks regarding effective supervision. In this sense, outsourcing should not interfere with the Bank's capacity to observe the regulatory requirements;</li> <li>• Executing the due diligence process regarding the provider and verifying that it has the necessary financial soundness, reputation, policies and controls for the management of the risks inherent to the bank and the ability to fulfill its obligations;</li> <li>• The relationship between the banking entity and the provider must be ruled by a written contract which clearly describes all relevant aspects of the service rendering agreement, including the rights, guarantees, responsibilities and expectations of both parties;</li> <li>• Establishing and keeping, jointly with the service provider, contingency plans regarding the activity or process, including recovery plans in case of disasters and the periodic tests pertinent to the provider's support systems;</li> <li>• Requiring the service provider to protect and maintain due reticence on all confidential information he is furnished, regarding the banking entity as well as its customers;</li> <li>• A viable alternate plan in case of the provider's service discontinuance.</li> </ul>

	Article 6 refers to the need for Internal Audit and External Audit to have influence in the process and Article 7 relates to general obligations of the bank such as record keeping etc. Banking entities may outsource activities specific to their raison d'être with the prior authorization of the SBP, in accordance with the provisions of Article 4 of Agreement 9-2005. The assessment of the application for authorization for outsourcing shall determine whether the outsourcing contract or agreement contains at least Article 9 of that agreement. Similarly, Article 14 of Agreement 3-2012 establishes that "Any bank that outsources the functions or processes of IT, must ensure that they comply with the provisions of the Agreement on Outsourcing issued by this Superintendency of Banks" and its numerals 1 and 2, regulate access by the Superintendency of Banks to IT infrastructure, to information systems and databases... and the obligation of the contracted company to send the bank all the information required by the Superintendence, respectively. Also Article 19 of Agreement 6-2011, refers to the relationship with third parties and security providers of the Electronic Banking service.
<b>Additional criteria</b>	
<b>AC1</b>	The supervisor regularly identifies any common points of exposure to operational risk or potential vulnerability (e.g., outsourcing of key operations by many banks to a common service provider or disruption to outsourcing providers of payment and settlement activities).
Description and findings re AC1	
<b>Assessment of Principle 25</b>	Compliant
Comments	Comprehensive regulations provide a solid foundation for banks' management of operational risks. The regulations are specific in terms of requiring elements of the governance framework for the BoD to be responsible for setting a risk appetite and for KRIs to be developed as forward-looking indicators. In terms of governance, board reporting is via the risk committee. The SBP dedicates time during on-site examinations to review the adequacy of reporting and identifies weaknesses. Capital is calculated using the basic indicator approach. Banks collect loss data that is included in their risk measurement and monitoring. Responsibilities for contingency planning is clearly described in the regulations. A specific requirement in the regulations to keep the SBP apprised of developments affecting operational risks is nonetheless warranted.
<b>Principle 26</b>	<b>Internal control and audit.</b> The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and

	appropriate independent <sup>68</sup> internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
<b>Essential criteria</b>	
<b>EC1</b>	<p>Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank's Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these controls address:</p> <ul style="list-style-type: none"> <li>(a) organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g., clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g., business origination, payments, reconciliation, risk management, accounting, audit and compliance);</li> <li>(b) accounting policies and processes: reconciliation of accounts, control lists, information for management;</li> <li>(c) checks and balances (or "four eyes principle"): segregation of duties, cross-checking, dual control of assets, double signatures; and</li> <li>(d) safeguarding assets and investments: including physical control and computer access.</li> </ul>
Description and findings re EC1	<p>The two most relevant regulations pertaining to internal control and audit are Decision No. 5-2011 "Issuing a new Decision to update the provisions on corporate governance" (Articles 4–7 and 27) and Decision No. 7-2014 "Establishing rules for the consolidated supervision of banking groups" (Article 4, paragraph 1; Article 5; Article 7, paragraphs 5 and 7; Article 9, paragraph 9). The two regulations are relatively comprehensive stipulating the need for controls to address organizational structure; accounting policies and processes; checks and balances; and safeguarding assets.</p> <p>The regulation states that "Regulated entities shall have an effective internal control system with sufficient authority, standing, independence, resources, and access for the Board, where internal control management is adapted to changes in the bank's or banking group's risk profile. Both the Board and senior management shall effectively use the work carried out by the internal audit, external audit, and internal control units. Accounting systems shall comprise established procedures for identifying, consolidating, classifying, computing, analyzing, recording, summarizing, and reporting operations and the documentation produced." Articles 4-7 of (No5.2011) are a complete list of requirements for banks' internal control functions that fully address the requirements of this CP (a) – (d). Regulation (No.7-2014) stipulates these same internal control requirements to be applied across the consolidated group. The regulations clearly describe the minimum standards</p>

<sup>68</sup> In assessing independence, supervisors give due regard to the control systems designed to avoid conflicts of interest in the performance measurement of staff in the compliance, control and internal audit functions. For example, the remuneration of such staff should be determined independently of the business lines that they oversee.

	<p>for the BoD to take responsibility for developing and implementing an internal control environment that is appropriate for the size, scale, complexity and risk profile of the business model as well as ensuring sufficient independence from Line 1 and reporting structures such that control and compliance matters are escalated through the organizational structure to the BoD.</p> <p>Article 7, paragraph a of the regulations (Decision No. 5-2011 "Issuing a new Decision to update the provisions on corporate governance") sets out the need for banks to establish an appropriate controlling environment. The Article states "An organizational and administrative system corresponding to the establishment of an appropriate organizational and administrative structure defining clearly the obligations, responsibilities, and the degree of dependency and existing interrelation between the operational and administrative areas which shall be contained in the corresponding organizational and duties manual. This system shall consider an appropriate segregation of activities attributed to the members of the institutions so as to avoid, among others, conflict of interest, as well as to foresee the means to minimize and adequately control areas identified as of potential conflict."</p>
<b>EC2</b>	<p>The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the bank's Board) to be an effective check and balance to the business origination units.</p>
Description and findings re EC2	<p>There are two aspects of supervisory practice to evaluate the adequacy of skills and resources of the internal control functions of banks, including the compliance functions:</p> <ul style="list-style-type: none"> <li>• A questionnaire is sent to banks on an annual basis as a self-assessment of, amongst other things, the control and compliance functions. Questions will cover the sufficiency of resources for control environments across the banks various business units and materials will be collected and reviewed to evidence responses to the self-assessments. The SBP will use the self-assessment as an input into the on-site examination and will validate the responses. Specifically in relation to assessing the skills, experience and expertise of back office and compliance staff, the SBP will review: organizational structures and reporting lines, resumes of personnel and staffing numbers for compliance functions.</li> <li>• The SBP will evaluate the self-assessment and use the results as an input into the scoping of the on-site examination.</li> <li>• During the on-site examination, the SBP will meet with back office and compliance staff to verify the self-assessment and assess the quality of staff to ensure adequacy of resources, skills and experience to be commensurate with the risk profile and complexity of the bank and the respective business units. Higher risk areas will attract more attention by the SBP and expectations for the adequacy of resources in those compliance areas.</li> </ul>

<b>EC3</b>	The supervisor determines that banks have an adequately staffed, permanent and independent compliance function <sup>69</sup> that assists senior management in managing effectively the compliance risks faced by the bank. The supervisor determines that staff within the compliance function is suitably trained, have relevant experience and have sufficient authority within the bank to perform their role effectively. The supervisor determines that the bank's Board exercises oversight of the management of the compliance function.
Description and findings re EC3	<p>Inspections include an analysis of key elements in the internal control structure: the accounting system, the information technology control environment, the control environment for the prevention of money laundering, terrorist financing, and the financing of the proliferation of weapons of mass destruction, and the control environment specific to the relevant business lines.</p> <p>Off-site analysis confirms on an ongoing basis adherence to prudential requirements and supervisors follow up the results of their analysis with bank staff including the independent risk units and compliance functions. These regulator and routine interactions provide insights into the adequacy of the compliance function and the three lines of defense.</p> <p>As per the supervision manual (MUSBER), the on-site examination will include meetings with the Board Risk Committee, compliance functions, internal audit staff and staff from the risk unit. Through these activities (on-site and off-site), the SBP forms a view as to the adequacy of internal control staff to perform their role effectively.</p> <p>The evaluation identifies the independent units (internal audit, risk, compliance) responsible for managing the internal control system and the various risks to which the bank is exposed. The review of Board minutes also looks at participation and feedback for decision making from Board members and their actions as members of the various committees on which they sit. The SBP will review the role of the BoD in overseeing the compliance function and risk governance writ large.</p>
<b>EC4</b>	<p>The supervisor determines that banks have an independent, permanent and effective internal audit function<sup>70</sup> charged with:</p> <ul style="list-style-type: none"> <li>(a) assessing whether existing policies, processes and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the bank's business; and</li> <li>(b) ensuring that policies and processes are complied with.</li> </ul>
Description and findings re EC4	<p>The regulation clearly describes banks' obligations to establish an independent and permanent internal audit (IA) function. The relevant articles of the regulation are Articles 8, 9, and 10 of the regulation (Decision No. 5-2011) which state:</p> <p>Article 8 - Banks shall have an internal audit area to meet the duties established in article 9 of this Rule. Also, they must ensure to establishing the minimum parameters to</p>

<sup>69</sup> The term "compliance function" does not necessarily denote an organizational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance who should be independent from business lines.

<sup>70</sup> The term "internal audit function" does not necessarily denote an organizational unit. Some countries allow small banks to implement a system of independent reviews, e.g., conducted by external experts, of key internal controls as an alternative.

	<p>guarantee internal audit's professional and smoothly execution of their job in accordance with international standards and best practices. Article 9 is a comprehensive set of duties for the IA unit. While Article 10 is minimum standards of the IA function with respect to experience and expertise. These regulations are complemented with Decision No. 7-2014 "Establishing rules for the consolidated supervision of banking groups" (Articles 8 and 9)</p> <p>In terms of the supervisory activity to assess the effectiveness of the IA function, supervisors interact frequently with those responsible for the internal audit function, either during inspection processes or with meetings scheduled as part of the oversight strategy agreed in the GRENP Committee or through any other communication vehicle (e.g., email, telephone, in-person or virtual meetings). These interactions enable an open and timely dialogue between the bank and supervisors on a range of topics included in the agreed action plan, which may range from strategies and business model, corporate governance, asset management issues and succession plans, and other informed findings. Contacts or interactions can be made on a quarterly basis, either through occasional visits; these processes are part of the "continuous monitoring" program (See MUSBER Section III.1.3 Continuous monitoring).</p>
<b>EC5</b>	<p>The supervisor determines that the internal audit function:</p> <ul style="list-style-type: none"> <li>(a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing;</li> <li>(b) has appropriate independence with reporting lines to the bank's Board or to an audit committee of the Board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations;</li> <li>(c) is kept informed in a timely manner of any material changes made to the bank's risk management strategy, policies or processes;</li> <li>(d) has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties;</li> <li>(e) employs a methodology that identifies the material risks run by the bank;</li> <li>(f) prepares an audit plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly; and</li> <li>(g) has the authority to assess any outsourced functions.</li> </ul>
Description and findings re EC5	<p>To strengthen the evaluation process conducted by the SBP on the effectiveness of the internal audit function and to standardize requests for information from regulated entities on this topic, entities are asked, pursuant to Circular No. SBP-DR-0301-2020, to fill out an annual internal audit questionnaire containing a series of questions developed based on the supervisor's principles and expectations regarding the internal audit function, in accordance with the document of the Basel Committee on Banking Supervision. This questionnaire focuses on the following areas:</p> <ul style="list-style-type: none"> <li>• Internal audit charter and/or manual</li> <li>• Characteristics of the internal audit function</li> <li>• Organization and human resources</li> <li>• Scope of its activities</li> <li>• Work planning and execution</li> <li>• Reports</li> </ul>

	<ul style="list-style-type: none"> <li>• Quality control</li> <li>• Corporate governance considerations</li> <li>• Outsourcing of audit activities</li> </ul> <p>The processes for evaluating the internal audit questionnaire submitted by entities are contained on pages 196 and 197 of the MUSBER in Annex 35 – Procedures for Reviewing Bank Responses to the Internal Audit Questionnaire.</p> <p>Specifically in relation to the requirements in this EC:</p> <ul style="list-style-type: none"> <li>(a) The SBP assesses the adequacy of IA resources on an ongoing basis through off-site and on-site evaluation processes.</li> <li>(b) The regulations require a direct reporting line of the Head of IA to the BAC. The independence of the IA function is assessed through analysis of reporting structures across business units and through interactions with IA staff.</li> <li>(c) interactions with the IA function are typically undertaken as part of the on-site examination process unless a specific issue has been identified that requires intervention by the SBP. There is scope for the SBP to enhance the frequency and structure of engagements with the IA function to ensure confidence that the IA function remains apprised of significant changes in risk management, strategy and similar issues.</li> <li>(d) This is fully met.</li> <li>(e) IA is required to employ a risk-based approach and the SBP tests the methodology during the on-site examination.</li> <li>(f) The SBP receives the IA plan after ratification by the BAC and BoD. There is scope to enhance the engagement with the IA function in the planning process and the review process to evaluate whether the IA plan was achieved, was risk-based and whether the methodology is working as intended. A more structured process is desirable.</li> <li>(g) The regulations stipulate the power for bank IA to have full access to outsourced service providers.</li> </ul>
<b>Assessment of Principle 26</b>	Compliant
Comments	<p>The regulations stipulate the need for banks to establish an appropriate control environment and audit arrangements. Governance arrangements are established for audit committees to oversee compliance and internal controls to ensure compliance with prudential requirements. As part of on-site examinations (and follow-up examinations/processes), the SBP dedicates considerable attention to line 2 (compliance and back-office staff) and IA (line 3). Given on-site examinations involve extensive teams across multiple weeks and themes, there is a wide range of opportunities for the SBP to gain insights into the quality, resourcing, independence and effectiveness of compliance and IA functions within the banks. The area where there is scope for improvement is more frequent and structured engagements with two key areas of Line 3: (i) Head of IA; and (ii) BAC. The SBP could make use of more frequent and structured engagements with these two functions to keep apprised of findings of IA work on an ongoing basis.</p>
<b>Principle 27</b>	<b>Financial reporting and external audit.</b> The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in

	accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor <sup>71</sup> holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems to produce adequate and reliable data.
Description and findings re EC1	<p>Regulations issued by the SBP set out a comprehensive set of requirements for banks' Board and senior management to be responsible for preparing financial statements that adhere to international accounting standards. In this regard, the main regulations pertaining to this CP include:</p> <ul style="list-style-type: none"> <li>• Banking Law, Article 87 (Presentation of Audited Statements)</li> <li>• Decision No. 1-2010 "Establishing guidelines on the integrity and accuracy of financial statements" (Article 2)</li> <li>• Decision No. 4-2010 "Updating the provisions on bank external audit" (Article 2-Responsibilities of the Board of Regulated Banks)</li> <li>• Decision No. 5-2011 "Issuing a new Decision to update the provisions on corporate governance" (Articles 6-Internal Control System Managers, 7-Minimum Internal Control System Requirements, and 13-Board Responsibilities)</li> <li>• Decision No. 7-2014 "Establishing rules for the consolidated supervision of banking groups" (Article 33-Accuracy and Integration of Information from Banking Group Financial Statements)</li> </ul> <p>The Banking Law stipulates that banks with a general or international license shall, within three months following the close of each fiscal year, submit to the Superintendency their corresponding audited financial statements, observing the accounting, technical and prudential standards established by the Superintendency with respect to their operations. The aforementioned documentation shall bear the signature of the legal representative or a representative of the bank with such powers.</p> <p>The regulations require directors of regulated entities to be responsible for proper accounting management and shall therefore ensure that appropriate systems and procedures exist so that not only the financial statements prepared by the regulated entities and the complementary information based on which the external auditor issues an opinion, but also the special reports required by banking regulation are all prepared and presented reliably and truthfully. Furthermore, the regulations clearly stipulate that the BoD is responsible for ensuring the accuracy, reliability, and integrity of the</p>

<sup>71</sup> In this Essential Criterion, the supervisor is not necessarily limited to the banking supervisor. The responsibility for ensuring that financial statements are prepared in accordance with accounting policies and practices may also be vested with securities and market supervisors.



	<p>consolidated financial statements, which shall present in an objective and reasonable manner the financial position and performance of the banking group in all its material respects, in strict adherence with the International Financial Reporting Standards (IFRS). Taken together, the regulations require banks and banking groups responsible for accounting and internal control procedures that promote the maintenance of sufficient documentation to support the content of the financial statements.</p> <p>The accounting standards and principles applied by banks are IFRS implemented in 2018 (see Article 2 of Agreement 6-2012).</p>
<b>EC2</b>	<p>The supervisor holds the bank's Board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor's opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.</p>
Description and findings re EC2	<p>The regulations clearly require directors to be responsible for ensuring that the general external audit plan is consistent and appropriate for fulfilling the financial reporting aspects related to the most significant and risky areas of the institution's banking business, as established in the Corporate Governance Decision issued by this Superintendency.</p> <p>The regulations require external auditors be responsible for issuing an independent opinion on the financial statements, in accordance with the applicable International Standards on Auditing, and state in their audit report whether, in their opinion, they present an accurate and reasonable picture of the bank's financial position, financial performance, and cash flows and whether the financial statements conform to the accounting, technical, and prudential standards established by the Superintendency, assuming full liability for the reports they issue. The governance arrangements for the approval of audit financial statements are overseen by the Board Audit Committee (BAC) and ultimately the full BoD.</p> <p>The relevant regulations include: Banking Law, Article 81 (Appointment of External Auditors), Article 82 (External Auditor Reports), and Article 87 (Presentation of Audited Financial Statements); Decision No. 1-2010 "Establishing rules for the consolidated supervision of banking groups" (Article 3-Declaration, paragraph e); Decision No. 4-2010 "Updating the provisions on bank external audit" (Article 2-Responsibilities of the Board of Regulated Entities); Decision No. 5-2011 "Issuing a new Decision to update the provisions on corporate governance" (Article 12-Guidelines for Corporate Governance Management); and Decision No. 7-2014 "Establishing rules for the consolidated supervision of banking groups" (Article 3-Corporate Governance Requirements for Banking Groups; Article 4-Responsibilities of Members of the Board of the Bank Stock Owner).</p>
<b>EC3</b>	<p>The supervisor determines that banks use valuation practices consistent with accounting standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that banks document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes.</p>
Description and findings re EC3	<p>The regulation states that external auditors shall evaluate the bank's internal control system at least once annually. Such evaluations are carried out in compliance with the provisions issued by the Superintendency and the International Standards on Auditing.</p>

	<p>The regulation also provides that use of IFRS is mandatory. All banks are subject to IFRS and the SBP reviews financial statements to ensure compliance.</p> <p>Fair value estimation is guided by the accounting methodology, and no formal framework is in place for fair value adjustments for prudential purposes. The regulations provide guidance regarding valuation processes, including the role of independent risk units and governance arrangements to validate and verify valuation estimations. In the case of collateral, the regulations for credit and market risk stipulate risk management processes. Trading activities of banks is relatively limited (with traded market risk comprising approximately 1 percent of total risk weighted assets for the system). In the case of fair value adjustments, no models are used and inputs for pricing are derived from market prices and public indexes.</p> <p>The SBP reviews bank's audited financial statements annually to assess the content and the notes and compare against the regulatory returns. A list of questions is typically prepared and followed up with the institution that is material or requires an explanation. The SBP reviews all banks' annual reports more generally.</p> <p>The relevant regulations for this CP include: Decision No. 1-2010 "Establishing guidelines on the integrity and accuracy of financial statements" (Article 2). Decision No. 5-2011 "Issuing a new Decision to update the provisions on corporate governance" (Article 8- Internal Audit and Internal Control System Monitoring) Decision No. 6-2012 "Issuing a new Decision amending the provisions on technical accounting standards applicable to banks established in Panama" Decision No. 7-2014 "Establishing rules for the consolidated supervision of banking groups" (Article 33-Accuracy and Integration of Information from Banking Group Financial Statements)</p>
<b>EC4</b>	<p>Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk- and materiality-based approach in planning and performing the external audit.</p>
Description and findings re EC4	<p>The SBP does not have the power to establish the scope of external audits. There are, however, several examples where the SBP has exercised influence over the scope of the EA. Only by exception is the EA to report to the SBP. Informally the SBP has the ability to influence and can demonstrate examples. Some meetings are held with all the EA firms before year end and the SBP (Oct, Nov) holds these meetings to present concerns the supervisory may have.</p> <p>There is the power for the SBP to require the external auditor to prepare a 'special report' where the SBP decides it is warranted (see 4-2010 Article 9). Relevant to the influence of the EA scope, during the pandemic the SBP regularly met the EA to share with them the concerns they had about modified portfolios.</p> <p>The appointment of the external auditor of a bank does not require prior approval by the SBP; however, Article 8 of Agreement 4-2010 states that the regulated bank must make the notice of hiring of the firm of external auditors and the detail of the team that will perform the external audit. With regard to the contracting letter and audit contracts, Article 9 of Agreement 4-2010 states that the regulated parties will keep them available and will send to the SBP, when requested, a copy of these documents, so that both the</p>

	<p>contracting letter and the audit contract can be expressly requested from the bank or requested during the inspection processes carried out.</p> <p>Decision No. 6-2012 "Issuing a new Decision amending the provisions on technical accounting standards applicable to banks established in Panama" (Article 4-Auditing Standards). The reports and opinions of external auditors appointed by the regulated entities or by the Superintendency of Banks for the purposes of Chapters VIII and IX of the Banking Law are governed by the International Standards on Auditing issued by the International Auditing and Assurance Standards Board and the International Federation of Accountants. However, in addition to what is stipulated in the preceding paragraph, the auditor may note the use of other auditing standards.</p>
<b>EC5</b>	<p>Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting.</p>
Description and findings re EC5	<p>Article 4 of Decision No. 6-2012 covers the need for auditing standards to adhere to International Standards on Auditing. Decision No. 4-2010 "Updating the provisions on the external audit of banks" (Article 9-Special Reports) is relatively comprehensive in coverage of audit areas to cover. Article 9 states: "The board of directors of the regulated parties shall request to the external auditors, within the period foreseen for the delivery of their audited financial statements, to submit a separate document and with a copy to the Superintendency of Banks, reports prepared by their auditors on the following matters:</p> <ul style="list-style-type: none"> <li>• The accounting principles used by the regulated party's top management.</li> <li>• The consistency with which those principles are actually applied.</li> <li>• The incorporation of the various standards issued by the Superintendency of Banks to the accounting practices followed by the bank.</li> <li>• The financial impact of any discrepancy between the accounting principles referred to the Rule on Technical Standards for Accounting and Auditing issued by this Superintendency and the accounting practice followed by the top management when preparing the financial statements.</li> <li>• Provisioning for loan losses and recognition of other devaluations.</li> <li>• Consolidation of off-balance instruments and its implications.</li> <li>• Estimates of fair value and the uncertainties related.</li> <li>• Findings of alleged relevant activities that could jeopardize the regulated party's operations.</li> <li>• Questionable transactions with affiliated companies, related parties or the same banking group as the regulated party.</li> <li>• Evidence of misuse of classified information.</li> <li>• Compliance with the recommendations made in the past by the external auditors of the regulated party.</li> <li>• Any acts or illegal situations detected throughout the course of the external auditing."</li> </ul> <p>The stipulations in the regulations are comprehensive for the EA to evaluate the adequacy and accuracy of financial reporting for the risk areas mentioned in this EC.</p>

<b>EC6</b>	The supervisor has the power to reject and rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards.
Description and findings re EC6	Banking Law, Article 84 (Objection of External Auditors) states that the Superintendency will have the power to reject or object to the appointment of external auditors where it deems that they do not have sufficient experience, specialization, or independence. The Superintendency will not accept audit reports prepared in violation of this Decree Law and the accounting, technical, and prudential rules established by it, in which case it will have the power to order the removal of the external auditors.
<b>EC7</b>	The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.
Description and findings re EC7	According to Article 4 of Decision No. 4-2010 "Updating the provisions on the external audit of banks" (Article 14-Rotation of the Team of External Auditors); the audit firm must be rotated on a five-year basis and partners and managers must be rotated a three-year period. In this regard the EC is fully met. No formal rules to have separation between consulting and EA for the same firm. But SBP does look at this area and whether there is an impact on independence. Especially if the same firm is doing extra work or services, banks need to inform of two events: (i) define what is the auditing firms and team perform the audit.
<b>EC8</b>	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings re EC8	There is no routine meeting between the SBP and the external auditors of individual banks on a periodic basis. While the SBP has the power and discretion to meet the EA if required, this type of engagement is not currently a feature of routine supervision plans. The SBP will meet with the accounting and audit profession on an industry basis to discuss issues that affect the sector. However, individual bank meetings are exceptional. The general audit plan that the auditor must deliver to the reporting entity shall contain the consent of the external auditors to be available to attend working meetings with the Superintendency of Banks. Meetings are held with external auditors every year to address areas of concern to the Superintendency that require an audit focus. They are generally convened before the end of the year or as required.
<b>EC9</b>	The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings re EC9	Article 9 of Decision No. 4-2010 states that "the regulated parties shall be available and shall submit to the Superintendency of Banks, when required so, a copy of the following documents: (a) Letter of the audit Rule between the regulated party and the auditing firm,

	<ul style="list-style-type: none"> <li>(b) External audit plan, Evidence of communication between the external auditor and the board of directors or audit committee of the regulated party,</li> <li>(c) Meeting minutes of audit committee,</li> <li>(d) Differences of the external auditor with the top management on the implementation of IFRS or US-GAAP, as applicable.</li> <li>(e) Letters to top management of the bank, whereby the auditor submits his comments and recommendations about internal control.</li> <li>(f) Representation letter issued by the regulated party to the external auditor.</li> <li>(g) The sheets of audit differences.</li> <li>(h) Any other special report issued by an external auditor on a particular matter.</li> <li>(i) Other documents that may be requested by the Superintendency.</li> </ul> <p>The BoD together with the audit committee of the regulated must take cognizance of all reports issued by external auditors and take the necessary corrective measures, which shall be proven by the BoD meeting minutes.</p> <p>Working papers and inspection reports are asked to be prepared in case certain situations are detected. They shall also have available the internal control charts, unregistered adjustment sheet, and other documents that may be requested by the Superintendency. Regulated entities shall share the inspection reports issued by the Superintendency of Banks with their external auditors under conditions of confidentiality expressly agreed in writing. This EC requires the external auditor to report to the SBP, which is a power the SBP currently does not have. The reporting typically is from the bank to the SBP.</p>
<b>Additional criteria</b>	
<b>AC1</b>	The supervisor has the power to access external auditors' working papers, where necessary.
Description and findings re AC1	
<b>Assessment of Principle 27</b>	Largely compliant
Comments	<p>All banks apply IFRS and thus meet international standards for accounting treatment. The SBP has not implemented a framework for prudential valuations such as promulgated by the BCBS.</p> <p>Regulations issued by the SBP set out a comprehensive set of requirements for banks' Board and senior management to be responsible for preparing financial statements that adhere to international accounting standards. There is scope for the SBP to have a more frequent and periodic engagement with the external auditors to discuss the scope of the audit, main findings and seek their views in terms of: vulnerabilities, risk management standards and opinion on the soundness of internal controls (EC8). The SBP does not have the power to establish the scope of external audits (EC4). Only by exception does the EA report to the SBP. The engagement is typically between the bank and the EA. Informally the SBP has the ability to influence and can demonstrate examples, especially recently in relation to the Pandemic where loan moratoria were made law by the Government. Periodic meetings are held with the audit firms collectively. In relation to EC9, there is a need for the SBP to have a power to require the external auditor to report to the SBP any</p>

	material issues directly. Currently, the external auditor will report via the bank and not directly.
<b>Principle 28</b>	<b>Disclosure and transparency.</b> The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.
<b>Essential criteria</b>	
<b>EC1</b>	Laws, regulations or the supervisor require periodic public disclosures <sup>72</sup> of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC1	<p>The Banking Law and Decisions require information from both individual and consolidated financial statements. The relevant sections of the Banking Law include:</p> <p>ARTICLE 88. PUBLICATION AND DISPLAY OF AUDITED FINANCIAL STATEMENTS. Banks shall publish, in a journal of national circulation in the Republic of Panama, an unsigned copy of the audited financial statements referred to in the preceding article, with their respective notes, if any, within 30 days after their submission to the Superintendency and shall display them for the next 90 days in a location accessible to the public in each of their establishments in Panama.</p> <p>ARTICLE 92. PUBLICATION OF INFORMATION. The Superintendency shall disclose and publish the financial and statistical information of the banking system and of each bank in particular and may require banks to disclose specific financial information.</p> <p>ARTICLE 33-A. PUBLICATION OF CONSOLIDATED FINANCIAL STATEMENTS. Banking groups that consolidate their operations in Panama and over which the Superintendency exercises home office supervision shall publish, on their website and in a visible location of the group's main banking establishment, their consolidated financial statements within seven (7) business days of their submission to this Superintendency.</p> <p>Article 92 gives the SBP the power and obliges it to publish material regarding the banking sector and individual banks to the market. The banking Law clearly fulfills the need to publish financial disclosures frequently.</p> <p>In addition to the Banking Law, the regulations (Decision No. 7-2014) establish the requirement for the publication of consolidated financial statements. Specifically, the relevant sections of the regulation include:</p> <p>ARTICLE 33-A2. PUBLICATION OF CONSOLIDATED FINANCIAL STATEMENTS – "Banking groups consolidating their operations in Panama and over which the Superintendency exercises home supervision shall post their consolidated financial statements on their websites and in a visible place in the group's main banking establishment within seven (7) business days after having submitted them to the Superintendency.</p> <p>ARTICLE 35. REPORT OF THE BOARD OF DIRECTORS OF THE BANKING GROUP HOLDING COMPANY. The board of directors of the bank holding company shall submit a report on</p>

<sup>72</sup> For the purposes of this Essential Criterion, the disclosure requirement may be found in applicable accounting, stock exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.

	<p>its compliance with the global and risk concentration limits established hereinto the Superintendency within ninety (90) calendar days of the closure of each fiscal period. This report must follow the format provided by the Superintendency.</p> <p>ARTICLE 36. TRANSPARENCY. The board of directors of the bank holding company must submit an annual report to the Superintendency containing corporate information on risk management and financial management of the banking group.</p> <p>Through General Resolution SBP-RG-0001-2022, banks are required to submit financial statements with the following frequencies:</p> <ul style="list-style-type: none"> <li>• Audited financial statements – Annual frequency. That in addition to its submission to the SBP, the regulation in compliance with Article 88 of the Banking Law requires banks to publish in a newspaper of national circulation in the Republic of Panama, an unsigned copy of the audited financial statements, with their respective explanatory notes, if any, within 30 days after their presentation to the SBP, and exhibit them for the next 90 days in a publicly accessible location in each of their establishments in Panama.</li> </ul> <p>There is a high degree of comparability of financial statements as banks use IFRS. Decision No. 6-2012 ("Issuing a new Decision amending the provisions on technical accounting standards applicable to banks established in Panama") sets out general provisions that disclosures correspond to those required by IFRS. The SBP discloses a comprehensive suite of disclosures, such as portfolio classification and amended portfolio published on its website. The disclosures are both in aggregate for the system and for individual banks. Public disclosures of the largest banks are typically published quarterly. Analysis of bank financial statements evidenced disclosures on a solo and consolidated basis.</p>
<b>EC2</b>	<p>The supervisor determines that the required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.</p>
Description and findings re EC2	<p>The SBP has not formally adopted Pillar III of the Basel Accord. Public disclosure requirements of financial statements are stipulated, however, the full extent of qualitative and quantitative information particular to a bank is not required to be publicly disclosed. There has been no direct guidance to banks in terms of disclosures for remuneration and or additional disclosures for systemically important banks. However, banks are required to submit financial statements and their annual reports and additional information to the SBP which the SBP publishes on its website. Further, the SBP publishes statistical reports using this information. The SBP expanded the information that needs to be included in bank annual reports to include qualitative disclosures. Additionally, as of December 31, 2015, the bank holding group's board of directors must submit its annual report to the Superintendency within one hundred and twenty (120) calendar days after its fiscal year closure (See Circular 200-2015). The circular states, "The annual report must contain, as a minimum, the following items and must be submitted electronically (not hardcopy):</p> <ul style="list-style-type: none"> <li>• Introduction with the banking group's general information</li> </ul>

	<ul style="list-style-type: none"> <li>• Banking group's structure</li> <li>• Economic, financial and regulatory context in which the banking group operates</li> <li>• Summary of the banking group's corporate governance structure</li> <li>• Established principles for the banking group's comprehensive risk management regarding: Geographically delimited credit risk; Market risk; Liquidity risk; Operational risk. Risk of money laundering, terrorism financing and financing the proliferation of weapons of mass destruction; and Social and environmental risk.</li> <li>• Analysis of the banking group's solvency</li> <li>• Summary of the regulatory impact in areas where the banking group has a presence</li> <li>• Consolidated audited financial statements</li> </ul> <p>The Circular requires the above data to be submitted to the SBP which it evaluates to ensure the annual reports meet regulatory obligations.</p> <p>The disclosure requirements are relatively comprehensive, but do not meet all aspects of this EC, specifically transactions with related parties and compensation have not been specified. In relation to compensation, the SBP has not adopted a framework for assessment of senior management remuneration (such as the principles proposed by the Financial Stability Board). The requirements specified by the SBP are uniform across all banks and are not adjusted for systemic importance.</p>
<b>EC3</b>	Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.
Description and findings re EC3	<p>The SBP has requirements for banks to submit group information to the SBP. For example, BAN03 Chart on Economic Groups and Related Parties: It must be submitted on a quarterly basis within thirty (30) calendar days after the relevant quarter has expired. Additionally, the bank holding group's board of directors must submit its annual report to the Superintendency within one hundred and twenty (120) calendar days after its fiscal year closure. The annual report must contain, as a minimum, the following items and must be submitted electronically (not hardcopy):</p> <ul style="list-style-type: none"> <li>• Introduction with the banking group's general information</li> <li>• Banking group's structure</li> <li>• Economic, financial and regulatory context in which the banking group operates</li> <li>• Summary of the banking group's corporate governance structure</li> </ul> <p>The regulation to require banks to publicly disclose all material entities within the groups is not explicit.</p>
<b>EC4</b>	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Description and findings re EC4	The supervisor reviews the audited financial statements and calls attention to cases of non-compliance (see also EC1). The Corporate Governance Evaluation Form (FEGOB), "Reporting and Transparency" Subcomponent, is also used to evaluate the effectiveness of information disclosure methods used by banks. The SBP assesses annual financial statements and annual reports and compares the data against regulatory reporting.
<b>EC5</b>	The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet



	indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).
Description and findings re EC5	The SBP publishes a comprehensive suite of banking sector reports regarding individual banks and for the system on its website monthly. It also presents the information graphically, called "Dynamic Financial Statistics". Statistical reports are available for the IBC and for general license banks and state banks. Individual bank data is also published on a quarterly basis which includes full balance sheet data (assets, liabilities with breakdowns including capital adequacy. Aggregate data covers areas such as the income statements of the banking sector, loan quality and provisions, interest rates sector portfolios. In addition, the SBP's annual report contains statistical information for the banking system which is also published on the SBP website. These publications help improve the transparency of financial data for the banking system.
<b>Additional criteria</b>	
<b>AC1</b>	The disclosure requirements imposed promote disclosure of information that will help in understanding a bank's risk exposures during a financial reporting period, for example on average exposures or turnover during the reporting period.
Description and findings re AC1	
<b>Assessment of Principle 28</b>	Largely compliant
<b>Comments</b>	<p>The SBP regularly publishes data on its website pertaining to the performance of the banking system. These reports provide insights into the balance sheet of the sector, performance in terms of revenue, composition of credit portfolios and a breakdown of data sets. The data is publicly accessible, granular, and contains system and individual bank data. Banks publish reports consistently, regularly and according to international standards which are publicly available. Banks publish on a solo and consolidated basis, with quarterly financial statements and semiannual and annual audited.</p> <p>The disclosure requirements are relatively comprehensive, but do not meet all aspects of this EC, specifically transactions with related parties and compensation have not been specified. In relation to compensation, the SBP has not adopted a framework for assessment of senior management remuneration (such as the principles proposed by the Financial Stability Board). The requirements specified by the SBP are uniform across all banks and are not adjusted for systemic importance. Doesn't appear to be met based on absence of Pillar III requirements. What is missing is a standardized set of reporting requirements for banks to publish materials in addition to financial statements consistent with Pillar 3 of BCBS. No publications for related party loans, LE asset quality, remuneration and D-SIBs data.</p>
<b>Principle 29</b>	<b>Abuse of financial services.</b> The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical

	and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities. <sup>73</sup>
<b>Essential criteria</b>	
<b>EC1</b>	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	<p>The legal and regulatory framework pertaining specifically to AML/CFT includes the following:</p> <ul style="list-style-type: none"> <li>• Banking Law Chapter III Prevention of Money Laundering the financing of terrorism and related crimes - Article 112 – 114 – Prevention.</li> <li>• Decision No. 5-2011 (Article 5-Internal Control System Principles; Article 6-Internal Controls System Managers; Article 7-Minimum Internal Control System Requirements; Article 8-Internal Audit and Internal Control System Monitoring)</li> <li>• Law No. 23 of 2015 on the "Adoption of Measures to Prevent Money Laundering, Terrorist Financing, and the Financing of the Proliferation of Weapons of Mass Destruction" (Article 19-Supervisory Bodies; Article 20-Powers of Supervisory Bodies, paragraph 4)</li> <li>• Decision No. 10-2015 "Prevention of the misuse of banking and trust services" (Article 37-Internal Audit)</li> <li>• Law No. 23 of 2015 on the "Adoption of Measures to Prevent Money Laundering, Terrorist Financing, and the Financing of the Proliferation of Weapons of Mass Destruction" (Article 19-Supervisory Bodies; Article 20-Powers of Supervisory Bodies, paragraph 4; Article 26-Proper Identification, Reasonable Verification, and Documentation; Article 41-Special Review; Article 42-Know Your Employee Policy; Article 49-Preventive Freezing; Article 53-Reporting of Transactions; and Article 54-Obligation to Report Suspicious Transactions)</li> </ul> <p>The regulations clearly establish the responsibility of the SBP for supervision of the banking sector's compliance with AML/CFT standards of risk management. The SBP has responsibility for different types of financial institutions with respect to ML, however this assessment focuses specifically on banks.</p>
<b>EC2</b>	The supervisor determines that banks have adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.
Description and findings re EC2	The regulation (Decision No. 10-2015) is a relatively comprehensive description of the risk management obligations of banks to prevent the abuse of financial services. The

<sup>73</sup> The Committee is aware that, in some jurisdictions, other authorities, such as a financial intelligence unit (FIU), rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and the financing of terrorism. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in Essential Criteria 7, 8 and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this Principle.

	<p>regulation applies to all banks, trusts and banking groups supervised by the SBP. The regulation clearly requires banks to have adequate policies and processes to promote high ethical and professional standards to prevent the bank from being used for criminal activities (see Article 2). Within the regulations the specific requirements that address this EC include:</p> <ul style="list-style-type: none"> <li>• Article 3-Manual for the Prevention of Money Laundering; Article 10-Minimum Due Diligence Requirements;</li> <li>• Article 29-Unusual Transactions;</li> <li>• Article 30-Suspicious Transactions;</li> <li>• Article 31-Warning Signs)</li> </ul> <p>The SBP undertakes an on-site assessment of D-SIBs and higher risk banks on an annual basis and for other banks at least every two years. Banks complete a self-assessment questionnaire which the SBP evaluates in addition to supporting documentation. On-site examinations test and verify banks' compliance with internal policies and procedures and SBP requirements.</p>
<b>EC3</b>	In addition to reporting to the financial intelligence unit or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when such activities/incidents are material to the safety, soundness or reputation of the bank. <sup>74</sup>
Description and findings re EC3	<p>There is no specific compulsion for banks to make the SBP aware of a suspicious activity or transaction when such activities/incidents are material to the safety soundness or reputation of the bank. The regulation is explicit in relation to frauds where there is a notification requirement, but not in the case of suspicious activities or transactions. In the case of electronic banking, the obligation to notify the SBP is clearly specified.</p> <p>Banks are required to report cash transaction reports (CTRs) and (STRs) to the FIU via the electronic platform. The FIU/UAF provide regular reporting to the SBP pertaining to industry trends, historical statistics on reporting volumes, data by individual bank across time horizons etc. The relevant sections of the regulations include:</p> <ul style="list-style-type: none"> <li>• Banking Law, Article 113 (Provision of Information)</li> <li>• Decision No. 6-2011 "Establishing guidelines on electronic banking and the management of related risks" (Article 11-Security Incident Reports)</li> <li>• Decision No. 10-2015 "Prevention of the misuse of banking and trust services" (Article 33-Provision of Information)</li> <li>• Circular No. 0063-2010 and Circular No. SBP-DRB-0016-2011 on the notification of fraud in electronic channels</li> </ul>
<b>EC4</b>	If the supervisor becomes aware of any additional suspicious transactions, it informs the financial intelligence unit and, if applicable, other designated authority of such transactions. In addition, the supervisor, directly or indirectly, shares information related to suspected or actual criminal activities with relevant authorities.
Description and findings re EC4	The regulations require the SBP to inform the FIU if they become aware of a STR (see Decision No. 10-2015 Article 32-Notification to the Financial Analysis Unit). The SBP

<sup>74</sup> Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and the financing of terrorism to the relevant national centre, established either as an independent governmental authority or within an existing authority or authorities that serves as an FIU.

	confirmed this is undertaken when on-site or if it becomes aware of a suspicious activity or transaction. Routine meetings with the FIU further reinforce this level of coordination and sharing of information.
<b>EC5</b>	<p>The supervisor determines that banks establish CDD policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the bank's overall risk management and there are appropriate steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management program, on a group-wide basis, has as its essential elements:</p> <ul style="list-style-type: none"> <li>(a) a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks;</li> <li>(b) a customer identification, verification and due diligence program on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant;</li> <li>(c) policies and processes to monitor and recognize unusual or potentially suspicious transactions;</li> <li>(d) enhanced due diligence on high-risk accounts (e.g., escalation to the bank's senior management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk);</li> <li>(e) enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank's senior management level of decisions on entering into business relationships with these persons); and</li> <li>(f) clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five-year retention period.</li> </ul>
Description and findings re EC5	<p>According to the regulation (No.10-2015) banks are obligated to develop and implement CDD. Article 9 states that "regulated entities must maintain risk-based due diligence on their individual customers and their resources subject to the contractual relationship, whether customary or temporary, regardless the amount of the transaction, and to maintain that due diligence current during the course of the transaction." Article 3 of the regulation requires the policies and processes being contained within a manual that is approved by the Board on a frequent basis and that this manual is disseminated to all staff. In this way the regulations are sufficiently documented and communicated throughout the bank.</p> <p>The regulation also stipulates the need to undertake enhanced due diligence based on certain criteria, characteristics. A warning system also needs to be in place to automatically detect unusual transactions in addition to the manual identification by staff.</p> <p>In terms of the supervisory activity to assess the effective implementation of bank CDD policies and processes, the SBP undertakes a range of activities:</p> <ul style="list-style-type: none"> <li>• Off-site – analysis of self-assessment questionnaire with associated documentation;</li> </ul>

	<ul style="list-style-type: none"> <li>• On-site – sampling of files, transaction reports, monitoring systems, reporting to ML committee, meetings with staff and compliance officer responsible for ML; review of reporting to committees and board reporting;</li> <li>• Supervisory Colleges – inputs of assessments from home and host supervisors;</li> <li>• Routine meetings with the UAF – the SBP regularly meets with the UAF.</li> </ul> <p>The SBP undertakes both off-site and on-site supervision activities using a risk-based rating methodology.</p> <p>The law and regulations have dedicated standards. Law No. 23 of 2015 on the "Adoption of Measures to Prevent Money Laundering, Terrorist Financing, and the Financing of the Proliferation of Weapons of Mass Destruction" (Article 26-Proper Identification, Reasonable Verification, and Documentation; Article 27-Basic Customer Due Diligence Measures for Natural Persons; Article 28-Basic Customer Due Diligence Measures for Legal Persons; Article 40-Design of Controls for the Application of Preventive Measures with a Risk-Based Approach)</p> <p>Specifically in relation to the sections of the EC, the regulations are as follows:</p> <ul style="list-style-type: none"> <li>(a) Law -Article 36-Prohibition of Establishing a Relationship or Carrying Out a Transaction), Regulation 10-2015 Articles 3, 10, 14, 15, and 16</li> <li>(b) Law No. 23 of 2015 Article 26-Proper Identification, Reasonable Verification, and Documentation; Article 27-Basic Customer Due Diligence Measures for Natural Persons; Article 28-Basic Customer Due Diligence Measures for Legal Persons; Article 38-Know the Nature of the Customer's Business; Article 39-Continuous Monitoring of the Business Relationship; Article 40-Design of Controls for the Application of Preventive Measures with a Risk-Based Approach). Decision No. 10-2015 (Articles 6, 9, 10, 14, 15, 16, 19, 25, and 26)</li> <li>(c) Law No. 23 of 2015 (Article 54-Obligation to Report a Suspicious Transaction). Decision (Articles 29, 30, and 31)</li> <li>(d) Law No. 23 of 2015 Article 34-Expanded Client Knowledge Under the Politically Exposed Person Classification. Decision No. 10-2015 (Article 23)</li> <li>(e) Law No. 23 of 2015 Article 34-Expanded Client Knowledge Under the Politically Exposed Person Classification. Decision No. 10-2015 (Article 22).</li> <li>(f) Law No. 23 of 201 Article 29-Updating of Records and Their Protection. Decision No. 10-2015 (Article 25).</li> </ul>
<b>EC6</b>	<p>The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes include:</p> <ul style="list-style-type: none"> <li>(a) gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and</li> <li>(b) not establishing or continuing correspondent relationships with those that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.</li> </ul>

Description and findings re EC6	<p>The regulation (Decision No. 10-2015) Articles 7 and 8 stipulate the requirements for risk management associated with correspondent bank relationships. Banks are required to implement risk management commensurate with the risk profile of the operation or transaction. Importantly, the regulation has a strict prohibition that banks cannot establish or maintain any type of interbank or correspondent bank relationship that does not have a physical presence in their home jurisdiction or are not a member of a financial group subject to consolidated supervision. The regulations prescribe due diligence for correspondent relationships.</p> <p>The SBP undertakes on-site and off-site supervision which includes testing and verification of due diligence for correspondent relationships. The supervisory manual includes activities that the SBP will undertake when on-site (see MUSBER: Annex 14.1 FEPLABAN). The self-assessment questionnaire also has sections related to due diligence (see Questions 16, 42, 43, 44, 45, 46, 47, 48, and 49).</p>
<b>EC7</b>	The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.
Description and findings re EC7	<p>The Law (Law No. 23 of 2015) and the regulation (Decision No. 10-2015) set out the requirements for banks to implement policies and practices to prevent, identify and report potential abuses of financial services. The SBP conducts on-site examinations to test and verify the adequacy of internal controls and compliance with policies, including compliance with SBP requirements. The on-site assessments sample customer files to assess processes for customer due diligence and adherence to banks' internal policies and to the SBP's regulations. The SBP will undertake an assessment of the minutes of the ML Committee and reporting as well as governance of policy reviews. The SBP will sample STR reports and assess the bank's internal processes to identify high risk customers, the metrics used to determine high risk transactions and internal systems.</p> <p>To complement the periodic on-site examinations, the SBP issues a questionnaire annually for banks to self-assess against a range of topics including AML/CFT. Banks are asked to evidence their responses which provides the SBP data and qualitative information to routinely assess to the adequacy of controls and systems. The SBP regular meets with the UAF to discuss individual banks' reporting of STRs and market information that is used as an input into SBPs assessment of banks' risk management.</p>
<b>EC8</b>	The supervisor has adequate powers to take action against a bank that does not comply with its obligations related to relevant laws and regulations regarding criminal activities.
Description and findings re EC8	The Law No. 23 of 2015 Article 20-Powers of Supervisory Bodies, paragraph 5 provides the SBP powers to take actions against banks. Article 59-Criterion for Imposing Penalties is also relevant and Article 60-Generic Penalties. In addition, the regulation (Decision No. 10-2015) Article 39-Penalty for Noncompliance, states "Without prejudice of the penalties prescribed in Law 23 of 2015 whereby measures to prevent money laundering, the financing of terrorism and financing the proliferation of weapons of mass destruction are adopted, failure to comply with the provisions herein will be punishable by the Superintendent with a penalty of from five thousand balboas (B/.5,000.00) to one million balboas (B/.1,000,000.00), according to the seriousness or recidivism of the fault."

	There is another regulation which further augments the SBP's powers to apply sanctions if banks do not comply with obligations under the Act or regulations - Decision No. 9-2015 "Administrative procedure for possible violations of provisions on the prevention of money laundering, terrorist financing, and financing of the proliferation of weapons of mass destruction" The penalties for violating prevention regime rules are published on the Superintendency's website - <a href="https://www.superbancos.gob.pa/es/sanciones">https://www.superbancos.gob.pa/es/sanciones</a>
<b>EC9</b>	<p>The supervisor determines that banks have:</p> <ul style="list-style-type: none"> <li>(a) requirements for internal audit and/or external experts <sup>75</sup> to independently evaluate the relevant risk management policies, processes and controls. The supervisor has access to their reports;</li> <li>(b) established policies and processes to designate compliance officers at the banks' management level, and appoint a relevant dedicated officer to whom potential abuses of the banks' financial services (including suspicious transactions) are reported;</li> <li>(c) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship; and</li> <li>(d) ongoing training programs for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities.</li> </ul>
Description and findings re EC9	<p>The regulation has specific requirements for the role of internal audit to provide assurance regarding the effectiveness of internal controls. The SBP meets with the IA function as part of the on-site examination. It receives reporting to the BAC and review BAC minutes.</p> <ul style="list-style-type: none"> <li>(a) Law No. 23 of 2015 Article 45-Independent Evaluation. Decision No. 10-2015 Article 37-Internal Audit.</li> <li>(b) Law No. 23 of 2015 on the "Adoption of Measures to Prevent Money Laundering, Terrorist Financing, and the Financing of the Proliferation of Weapons of Mass Destruction" (Article 12-Linkage). Decision No. 10-2010 Article 30.</li> <li>(c) Law No. 23 of 2015 Article 42-Know Your Employee Policy. Decision No. 10-2015 Article 27.</li> <li>(d) Law No. 23 of 2015 (Article 42-Know Your Employee Policy; Article 47-Duty to Train). Decision No. 10-2015 Article 28-Duty to Train Employees.</li> </ul>
<b>EC10</b>	The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilize adequate management information systems to provide the banks' Boards, management and the dedicated officers with timely and appropriate information on such activities.
Description and findings re EC10	The legal framework (Law No. 23 of 2015) contains provisions for banks to have policies and processes. The regulation (Decision No. 10-2015) requires staff to be trained and policies communicated to staff including requirements for prevention. SBP verifies training

<sup>75</sup> These could be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	undertaken at banks and the implementation of staff policies for awareness of AML procedures.
<b>EC11</b>	Laws provide that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.
Description and findings re EC11	Law No. 23 of 2015 Article 54-Obligation to Report a Suspicious Transaction; Article 56-Exemption from Criminal and Civil Liability; Article 57-Protection and Suitability of Employees, Managers, and Agents). Decision No. 10-2015 "Prevention of the misuse of banking and trust services" (Article 35-Protection of Employees, Managers, and Agents)
<b>EC12</b>	The supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities or shares with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings re EC12	<p>In terms of domestic coordination, the SBP coordinates with the UAF. The SBP participates as a Joint Task Force member, together with the Public Prosecutor's Office of Panama, to support prosecutors through training on matters relating to banking products, services, and operations to strengthen their knowledge and clarify doubts so as to allow them to advance in their investigations. Meetings have been organized between prosecutors and representatives of the banking sector to expedite the delivery of information requested by the Public Prosecutor's Office as part of ongoing investigations. As a result of Joint Task Force meetings, the SBP conducted special inspections to delve into specific aspects related to their investigations.</p> <p>The SBP signed Memoranda of Understanding with 29 foreign supervisors. The SBP signed Institutional Memoranda of Understanding to take joint action with some local supervisory agencies and other institutions that participate in the fight against criminal activities related to money laundering and terrorist financing. The memoranda of understanding or interinstitutional agreements signed are detailed below:</p> <ul style="list-style-type: none"> <li>• Interinstitutional Agreement between the Ministry of Trade and Industry and the Superintendency of Banks (May 2017), whose objective is to adopt reciprocal technical assistance and joint action between parties with the aim of strengthening the regime for the prevention of money laundering, terrorist financing, and the financing of the proliferation of weapons of mass destruction.</li> <li>• Interinstitutional Agreement between the Superintendency of Nonfinancial Entities Subject to Supervision and the Superintendency of Banks (November 2018), whose objective is to adopt cooperation and collaboration measures that facilitate risk-based supervision with the aim of strengthening the regime for the prevention of money laundering, terrorist financing, and the financing of the proliferation of weapons of mass destruction.</li> <li>• Interinstitutional Cooperation Agreement between the Superintendency of Banks, the Ministry of Trade and Industry, and the Public Prosecutor's Office for matters of ML/TF/FPWMD Prevention (February 2020), whose objective is to issue joint action between parties to determine which companies are conducting remittance activities illegally and initiate the corresponding corrective processes.</li> <li>• Interinstitutional Agreement between the Superintendency of the Stock Market of Panama and the Superintendency of Banks of Panama (March 2022), whose objective</li> </ul>



	is to unify efforts through mutual collaboration between parties to carry out the supervisory function for the prevention of money laundering, terrorist financing, and the financing of the proliferation of weapons of mass destruction of retirement and pension fund administrators and retirement and pension funds.
<b>EC13</b>	Unless done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities. In this case, the supervisor regularly provides information on risks of money laundering and the financing of terrorism to the banks.
Description and findings re EC13	The SBP has an annual inspection plan that includes the banking entities that will be inspected during the current year. All banks are inspected at least once every two years. However, systemic banks are inspected every year. The SBP has an annual training program that includes all entities subject to supervision. The SBP has a team of specialists dedicated to prevention. Resources are assessed as adequate.
<b>Assessment of Principle 29</b>	Largely Compliant
Comments	<p>The regulations clearly establish the responsibility of the SBP for supervision of the banking sector's compliance with AML/CFT standards of risk management. The SBP has responsibility for different types of financial institutions with respect to AML, however this assessment focuses specifically on banks. The SBP undertakes on and off-site activities to test and verify banks' compliance with SBP requirements. The SBP routinely liaises with the UAF exchanging data relevant to the supervision of banks. Panama's grey listing by FATF has helped make this risk a high priority for the SBP. Data shared with the SBP on STR reporting was found to be extensive and frequent. Issues are routinely followed up between the two agencies which demonstrated good cooperation.</p> <p>EC4 partially met. Notification requirements for internal fraud and technology but not suspicious activity. The EC requires if the supervisor becomes aware of any additional suspicious transactions, it informs the financial intelligence unit and, if applicable, other designated authority of such transactions. In addition, the supervisor, directly or indirectly, shares information related to suspected or actual criminal activities with relevant authorities. Because of the potential reputation risk to individual banks and the banking system, the need for immediate notification is perceived as significant for this assessment.</p>

**Table 2. Panama: Summary Compliance with the Basel Core Principles—Detailed Assessments**

Core Principle	Grade	Comments
1. Responsibilities, objectives, and powers	MNC	<p>The legal framework provides the SBP, as sole regulator of banks and banking groups in Panama, with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness.</p> <p>The Banking Law sets out the SBP's four separate objectives, which have equal status</p>

Core Principle	Grade	Comments
		<p>in the Law. These include two objectives, namely safeguarding the soundness and efficiency of the banking system and strengthening and fostering the Republic of Panama as an international financial sector, which have the potential to conflict with each other. The SBP's primary objective should be to safeguard the soundness of the financial system, with the remaining three objectives subordinate to this objective. The remaining two objectives, namely promoting trust in the banking system and safeguarding the judicial balance between the banking system and its clients, do not pose a potential conflict with the SBP's safety and soundness objective.</p> <p>The SBP consults on all material changes to its regulatory framework, but timelines for responses are short (usually one month).</p>
2. Independence, accountability, resourcing, and legal protection for supervisors	MNC	<p>Although Article 4 of the Banking Law established the SBP with full legal status as an autonomous agency of the government, including administrative, budgetary, and financial independence, this autonomy has been significantly constrained following the passing of consecutive annual Budget Laws since 2019. Since the passing of the 2019 Law, all recruitment and other personnel decisions that have a budgetary impact need to be pre-approved by the relevant state institutions. Prior to 2019, the SBF had only to notify the MEF of its recruitment and other budgetary expenditure. Delays in getting approval for the initiation of new recruitments have given rise to the high level of current vacancies in the SBP.</p>
3. Cooperation and collaboration	C	<p>The Banking Law provides the SBP with appropriate powers to establish cooperation links with all domestic and foreign regulatory authorities, and MoUs, both bilateral and multilateral, have been agreed with all relevant authorities. The Banking Law also enshrines strict confidentiality requirements</p>

Core Principle	Grade	Comments
		on information received in the course of supervisory activities. Recent MoUs have included full confidentiality clauses, and these should be incorporated in all MoUs when updated.
4. Permissible activities	C	The permissible activities of institutions that are licensed and subject to supervision by the SBP as banks are clearly defined and the use of the word "bank" in names is controlled.
5. Licensing criteria	C	The SBP's approach to licensing banks is thorough. The legal framework provides the SBP with the necessary powers to set criteria and reject applications from applicants that do not meet those criteria. The process involves discussions with applicants at an early stage to assess the viability of the application, and detailed assessment as the application proceeds of the ownership structure, fitness and propriety of Board members and senior management, financial viability of the proposal and of the proposed corporate governance arrangements. Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
6. Transfer of significant ownership	MNC	The definitions of significant ownership and change of control are clearly set out in the Banking Law. A threshold of 25 percent is set for pre-approval by the SBP of transfers of significant ownership or controlling interests held directly or indirectly in existing banks to other parties. The transfer of any shares in banks below this 25 percent pre-approval threshold must be notified by the bank in advance. The SBP has no power to reverse a share transaction or remove voting rights if a transfer of significant ownership were undertaken without prior approval or based on misleading information.
7. Major acquisitions	MNC	The SBP has the power to approve or reject major acquisitions or investments by banks or

Core Principle	Grade	Comments
		banking groups above a threshold of 25 percent of capital. There is no requirement in law or in regulations for banks or banking groups to notify of any acquisition or investment below this threshold of 25 percent of capital. This hinders particularly the SBP's ability to assess risks that acquisitions of or investments in non-banking activities may pose to a banking group.
8. Supervisory approach	LC	<p>The SBP's supervisory framework provides an effective methodology for assessing the risks that banks are running at the time of the assessment, but there is limited consideration within the methodology of the future risks a bank or banking group may run. The methodology includes a review of a bank's strategic plan within the Governance (G) component of the framework, and discussions on the strategic plans are held with management during on-site inspections. The SBP requires banks periodically to stress their capital adequacy requirements, but this process is not systematically built into the supervisory framework. The SBP has drafted a framework for an Internal Capital Adequacy Assessment Process (ICAAP) but has set no timeline for implementation. When in place, the ICAAP would provide the SBP with useful data on a bank's forward-looking risk profile and capital needs. Proposals to roll out implementation of the ICAAP should be incorporated within the SBP's strategic plan. As noted in BCP9, regular engagement with Board members and heads of the key control functions is not built into the supervisory framework. Such meetings complement the forward-looking assessment of risk, providing useful insight into developments and challenges in implementing the bank's strategic plan, and on any strains that</p>

Core Principle	Grade	Comments
		expected growth may be placing on the risk and internal control framework within a bank.
9. Supervisory techniques and tools	LC	<p>The SBP employs an effective range of examination techniques and tools to support its supervisory processes and approach. On-site and off-site monitoring is integrated within supervisory departments, and multiple bank-specific and macro-economic analyses are taken into consideration in scoping and conducting examinations. Supervisory planning is thorough and structured, with detailed processes set out in the supervisory manual (MUSBER). The examination program is risk-based, ranging from full scope inspections to targeted reviews. All banks must have a full scope inspection at least every two years. The risk assessment process involves reviews of regulatory reports, financial statement and accounts, business model analysis and horizontal peer reviews. Findings are communicated to banks in a timely fashion, with clear deadlines set for remedial action. Mandated corrective actions are monitored in quarterly updates and follow-up on-site examinations are conducted where necessary.</p> <p>Bank internal management information is reviewed during on-site examinations but is not requested from banks as a matter of routine supervisory practice, and regular meetings with the heads of material business units, finance and control functions do not form part of the SBP's supervisory plans. Greater use of internal management information and more frequent engagement with bank senior management would enhance the SBP's risk assessment of banks and inform the planning of future supervisory inspections. (See BCP 8.)</p>
10. Supervisory reporting	LC	The SBP collects and analyzes a wide range of prudential reports from banks on both a solo

Core Principle	Grade	Comments
		and a consolidated basis, but the reports do not cover consolidated liquidity returns, the wider concentration risks that banks or banking groups may run (e.g., geographic, sectoral, currency), or a bank or banking group's exposure to interest rate risk in the banking book. Verification of the accuracy of the data within the reports submitted by banks is undertaken by supervisors through on-site examinations, but the timing of such examinations is periodic and not systematic, and there is no regulation requiring the prudential reports to be signed-off by an appropriate level of the bank's senior management certifying their accuracy.
11. Corrective and sanctioning powers of supervisors	LC	Although the SBP does not have a formal resolution regime, it has demonstrated through its actions that it has an adequate range of supervisory tools at its disposal to address concerns identified in banks and the ability to revoke banking licenses. The actions include dismissing Board and senior management, forcing mergers, and assuming control of a distressed bank. The SBP does not, however, have the specific power to ringfence a bank from the actions of wider group entities which may impair its safety and soundness.
12. Consolidated supervision	C	The legal and regulatory framework for conducting consolidated supervision is robust and, through its supervisory processes and practice, the SBP has a good understanding of the overall structure of banking groups and of their material activities (including non-banking activities), both domestic and cross-border. The SBP applies most prudential standards to consolidated entities but does not collect any data on the consolidated liquidity positions of banking groups - See BCPs 10 and 24). However, since August 2020, the liquidity of all regional financial groups has been

Core Principle	Grade	Comments
		monitored weekly at the Technical Liaison Committee level of the CCSBSO, both in local currency and in foreign currency.
13. Home-host relationships	LC	The SBP has agreed bilateral MoUs with all foreign regulators of banking groups with cross-border activities and holds periodic colleges of regulators meetings with relevant host regulators to share information and cooperate. The SBP is also a key participant in multilateral college meetings under the umbrella of the CCSBSO. The CCSBSO provides an effective forum for sharing information and cooperation between the various authorities and the Liaison and Resolution and Crisis Committees established under the CCSBSO provide a useful channel for coordination on weak banks. However, these meetings do not specifically consider resolution plans for distressed banks.
14. Corporate governance	LC	The SBP has a comprehensive regulation covering the corporate governance arrangements in banks and banking groups, and monitors compliance with the regulation through regular on- and off-site supervisory approaches. The supervisory assessment is tailored to the risk profile and systemic importance of the entity and covers, inter alia, Board and senior management recruitment, responsibilities and compensation, the effectiveness of the risk and internal control functions, and whether the organizational structure presents any hindrance to effective consolidated supervision. However, outside the on-site inspection, the SBP has limited engagement with Board members or senior management within a bank. This lack of dialogue constrains the authority's ability to maintain an ongoing understanding of the bank's strategic direction, group and organizational structure and control environment.

Core Principle	Grade	Comments
15. Risk management process	MNC	<p>While the regulations are generally comprehensive, there are several areas that need to be developed: (i) There is no regulation which stipulates a comprehensive approach to stress testing where all risks are considered against an assessment of capital and liquidity. The individual risk areas include requirements for stress testing, though scope for improvement exists; (ii) There is no regulation for banks to undertake recovery planning; (iii) There is no explicit provision in the regulation for a bank to notify the SBP if the CRO is removed. An area where there is scope to improve the assessment of all materials risks and capital strength is the ICAAP framework. The SBP plans to implement this process in the near-term future. The ICAAP would contribute to a structured approach to the assessment of all material risks on an individual bank basis including the results of stress testing which would inform the assessment of the adequacy of capital. In terms of supervisory practice, there is a lack of routine contact with the Board. Implementation of an ICAAP and Internal Liquidity Adequacy Assessment Process (ILAAP) would help structure an assessment of all material risks. Weaknesses in stress testing are evident in other Principles (e.g., market risk - CP22 and IRRBB - CP23). We have consolidated the grading into CP 15 to avoid double counting. While a differentiated approach to supervising D-SIBs has been implemented, the calibration against capital and liquidity is not explicitly mentioned in the regulations and it is not evidenced that D-SIBs are subject to higher capital and liquidity requirements reflecting their risk profile, size, scale, complexity and systemic importance. Reflecting these material weaknesses, an MNC rating is appropriate.</p>



Core Principle	Grade	Comments
16. Capital adequacy	MNC	<p>The capital framework is largely aligned with the Basel III Accord. Definitions of capital, thresholds, calibration of risk-weighted assets and deductions are equivalent to the Basel standards. While the SBP has developed and implemented a differentiated approach to supervising D-SIBs, the capital framework has not been changed, e.g., a systemic risk buffer has not been implemented. A further deviation from the Basel Capital Framework is that no formal buffer framework (as envisaged by Basel III such as the capital conservation buffer and countercyclical buffer) has not been implemented. In this regard, internationally active banks are not meeting the Basel capital standards (EC2) which is a material deviation from the requirements of this Principle. There is scope to deepen the assessment of capital adequacy to include a broader range of risks (mainly Pillar II risks). A comprehensive assessment of capital and all material risks was not evidenced such as: (i) the potential loss absorbency of the instruments included in the bank's capital base, (ii) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (iii) the adequacy of provisions and reserves to cover loss expected on its exposures and (iv) the quality of its risk management and controls. The implementation of the ICAAP will help support the annual assessment of all material risks across banks and of integrated risk management across the entire bank with qualitative and quantitative inputs and the use of stress testing.</p>
17. Credit risk	C	<p>The SBP has a strong focus on credit risk management. Off-site analysis occurs on a frequent basis using a comprehensive suite of indicators and data points. Banks report detailed credit information relating to the counterparty, valuations of collateral, loan-</p>

Core Principle	Grade	Comments
		to-value ratios, details regarding serviceability, vintage, loan type, region, geography etc. Using this information, the SBP undertakes analysis on an individual bank basis and across the sector to identify early vulnerabilities, build-up in credit risks and outliers. The on-site examination samples files from a range of portfolios, and loan files are tested and verified for compliance with banks' internal policies and the SBP's regulations. The regulations consist of a detailed suite of risk management for risk governance and risk management. The regulations emphasize, amongst other things: segregation of duties, governance, delegations, the three lines of defense, appropriate due diligence to assess serviceability and collateral management.
18. Problem assets, provisions, and reserves	C	The regulations are generally sound and require banks to classify all on- and off-balance sheet exposures using a prescribed framework. Guidance for classifying loans is extensive and reporting to the supervisor is extensive and frequent. On-site, the SBP focuses on the appropriate classification of loans, handling of problem assets and the calculation of provisioning. Guidance surrounding collateral valuation is extensive and there is a prescribed set of eligible collateral types for provisioning.
19. Concentration risk and large exposure limits	LC	The SBP has implemented a framework for credit concentration risk and large exposure limits. The regulations require that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of credit risk on a timely basis, reported on a monthly and quarterly basis. The SBP sets prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties of 25 percent total capital. The SBP undertakes extensive analysis to assess

Core Principle	Grade	Comments
		<p>concentration risk based on detailed reporting.</p> <p>The regulations for concentration risk are focused predominantly on management of credit-related exposures. However, this Principle envisages a comprehensive view of significant sources of concentration risk (such as market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies). Analysis undertaken by supervisors is detailed in respect of large exposures and credit concentration risks, but a broader definition is needed together with data and supervisory processes.</p>
20. Transactions with related parties	LC	<p>The SBP receives a comprehensive suite of regulatory reporting pertaining to related party exposures. Banks are required to have policies and processes to identify individual exposures with related parties, the definition of which is expansive. The regulation contains several prohibitions to ensure banks enter into related party exposures on an arm's length basis. The regulations are not sufficiently comprehensive in terms of the following: (i) The requirement for material related party exposures to be monitored and reported to the Board; (ii) Expansion of the definition of exposures to be more than credit-related (such as service contracts); (iii) Need for Board approval to write-off; (iv) Notification to the SBP when a material related party exposure has been entered into. The regulations allow banks discretion to set thresholds for board approval of a related party transaction (EC5).</p>
21. Country and transfer risks	C	<p>Regulations are comprehensive , except for the absence of stress testing (see EC5) and on-site and off-site activities are robust.</p>
22. Market risk	C	<p>The regulation sets out minimum standards for market risk management and the necessary policies and processes. Banks must</p>

Core Principle	Grade	Comments
		identify and appropriately manage the market risks they run, and the Board of Directors has primary responsibility to establish policies and procedures and identify these risks. The measurement and management tools most commonly used by banks in the market are: concentration limits, loss limits, Value at Risk (VaR) limits, rating limits, and sensitivities to movements in interest rates. This information is reported by the banks' Risk Units at the meetings of the Risk Committee and Board of Directors. Exposure to market risk is de minimis in terms of the proportion of total income derived from trading and in terms of market risk weighted assets.
23. Interest rate risk in the banking book	MNC	The regulatory framework has not been updated to include IRRBB, instead guidance remains in draft form. The draft guidance is closely aligned with the BCBS frameworks (2016) and the SBP plans to formalize the draft in due course. There is a reliance on on-site examinations to assess exposure to IRRBB. Off-site reporting is not adequate and therefore problematic in terms of ongoing surveillance for risks to net interest income (NII) and capital. There are no specific stress testing requirements. The SBP does not receive routine reporting on IRRBB. The lack of a dedicated reporting format inhibits the off-site analysis process and consideration for impacts on the business model and capital adequacy.
24. Liquidity risk	MNC	Supervision of liquidity risk is not undertaken on a consolidated basis. For example, the LCR is calculated and reported on a Level 1 basis and not Level 2 or group wide. As a result, material subsidiaries are omitted from the calculation. In relation to offshore bank operations, the SBP places reliance on the host supervisor to set liquidity limits and to ensure compliance with liquidity requirements and risk management standards. Liquidity needs of domestic non-

Core Principle	Grade	Comments
		bank subsidiaries are not captured in LCR reporting. As a result, a consolidated view of group-wide liquidity is not achieved. The lack of a consolidated approach impairs both liquidity supervision and the effectiveness of consolidated supervision but the issue is only reflected in the grade of CP 24 to avoid double jeopardy.
25. Operational risk	C	Comprehensive regulations provide a solid foundation for a bank's management of its operational risks. The regulations are specific in terms of requiring elements of the governance framework for the Board of Directors (BoD) to be responsible for setting a risk appetite and for key risk indicators (KRIs) to be developed as forward-looking indicators. In terms of governance, board reporting is via the risk committee. The SBP dedicates time during on-site examinations to review the adequacy of reporting and identifies weaknesses. Capital is calculated using the basic indicator approach. Banks collect loss data that is included in their risk measurement and monitoring. Responsibilities for contingency planning are clearly described in the regulations. A specific requirement in the regulations to keep the SBP apprised of developments affecting operational risks is nonetheless warranted.
26. Internal control and audit	C	The regulations stipulate the need for banks to establish an appropriate control environment and audit arrangements. Governance arrangements are established for audit committees to oversee compliance and internal controls to ensure compliance with prudential requirements. As part of on-site examinations (and follow-up examinations/processes), the SBP dedicates considerable attention to line 2 (compliance and back-office staff) and Internal Audit (IA) (line 3). Given on-site examinations involve

Core Principle	Grade	Comments
		extensive teams across multiple weeks and themes, there is a wide range of opportunities for the SBP to gain insights into the quality, resourcing independence and effectiveness of compliance and IA functions within the banks.
27. Financial reporting and external audit	LC	<p>All banks apply IFRS and thus meet international standards for accounting treatment. The SBP has not implemented a framework for prudential valuations such as promulgated by the BCBS (CAP50 in the Basel Framework). Regulations issued by the SBP set out a comprehensive set of requirements for banks' Board and senior management to be responsible for preparing financial statements that adhere to international accounting standards.</p> <p>More frequent and periodic contact with the external auditor (EA) is needed to discuss the scope of the audit, main findings and seek their views in terms of: vulnerabilities, risk management standards and opinion on the soundness of internal controls. Only by exception does the EA report to the SBP. The SBP does not have the power to establish the scope of external audits. The engagement is typically between the bank and the EA. Informally the SBP has the ability to influence and can demonstrate examples, especially recently in relation to the Pandemic where loan moratoria were made law by the Government. There is a need for the SBP to have a power to require the external auditor to report to the SBP any material issues directly. Currently, the external auditor will report via the bank and not directly.</p>
28. Disclosure and transparency	LC	Disclosure requirements are uniform across all banks and not adjusted for systemic importance. The Basel Pillar III framework has not been implemented and, as a result, not all disclosure requirements in this Principle have been implemented. Absent is a standardized

Core Principle	Grade	Comments
		set of reporting requirements for banks to publish a full range of qualitative materials in addition to financial statements. Examples of qualitative data include: related party exposures, Large Exposures, executive remuneration and higher standards for D-SIBs.
29. Abuse of financial services	LC	No explicit notification requirement to the SBP if a bank becomes aware of a suspicious activity that could threaten its safety and soundness.

## RECOMMENDED ACTIONS AND AUTHORITIES' COMMENTS

### A. Recommended Actions

<b>Table 3. Panama: Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks</b>	
<b>Reference Principle</b>	<b>Recommended Action</b>
Principle 1	<ul style="list-style-type: none"> <li>• Amend the Banking Law to make explicit that the SBP's primary objective should be to promote safety and soundness.</li> <li>• Establish a bilateral agreement between the SBP and IPACO-OP to formalize co-ordination and data-sharing arrangements between the two authorities.</li> <li>• Review the current approach to consultation against international practice to ensure that it involves meaningful engagement with stakeholders and that respondents are given sufficient time to prepare responses.</li> </ul>
Principle 2	<ul style="list-style-type: none"> <li>• Amend the current Budget Law to restore the SBP's independence of action in respect of budgetary issues.</li> </ul>
Principle 3	<ul style="list-style-type: none"> <li>• Update existing MOUs with a clause that covers the issue of disclosure of confidential information received from other regulators</li> </ul>
Principle 6	<ul style="list-style-type: none"> <li>• Introduce a regulation that provides the SBP with the power to modify, reverse or otherwise address a change of control that has taken place without the necessary approval.</li> <li>• Consider introducing a threshold below the 25 percent pre-approval level at which immediate notification to the SBP of transfers of bank ownership is required.</li> </ul>
Principle 7	<ul style="list-style-type: none"> <li>• Introduce a threshold below the 25 percent pre-approval level at which immediate notification to the SBP is required after an acquisition or investment is made.</li> </ul>
Principle 8	<ul style="list-style-type: none"> <li>• Introduce regular meetings with the Board and heads of finance and control functions into the supervisory process.</li> <li>• Request regular submission of key internal management information (e.g., Internal Audit and Risk Committee reports) as part of the supervisory process to inform the ongoing risk assessment of banks and banking groups.</li> </ul>
Principle 10	<ul style="list-style-type: none"> <li>• Introduce reporting requirements capturing consolidated liquidity positions</li> </ul>



	<ul style="list-style-type: none"> <li>• Introduce reporting requirements capturing wider concentration risks run by banks and banking groups (e.g., geographic, sectoral, currency)</li> <li>• Introduce reporting requirements capturing interest rate in the banking book</li> <li>• Require regulatory reports to be signed off by a senior manager of the bank to verify their accuracy.</li> </ul>
Principle 11	<ul style="list-style-type: none"> <li>• Introduce the power to ring fence a bank from the actions of wider group actions which may impair its safety and soundness.</li> <li>• Consider introducing a Resolution Framework.</li> </ul>
Principle 15	<ul style="list-style-type: none"> <li>• Introduce an integrated approach to risk management in the assessment of all material risks against a bank's capital strength and liquidity</li> <li>• Introduce an integrated approach to stress testing for all material risks</li> <li>• Schedule more frequent and routine meetings with members of the Board of Directors</li> <li>• Amend the regulations to include notification to the SBP in the event a CRO is dismissed</li> </ul>
Principle 16	<ul style="list-style-type: none"> <li>• Introduce a capital buffer framework for internationally active banks aligned with that prescribed in the Basel III capital standards.</li> <li>• Introduce the ICAAP to help support a structured approach to a capital assessment, SREP and Pillar II.</li> </ul>
Principle 19	<ul style="list-style-type: none"> <li>• Expand the definition of concentration risk in the regulations to include all sources of concentration risk.</li> <li>• Include the requirement for stress testing of all material sources of concentration risk</li> </ul>
Principle 20	<ul style="list-style-type: none"> <li>• Amend the regulation to require Board approval of related party exposures and for Board approval to write-off.</li> </ul>
Principle 23	<ul style="list-style-type: none"> <li>• Formalize the regulations for IRRBB.</li> <li>• Integrate IRRBB into the assessment of capital adequacy.</li> </ul>
Principle 24	<ul style="list-style-type: none"> <li>• Undertake consolidated supervision of liquidity risk.</li> <li>• Expand the LCR reporting to a consolidated level.</li> </ul>
Principle 25	<ul style="list-style-type: none"> <li>• A specific requirement in the regulations to keep the SBP apprised of developments affecting operational risks is warranted.</li> </ul>
Principle 27	<ul style="list-style-type: none"> <li>• Amend regulations to include the scope to influence the external audit.</li> <li>• More regular engagement with EA.</li> </ul>

Principle 28	<ul style="list-style-type: none"> <li>• Introduce BCBS's Pillar III disclosure requirements.</li> </ul>
Principle 29	<ul style="list-style-type: none"> <li>• Strengthen regulation to notify the SBP if a bank becomes aware of a suspicious activity that could threaten the safety and soundness of banks.</li> </ul>

## B. Authorities' Response to the Assessment

**61. Panamanian authorities, including the Ministry of Economy and Finances, Superintendency of Banks of Panama, Superintendency of the Securities Market, Superintendency of Insurance and Reinsurance, FAU, and others, thank the FSAP mission for the time invested and dedication during the assessment of the Basel Core Principles, led by the International Monetary Fund and the World Bank.** The discussions and meetings, both face-to-face and virtual, proved highly beneficial for both parties.

**62. Since the last assessment in 2012, banking regulation and supervision in Panama have shown progress consistent with previous recommendations.** This progress is geared towards further enhancing the soundness and stability of the International Banking Center.

**63. The financial authorities of Panama value the recommendations outlined in this report and commit to making the necessary efforts to implement most of them.** Nonetheless, it is crucial to underscore additional considerations.

**64. Regarding Principle 1, it is important to emphasize that the primary objective of the Superintendency of Banks of Panama (SBP) is not to promote the International Banking Center (IBC), but rather to strengthen our country by fostering and adopting international standards in financial regulation, maintaining financial stability, and protecting depositors' money.** This commitment is evident in its strategic plans, including the 2015-2019 plan, which prioritized improvements in internal processes, technology, and human resources, as well as the modernization of the regulatory framework and the enhancement of risk-based supervision. The 2020-2024 strategic plan continues this dedication, with a focus on enhancing supervisory actions, maintaining an updated regulatory framework, strengthening the organization, and advancing institutional projects. The SBP's core objective remains the preservation of the stability and efficiency of the financial system, and it actively participates in activities of multilateral organizations such as the IMF and meetings of supervisors.

**65. With regard to the deadlines for consultation on important regulatory changes, the projects are shared with regulated institutions and the general public for approximately six weeks, once the draft regulations are structured, in order to facilitate the collection of valuable contributions and observations aimed at enhancing the proposed changes.** In cases involving projects with intricate technical implications, deadlines may be extended further, and collaborative working committees are established in coordination with the Banking Association of Panama (ABP) to address concerns and consider suggestions effectively.

**66. With respect to what is set forth by principle 6 about this Superintendency not having the power to reverse a transaction of banking entities involving a significant transfer of ownership without prior approval or based on misleading information, we must clarify that, in the event that such a situation were to occur, which has not happened to date, the absence of an explicit provision does not prevent this Superintendency from requiring its regulated entities to take the necessary measures to restore or reverse a transfer of shares made without the corresponding authorization.** We refer to the provisions of Article 16, paragraph 18 of the Banking Law, which empowers the Superintendent “to issue regulations to avoid or correct irregularities or flaws in bank operations which, in his/her judgment, may jeopardize the interests of depositors, the stability of a bank or the soundness of the banking system.” Furthermore, Banking Rule No. 1-2004 on acquisition or transfer of shares, establishes in article 28 the sanction for non-compliance with the provisions on the matter.

**67. Our perspective differs from the evaluators’ regarding the perceived weaknesses in Principle 15.** We emphasize the significance of the tools and information systems available to the Superintendency, which allow us to maintain a comprehensive oversight of the regulated entities. While there isn't a specific regulation for comprehensive stress tests in banks, we have addressed this aspect through macroeconomic assessments conducted by the Financial Stability Directorate and analyses related to political and macroeconomic factors that could impact banks in various scenarios. Furthermore, we have engaged experts in the real estate market to provide monthly analyses of housing prices, given their critical influence on the mortgage portfolio. We recognize the potential value of incorporating stress tests into entities' self-assessment processes, but we want to underscore the resilience displayed during the pandemic. Regarding the incorporation of the ICAAP (Internal Capital Adequacy Assessment Process), we acknowledge the need for time to ensure its proper adoption within banking entities, given its complexity. Thus, we consider Circular 37-2020 as the initial step in guiding regulated entities to develop the Future Capital Needs Report. This step aims to enhance internal processes for self-assessing capital sufficiency.

**68. Regarding the ILAAP, we accept that its main goal is to demonstrate that the bank has sufficient liquidity to function as usual while surviving the stresses of liquidity risk and that it can manage the liquidity risks it faces.** Article 3 of the Banking Rule 2-2018 establishes the general principles of liquidity risk management that aim to ensure that a bank is equipped to meet its liquidity obligations both in the short and long term, even during a major liquidity stress scenario. These principles include maintaining an adequate liquidity position, adjusted to the complexity of its operations and the diversity of its business model, using conservative assumptions about the tradability of assets and access to financing in times of stress, and keeping the competition from jeopardizing the integrity of management and control functions. In this banking center, all banks, regardless of their size or business model, must comply with all aspects of liquidity risk management according to the LCR. Regarding the lack of a standard requiring recovery plans, it is important to point out that there are recovery actions related to technology, business continuity plans and liquidity. Rule 2-2018 sets forth specific guidelines on the Liquidity Contingency Plan.

**69. This same Principle points out that: The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a Chief Risk Officer (CRO) or equivalent role, if the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the Board and generally should be disclosed publicly.** The bank should also discuss the reasons for such removal with its supervisor. The Risk Management Unit requirement is applied across all banks, which states that the unit must have a head. All regulated entities must have a unit for managing risk. Banking groups can have these roles fulfilled by one of the current risk management units within the group. However, for larger and/or more complex banking groups, the Superintendency may require a particular group to create a Risk Management Unit dedicated solely to the banking group that does not simultaneously perform functions for any subsidiaries. The CRO function reports to the CRJ [risk committee of the board of directors]. In this regard, the dismissal of a CRO is a relevant event that can affect the bank, and in practice banks report dismissals, resignations and hiring of CROs. If its shareholders, members of the board of directors, top management and the bank's key personnel do not comply with the integrity criteria defined in its policies, as the case may be, the bank must take the measures established therein and immediately inform this Superintendency of the reasons that supported the measure taken. We deem it appropriate to point out that the banks have notified the SBP of changes in their key personnel.

**70. With respect to the observations on Principle 16 on Capital Adequacy, we consider that the dynamic provisions have effectively served their role as a countercyclical capital buffer (minimum of 1.25% and maximum of 2.50%).** These provisions are designed to reduce procyclicality and strengthen banks' capital, especially of loan portfolio growth periods. Its subsequent use in periods of stress, such as experienced during the pandemic, has proven to be effective, achieving the broader macro-prudential goal of safeguarding the banking sector and maintaining the financial system stability. Additionally, the Banking Law grants the SBP the authority to request the bank to increase its current capital at any time, and to require banking entities to maintain a capital adequacy ratio higher than the minimum, prompting entities to make necessary capital injections to bolster higher-quality capital (Primary Capital) and absorb losses.

**71. Regarding the comments on aligning the capital framework with Basel III, Panamanian authorities have implemented the dynamic provisioning since 2013, which fulfills the purpose of a countercyclical capital buffer.** Additionally, a draft regulation for the requirement of a capital conservation buffer, as proposed in the Basel III framework, has already been presented to the SBP board of directors. The dynamic provisioning aims to reduce procyclicality and strengthen banks' capital in favorable economic conditions (loan portfolio growth). Its main objectives include reducing any excess cyclicality in minimum capital requirements, promoting the use of more forward-looking provisions, preserving capital as a buffer for individual banks and the banking sector, for later use during times of stress (as experienced during the COVID-19 pandemic), and achieving the broader macroprudential goal of protecting the banking sector from periods of excessive credit growth. It serves as a capital buffer and is not considered when calculating the minimum capital requirement. It is only taken into account if the capital adequacy ratio exceeds 8%. It is required for all banks with a loan portfolio, regardless of their status as a branch or an

internationally licensed bank under the supervision of the host authority. It applies to individual banks, bank and subsidiaries, and banking holding companies.

**72. During its implementation, it was considered that Panama has significant cross-border participation.** Therefore, the activation parameter is not based on GDP performance or gap behavior. Like the countercyclical buffer, it is a capital reserve derived from undistributed profits. The dynamic provisioning is calculated based on the growth of loan portfolios, with a cap of 2.5% and a minimum of 1.25% at the time of its establishment. As part of the measures implemented by the Superintendency during the pandemic, which was a real stress scenario, the accumulation of dynamic provisioning was suspended, and at the same time, its use up to 80% was authorized for the creation of specific capital provisions. However, it is important to note that dynamic provisioning does not count toward the 8% requirement. The General Board Resolution SBP-GJD-R-2023-01125 of June 6, 2023, has been published, reinstating the establishment of dynamic provisioning.

**73. In relation to Principle 23, concerning interest rate risk in the banking book, regarding the off-site reports for monitoring (NII) and Economic Value of Capital (EVE), we would like to emphasize that in December 2022, the Superintendency sent banks a format that they should begin using to report periodic information for interest rate risk in the banking book.** This form and the respective instructions for filling it out were sent to the banks through announcement SBP-2022-06901 of December 15, 2022, and we will begin collecting the information in the fourth quarter of 2023. It is worth noting that both the design of the format and the instructions were based on the principles of the IRRBB standard set out by the Basel Committee in 2016. In addition to this new template, it is important to remember that the Superintendency already receives the Rate Atom (AT09) every month, which provides detailed information on assets and liabilities distributed according to yield / repricing rates, along with applicable fees. This information is used to analyze how interest rate fluctuation affect the Net Interest Income (NII) of banks.

**74. Regarding Principle 24, we disagree with the evaluators' assessment because both off-site and on-site liquidity risk management, both at the individual bank level and at the consolidated level, constitute a significant aspect of the banking supervision process.** We have provided evidence of the tools used for supervision at the three levels of consolidation and we have highlighted the importance of liquidity in banking supervision management. Furthermore, we have submitted examples of additional tools and extracts from inspection reports that demonstrate the impact of supervision not only at the individual bank level, but also at the consolidated level. It is necessary to remember that, in December 2022, the adaptation period given to banks ended, consistent with the deadlines set out by Basel when the standard was issued. Given that the high-quality liquid asset principles that are included in the document for calculating the LCR have always been part of the basket of liquid assets for legal liquidity, the main liquidity elements used by banks in Panama, in the absence of a central bank, have been deposits in banks, which are not considered high-quality liquid assets for the LCR. This represented not only an operational change but also a strategic and business change, considering the profitability provided by tier one assets that had to be adequately measured. The Banking Rule 2-2018 paves the way for the incorporation of the indicator calculation at the holding level.

**75. As for recommendation to Principle 29 on the processes carried out by the SBP in matters of AML/CFT/FPADM, the FSAP report states the following: “No explicit notification requirement to the SBP if a bank becomes aware of a suspicious activity that could threaten its safety and soundness.”** We would like to clarify that the recommendation brought to our attention is already addressed in Corporate Governance Rule No. 5 of 2011. Specifically in its article 13, literal i) stipulates the following: “Article 13. Responsibilities of the Board of Directors: The board of directors shall have the following responsibilities and duties:/... i) To keep the Superintendency informed about the situations, events, and problems affecting or that may affect the bank and the specific actions to face and/or correct the deficiencies identified.” That being said, we hope to have clarified that the SBP currently maintains a specific requirement within existing regulations obligating banks to report to the regulator any situations, events, or issues that could pose a threat.

**76. Finally, we reiterate the commitment of the Panamanian authorities to continue advancing in the implementation of international recommendations and standards, ensuring the soundness, credibility, and competitiveness of Panama's financial system.**