Republic of Panama
Superintendency of Banks

RULE No. 004-2013[1]
(dated 28 May 2013)

"Whereby provisions on credit risk management inherent in credit portfolio and off-balance sheet transactions are established"

THE BOARD OF DIRECTORS
In use of its legal powers, and

CONSIDERING:

That due to the issuance of Decree Law 2 dated 22 February 2008, the Executive Branch reedited Decree Law 9 dated 26 February 1998 and all of its amendments as a sole text, and that this text was approved by means of Executive Decree 52 dated 30 April 2008, hereinafter referred to as the Banking Law;

That pursuant to the provisions of paragraph 2 of Article 5 of the Banking Law, fostering favorable conditions for the development of the Republic of Panama as an international financial center is an objective of the Superintendency of Banks;

That pursuant to the provisions of paragraph 2 of Article 11 of the Banking Law, approving generally applicable standards for the definition and identification of credit to clients related among themselves or related to banks or banking groups is among the technical duties of the Board of Directors;

That pursuant to paragraph 3 of Article 11 of the Banking Law, approving general criteria for the classification of assets at risk and rules for the provision of reserves against risk is among the technical duties of the Board of Directors;

That according to paragraph 4 of Article 11 of the Banking Law, approving general standards for suspending the accrual of interest in accordance with accepted international criteria is among the technical duties of the Board of Directors;

That pursuant to paragraph 5 of Article 11 of the Banking Law, establishing and interpreting the scope of the legal provisions and regulations on banking matters is among the technical duties of the Board of Directors;

That in conformance with paragraph 8 of Article 11 of the Banking Law, establishing the general standards that banks must follow in their accounting processes is among the technical duties of the Board of Directors;

That due to evolution of prudential regulations, best banking practices and accounting and auditing standards, it was deemed necessary to update the regulatory framework of the international banking center;

That it is the duty of the Board of Directors to define and establish the criteria for credit risk management, including the processes and procedures that must be complied with in each phase;

[1] Amended by Rule 8-2014 dated 16 September 2014.

That during the Board of Directors' working sessions it became obvious that it was necessary and advisable to update the regulatory framework for credit risk management in banks, in order to protect the interests of depositors and the stability of the banking system.

RESOLVES:

CHAPTER I
SCOPE OF APPLICATION AND DEFINITIONS

ARTICLE 1. SCOPE OF APPLICATION. The provisions of this Rule apply to:

1. State-owned banks.
2. General license banks.
3. International license banks.
4. Companies belonging to the banking group whose activities consist of providing banking or finance sector related services.

In the case of state-owned banks, the provisions of this Rule will be applicable to the extent that these are not contrary to the legal and regulatory provisions governing those institutions.

In the case of (1) banks acting as branch offices of foreign banks, and (2) international license banks host supervised by the Superintenency, compliance with this Rule may be proven, when applicable, through an annual certification issued by the parent company or responsible regional office certifying that the bank branch has the structures, organization and controls required to guarantee corporate governance pursuant to best banking practices and credit risk management. Should the Superintendency determine that these banks do not have the required structures, organizations and controls, the Superintendency shall require compliance. Should the Superintendency consider that the home regulation of the banks established in Panama is, in its judgment, insufficient for best practices in credit risk management, the Superintendency shall require compliance pursuant to this Rule. The above does not preclude the Superintendency requiring the information above be at its disposal.

Notwithstanding the above, the provisions of Chapter II, Section II, Articles 16, 18, 21, 24, 31, and 32 and Section III herein will apply to all types of bank.

Furthermore, depending on their structure and risk profile, Microfinance banks may request the Superintendent exempt them from compliance with some of the specific provisions above. The Superintendent may consider this exemption as long as it does not appear to increase the risk inherent in the credit portfolio or its management.

ARTICLE 2. DEFINITIONS. To the purposes of applying the provisions herein, the following definitions apply:

1. **Loan administration:** The execution of the policies, processes, procedures and controls of the credit cycle, its classification and the establishment of reserves.

2. **Vintage analysis:** A methodology that permits isolating and analyzing groups of loans having common features, especially regarding timeframe.

3. **Financial indicator databases:** The databases containing the results of the indicators used by the bank to measure the payment capacity of corporate clients, arranged by company size, economic sector and geographic location.

4. **Payment capacity:** The result of the objective measurement by the bank of the source of funding available to each debtor to pay his/her obligations.

5. **Credit portfolio:** Loans granted.

6. **Credit cycle or process:** The credit cycle is composed of the following stages:

   a. **Planning:** The strategy, target markets, products, segments, and customer profiles, up to the evaluation and analysis needed to approve programs and specific transactions.

   b. **Granting:** The set of policies, processes, and procedures used in the analysis and evaluation needed to approve or deny loans and specific transactions, and the procedures for documentation, disbursement and the management of documentation and collateral.

   c. **Monitoring and Control:** The processes for verifying the prompt payment of obligations and the positive or negative evolution of the clients capacity for payment. They also involve the verification of the correct use of funds, as well as the status and security of all collateral, and include ensuring that the risk category assigned to the debtor corresponds to his/her current status.

   d. **Recovery:** The administrative and coercive policies for recovery and/or write-off of the portfolio, and defines the levels of authority to manage cases in accordance with their seriousness. It should also guarantee the proper operational application of payments and installments within the system.

7. **Credit Committee:** A bank committee, appointed by the board of directors, responsible for approving and managing credit.

8. **Risk Committee:** A committee established by the board of directors pursuant to the provisions of the Rule on Comprehensive Risk Management, whose main duties are to establish objectives and policies for comprehensive risk management, as well as to set exposure limits for those risks approved by the board of directors.

9. **Restructured credit:** A credit transaction which modifies any of the original conditions of a transaction or replaces it as a result of any actual or potential event that damages the debtor's payment capacity. The purpose of restructuring is to provide a situation that improves the bank's chances of recovering a debt and postpones its classification as a bad debt.

10. **Refinanced Credit:** A credit is considered refinanced when there are changes in the term and/or amount of the original contract not caused by actual or potential difficulties in the debtor's payment capacity.

11. **Exposure due to noncompliance:** The total amount of capital, interest, fees and any other expenses incurred by the debtor that is registered on the books at the moment the noncompliance occurs, i.e. the total amount the bank is entitled to call in from the client on the date of noncompliance.

12. **Credit:** For the purposes of this Rule, this concept will consider only loans on books and off-balance sheet that generate a risk of noncompliance. In the case of off-balance sheet transactions, only irrevocable transactions will be considered for the purpose of this Rule.

13. **Past-due Loan:** Loans whose payments of capital, interest or expenses are between 30 and 90 days in arrears will be classified as past-due.

14. **Delinquent Loan:** Loans whose payments of capital, interest or expenses are more than 90 days in arrears from the date of required payment will be classified as delinquent. Single-payment transactions and overdrafts will be considered delinquent when the payment is over 30 days in arrears from the date of payment.

15. **Securities or collateral:** The pledge, mortgage, antichresis, security trust fund, cession or any other contractual relationship by which any good or right is secured to ensure recovery of an obligation.

16. **Senior management or top management:** The top executive authority (whether called general manager, executive vice president, executive president or by any other title), as well as the executive with the second highest position (whether called deputy general manager or by any other title) and other managers and employees performing key duties who report directly to the two above.

17. **Comprehensive credit risk management:** The process of identifying, measuring, monitoring, controlling, mitigating and reporting to the Risk Committee on the credit risks to which the bank is exposed.

18. **Noncompliance:** A credit transaction is considered noncompliant for all effects and purposes when it becomes delinquent.

19. **Board of directors:** The top body responsible for the management and control of the bank, watching over the best interests of the entity.

20. **Transition Matrixes:** Matrices indicating changes in the credit classifications granted to borrowers over time.

21. **Off-balance sheet transactions:** Those transactions representing the irrevocable commitment of the bank to granting or assuming the risk of payment by a debtor.

22. **Other Loans:** Those destined for funding governments, international organizations, and nongovernmental organizations.

23. **Expected Loss:** The expected loss is the mean of the distribution of losses over a specific timeframe—a year, for example. The expected loss calculation for a loan can be estimated with the use of three factors: the probability of noncompliance, the exposure on the date of noncompliance and the percentage loss due to noncompliance. None of these three factors is tangible, so it is necessary to estimate them by means of appropriate procedures. The expected loss for a portfolio is the sum of all expected losses on individual loans.

24. **Incurred Loss:** It is the economic consequence of the objective evidence of a shortfall.

25. **Unexpected Loss:** Unexpected losses, also called extreme losses, are low probability losses that have a significantly high value. Unexpected losses should be covered by capital requirements.

26. **Loans to people or consumers:** Those loans comprised of:

    a. **Consumer loans:** Those loans allocated to acquiring goods or services, not to manufacturing or marketing them. This type of loan includes occasional personal overdrafts, credit card debt, financial leasing, and loans secured by mortgages which comply with the purposes stated above.

    b. **Home loans (mortgages):** Those mainly allocated to acquire homes for residential use, as long as these loans are secured with mortgages that are duly constituted and filed.

27. **Corporate loans:** Those allocated for manufacturing and/or marketing goods and services within different sectors of the economy, such as: agriculture, mining, industry, construction, commerce and services. Included in this group are loans granted through corporate credit cards, corporate financial leasing, project

funding, commercial mortgages and those allocated to micro, small and medium companies or other funding forms destined to the above sectors. Funding to banks, credit unions, insurance companies, financial leasing companies, finance companies and factoring companies are also included.

28. **Probability of Noncompliance:** The probability of noncompliance as defined in item 18; i.e. the probability that the grantee will not comply with his/her payment obligations on time (more than 90 days in arrears, 180 days in the case of mortgages, from the contractual date of payment).in the case single-payment loan and overdraft delinquencies, the probability of noncompliance is the probability that the grantee will be more than 30 days in arrears on compliance with his/her payment obligations.

29. **Dynamic provisions:** Reserves provided to face possible future needs for specific provisions. They are governed by prudential criteria in the banking regulation.

30. **Specific provisions:** Reserves covering objective and concrete evidence of a shortfall.

31. **Stress testing:** An analysis of a hypothetical extreme scenario, from which to deduce its effect on the bank's balance sheet and income statement, in order to evaluate the ability of the capital requirements to absorb the unexpected losses generated in that scenario.

32. **Counterpart risk:** The possibility that in a financial contract to which the bank is a party, a counterpart does not fully comply with its financial obligations, causing the bank to incur in a loss.

33. **Credit risk:** The possibility that a bank incurs losses and loses asset value as a consequence of its debtors failing to comply on time or failing to fulfilling the terms agreed to in the credit contracts.

34. **Structured and integrated loan administration system:** The set of policies, processes, and procedures developing the strategic, regulatory and operational framework for the risk management cycle or process.

35. **Scoring system:** The process of classifying debtors through standardized methodologies consisting in assigning a specific credit risk level (usually denoted by a letter, category or score) that allows the bank to associate the debtor with a probability of noncompliance,

36. **Percentage Loss due to noncompliance:** The present value of the percentage representing the full loss, including all expenses associated with debt collection and, if necessary, the liquidation of existing collateral, with respect to the exposure on the date of noncompliance.

37. **Marketable value:** The amount for which an asset or liability can be exchanged between interested and fully informed sellers and a buyers under conditions of mutual independence. The best evidence of marketable value is a price listed in an active market. If the market for a financial instrument is not active, the entity will determine its marketable value using a valuation technique.

ARTICLE 3. CONCEPT AND SCOPE OF CREDIT RISK. For the purpose of this Rule, credit risk includes the concepts of counterpart risk and the risk of any economic mitigation requiring a collection process. The concept of credit risk pertains not only to the debtor's capacity to pay but to his/her record of willingness, ability and suitability, among others.

The provisions of this Rule will also apply to off-balance sheet transactions and those that must be revealed according to the accounting rules accepted by this Superintendency.

CHAPTER II
CREDIT RISK MANAGEMENT AND LOAN ADMINISTRATION

SECTION I
RESPONSIBILITIES

ARTICLE 4. STRUCTURED AND INTEGRATED CREDIT RISK AND LOAN ADMINISTRATION SYSTEM. All banks must have a structured and integrated credit risk system that will enable it 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 in 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 board of directors. The manuals must be available to internal auditors, external auditors and the Superintendency at all times.

ARTICLE 5. RESPONSIBILITIES OF THE BOARD OF DIRECTORS. The board of directors 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 board of directors will have the following responsibilities:

1. 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 portfoliosfor economic groups, products, economic sectors or any other classification relevant to the target markets and client profiles defined and approved within the strategy.

2. To approve credit risk exposure tolerance, providing credit limits for clients, market segments and products.

3. 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.

4. 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.

5. To ensure that the staff incentive policy is aligned with the bank's credit risk strategy and does not weaken the credit processes.

6. To supervise the credit risk level assumed by the bank, ensuring it is proportional to capital funds.

7. To approve the introduction of new products, segments or activities in the credit portfolio and off-balance sheet transactions generating credit risk.

8. To follow-up on exposures with related parties and economic groups, and ensure that internal auditing reviews that information.

9. To approve exceptions to internal policies and established limits proposed by top management and/or the person having been delegated that responsibility..

10. 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.

11. To ensure that the bank correctly applies the accounting and regulatory standards regarding credit risk management.

12. To establish a system for the delegation of authority for approving credit transactions and the authority necessary for their monitoring, recovery and collection.

13. To create a credit committee within the corporate governance system, pursuant to the provisions of this Rule.

ARTICLE 6. RESPONSIBILITIES OF TOP MANAGEMENT. Top management is responsible for implementing appropriate strategy, policies and practices approved by the board of directors for credit risk and loan administration. As a consequence, it is responsible for implementing and applying the structured and comprehensive credit risk and loan administration system, to which it will have the following responsibilities:

1. To ensure that activities involving granting, monitoring and recovering credits are consistent with the strategies and policies approved by the board of directors.

2. To adopt the structure, responsibilities and controls necessary for loan administration. The structure must identify the people responsible for oversight of the quality of loans and related risk mitigators. Similarly, top management must ensure that those responsible for assigning credit risk classification have enough information. When assigning responsibilities, top management must avoid potential conflicts of interest, pursuant to the provisions of the Rule on Corporate Governance issued by this Superintendency.

3. To approve relevant processes and procedures, ensuring their appropriate execution and their alignment with policies and practices approved by the board of directors.

4. To propose to the board of directors the policy and the levels of approval authority over credit that will be delegated within the bank's structure.

5. At least once a year and based on internal evaluations, propose to the board of directors corrections or improvements that must be made to the structured and integrated system of credit risk administration and management.

6. To define procedures and approval levels for exceptions to the limits and policies approved by the board of directors.

7. To ensure that the personnel involved have the ability and knowledge necessary to administer loans in accordance with the policies and procedures of the entity.

8. To communicate the key policies for adopting the strategy and structure for the management of that risk to all areas of the entity involved in risk management and loan administration. The people responsible for business lines carrying out activities that may affect credit risk must be fully aware of the strategy and operate in accordance with the established policies, processes, limits and controls.

9. To ensure the existence of appropriate internal controls to protect the integrity of the loan administration process and credit risk management. To this purpose,

internal auditing must regularly review the implementation and efficiency of the framework used.

10. To ensure continuous monitoring of market trends that might present significant or unprecedented challenges to loan administration, so that necessary changes to credit strategy can be achieved in a timely manner.

11. To ensure that there are stress tests available and that they are periodically applied, and that contingency plans are effective and appropriate for the entity.

12. To ensure that credit risk is included appropriately along with regular costs and income in the determination of prices, performance measures and the approval process for new products involving credit risk.

13. To ensure that the accounting policy has clear criteria and methodologies that will permit a consistent and objective analysis, using intended accounting standards, in determining the market value of credit portfolios.

ARTICLE 7. RESPONSIBILITIES OF THE RISK MANAGEMENT UNIT. Pursuant to the provisions of the Rule on Comprehensive Risk Management, the risk management unit has, among its duties that of managing credit risk. In addition to the responsibilities established in the cited Rule, it must:

1. 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.

2. To track compliance with the credit risk exposure limits approved by the board of directors.

3. 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.

4. To submit to the board of directors, through the risk committee, a suitable structure for credit risk management.

5. To implement the credit risk management methodology.

6. To prepare opinions on possible credit risks related to new credit products, services or promotions prior to their launch.

7. 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.

8. To develop and maintain stress testing methodology.

9. 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.

ARTICLE 8. RESPONSIBILITIES OF THE INTERNAL AUDIT UNIT. The internal audit unit will assess compliance with the internal control, policies and procedures used in risk management and loan administration, prepared according to the provisions of this Rule. Additionally, it must ensure that, in the plans approved by the audit committee, credit auditing processes are considered for each stage of the credit process or cycle, their classification and reserve requirements.

ARTICLE 9[2]. ESTABLISHMENT OF THE CREDIT COMMITTEE. Banks shall have a credit committee appointed by the board of directors as the top authority for evaluating and approving loans. Its members can be members of the board of directors, senior management, officers from business areas and the person responsible for credit risk management. Business areas may participate, presenting transactions and proposals, but will not have the right to vote. In the same manner, the person responsible for credit risk management may participate, but he/she will not have right to vote.

The credit committee must meet according to the needs of its business model but at least once a month. The proceedings of each of its meetings must be recorded in minutes, along with the reports reflecting issues leading to any decisions adopted. These minutes may be kept physically or in electronic archives and will be at the Superintendency's disposal upon request.

Bank branch offices of foreign banks and international licensed banks to which the Superintendency is host supervisor and whose credit decisions are made abroad, must confirm the existing structure of the parent company by means of an annual certification from their external auditors, and they must keep copies of all minutes and credit decisions made outside of the Republic of Panama. In addition, there must be a copy of all the files, including the information stated herein.

By prior evaluation and according to the complexity of each particular case, the Superintendent may grant waivers for the establishment of the Credit Committee provided for herein.

ARTICLE 10. RESPONSIBILITIES OF THE CREDIT COMMITTEE. The credit committee will have the following duties:

1. Approving those transactions falling within the level assigned to it by the board of directors.

2. Proposing to the board of directors improvements in policies, processes and procedures for credit approval.

SECTION II
STRUCTURED AND INTEGRATED CREDIT RISK MANAGEMENT AND LOAN ADMINISTRATION SYSTEM

ARTICLE 11[3]. MINIMUM COMPONENTS OF THE STRUCTURED AND INTEGRATED CREDIT RISK MANAGEMENT AND LOAN ADMINISTRATION SYSTEM. The system information must be compiled in manuals and/or annual business plans that must address, as a minimum, the following items:

1. Definition of target market.
2. Policies for each type of loan.
3. Organizational structures.
4. Maximum and minimum exposure limits.
5. Debtor risk classification system.
6. Mechanisms for monitoring and tracking bank credit risk.
7. Categories for portfolio classification.
8. Types of reserves.
9. Methodology for establishing the amount of reserves.
10. Risk management processes.
11. Origination processes.
12. Policies on collateral.
13. Monitoring and control processes.
14. Recovery and normalization processes.

[2] Amended by Article 1 of Rule 8-2014 dated 16 September 2014.
[3] Amended by Article 2 of Rule 8-2014 dated 16 September 2014.

15. Management system for exceptions to policy.
16. Documentation.

ARTICLE 12. DEFINITION OF TARGET MARKET. The bank must clearly establish and define, at the highest level:

1. **Business lines:** The specialization that groups processes designed to generate specialized products and services to respond to a segment of the target market.

2. **Market segments:** Clients defined and grouped based on social and geographic criteria. Additionally, the bank must clearly define:

   a. The participation of the different market segments within the desired credit portfolio, and
   b. The percentage participation of the market segments in the productive assets of the bank, establishing minimum and maximum levels and limits.

ARTICLE 13. POLICIES FOR EACH TYPE OF CREDIT.T he bank must define the rules and policies for the following credit categories pursuant to its strategic planning, specifically the criteria for admissibility, term characteristics and required collateral.

1. **Corporate Loans:** The following items must be considered: bank strategy, size and profile of the client, the economic sectors and the credit terms.

2. **Personal loans:** The following items must be considered: bank strategy, purpose of the funding, the terms and the debtor's profile, among others.

3. **Other loans to financial institutions, non-governmental organizations, international organizations and governments.** The following items must be considered: bank strategy and purpose of the funding.

ARTICLE 14. ORGANIZATIONAL STRUCTURES AND SUPPORT COMMITTEES. The bank must have an organizational structure that ensures appropriate risk management and loan administration in each and all stages of the credit cycle.

In the performance of the duties of the credit committee, the bank must have a decision-making structure that conforms to the delegation of authority made by the credit committee or the responsible entity.

Within the structure, they shall consider the limits and approval levels for transactions and the approval policies. When there are exceptions to the approval policy, the decision will be made by the higher authority appointed for that purpose.

Within the organizational structure, the bank must ensure it has a document approved by the board of directors setting up:

1. The bodies making credit decisions and their members.
2. The maximum amounts that may be granted.
3. The registration and recording system for decisions.

ARTICLE 15. EXPOSURE LIMITS. The bank must establish maximum and minimum limits by business line, economic sector, geographic location and client, based on its strategic definitions. This without prejudice to compliance with limits established by economic group and related parties concentration standards. These limits must be defined by the risk management unit, the risk committee and the board of directors.

The bank must have clearly identified and consolidated the economic groups and related parties for which there is credit risk exposure.

ARTICLE 16. CREDIT SCORING SYSTEM. Under the direction of the risk management unit, the bank must design credit scoring systems consonant 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.

ARTICLE 17. 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.

ARTICLE 18[4]. LOAN CLASSIFICATION CATEGORIES. For the purpose of determining specific and dynamic reserves, banks will classify all of their obligations based on their book value on the assessment date, using the following categories:

I. CORPORATE LOANS AND OTHER LOANS:

1. **Normal:** Loans paid on time or less than thirty (30) days in arrears. A loan is considered normal when the debtor's operating cash flow is sufficient or exceeds the amount required to honor the debt until its cancellation. It is also considered normal when the debtor:

    a. Has an acceptable level of capital debt;

    b. Pays his/her obligations on time, as long as the debtor meets his/her obligations without recurring to new direct financing;

    c. Collateral has been checked, clearly defined and periodically assessed by suitable professionals independent of the debtor.

    d. There is verification that the debtor has an adequate management system that provides him/her a continuous understanding of his/her economic situation and he/she has suitable internal control systems.

    e. The debtor is part of an economic sector that demonstrates favorable behavior in the regular course of business.

2. **Special Mention:** Loans classified in this category are those having some weaknesses. Additionally, the general status of his/her business and the collateral supporting his/her financial commitments require special attention for loan recovery, avoiding damage to the debtor's payment capacity. This debtor weakness may come from:

    a. Payments thirty-one (31) days in arrears but not exceeding ninety (90) days. In the case of loans with real property as collateral and for which the current value of the loan is less than 50% of the value of the collateral, the period will be extended to up to one hundred eighty (180) days.

    b. Situations that affect it directly or indirectly, such as: higher indebtedness, adverse situations that affect the economic sector in which the debtor conducts his/her business, an inappropriate loan agreement, a situation in which the debtor's operating cash flow is weakening or one which forecasts economic conditions that may affect the collateral held by the bank.

[4] Amended by Article 3 of Rule 8-2014 dated 16 September 2014.

c. Delays in submitting reports on the business' economic and financial situation.

d. If the loan was granted without sufficient analysis or for subjective reasons.

3. **Substandard:** A loan must be classified in this category when the operating cash flow or other payment source classified as a primary payment source is inadequate and jeopardizes the recovery of debt balances. The bank must evaluate the seizure of collateral, taking into consideration its marketable value, if the loan deficiencies are not corrected within a reasonable time. The bank must take into consideration whether the debtor is in any of the following circumstances:

   a. Payments are ninety-one (91) days in arrears, but not exceeding one hundred eighty (180) days. In the case of loans with real property as collateral and for which the current value of the loan is less than 50% of the value of the collateral, the period will be extended to up to two hundred seventy (270) days.

   b. An operating cash flow or other payment source classified as a primary payment source is inadequate to cover the total payment of the debt within the terms originally agreed on.

   c. Knowledge of delinquent loans and/or loans under court-ordered collection in other banks of the system.

   d. Shows clear evidence of deterioration in working capital that will not allow coverage of payments on the terms agreed on.

   e. Problems with the credit relationship with suppliers and clients.

4. **Doubtful:** Loans grouped in this category are those that are very hard to recover due to the fact that the debtor has a much deteriorated financial and economic situation. Normally, the bank has already started legal action, because the debtor's income sources, constituted collateral or capital will not permit the bank to recover part of the loan. To classify a loan under this category, the bank must take into consideration whether the debtor is in any of the following circumstances:

   a. Payments are one hundred eighty-one (181) days in arrears, but not exceeding two hundred seventy (270) days. In the case of loans with real property as collateral and for which the current value of the loan is less than 50% of the value of the collateral, the period will be extended to up to three hundred sixty (360) days.

   b. An operating cash flow or other payment source classified as a primary payment source that shows a continuing inadequacy in covering payment of the debt within the terms originally agreed on.

   c. If there are adverse conditions out of the debtor's control that may affect loan recovery, such as variations in the economic cycle of the country from which the loan payment sources come, unpredictable events such as fires, technology changes, political changes and others.

   d. If the loan has been renewed more than once without payment towards capital or interest, or if the loan was diverted to other projects.

5. **Unrecoverable:** Loans belonging to this category are all those for which the impossibility of recovery is so evident that they cannot justify being considered

financial assets and must be promptly written off, regardless of the possibility of the bank recovering part or all of the sums owed. Also included in this category are loans granted to companies whose ability to generate resources depends on other companies that are also in a precarious financial position in facing their commitments due to their own indebtedness, their operational incapacity or the situation of the economic sector in which the business belongs. To classify loans in this category, the bank must take into consideration whether the debtor is in any of the following circumstances:

a. Payments are over 270 days in arrears. In the case of loans with real property as collateral and for which the current value of the loan is less than 50% of the value of the collateral, the period will be greater than three hundred sixty (360) days.

b. There is a deterioration of the debtor's capacity to pay that compromises business continuity, or he/she is in temporary receivership and it is reasonable to assume that he/she will also find it difficult to comply with restructuring agreements, or he/she is insolvent or has requested to be declared bankrupt.

c. If the debtor has ceased his/her business activity and his/her loans are under a judicial order of collection.

d. If the bank's information on the client is uncertain, especially with respect to his/her current financial situation and location.

e. If the loan documentation is inadequate, deficient or false.

f. If there is no collateral or if it is insufficient or was not properly provided.

Occasional corporate overdrafts and other occasional overdrafts no more than thirty (30) days in arrears will be considered within the normal category. After this period, overdrafts will be classified in the substandard category for up to thirty (30) days. After thirty (30) days in the substandard category, the bank must classify the loan as unrecoverable.

II. PERSONAL LOANS:

Consumer loans will be classified according to the following criteria:

1. Personal consumption loans:

All consumer loans, with or without collateral, will be classified pursuant to the following criteria:

a. Normal: Loans without arrears or with arrears of less than sixty (60) days.

b. Special mention: Loans sixty-one (days) in arrears but not exceeding ninety (90) days. In the case of loans with real property as collateral and for which the current value of the loan is less than 50% of the value of the collateral, the period will be extended to up to one hundred eighty (180) days.

c. Substandard: Loans ninety-one (91) days in arrears but not exceeding one hundred twenty (120) days. In the case of loans with real property as collateral and for which the current value of the loan is less than 50% of the value of the collateral, the period will be extended to up to two hundred seventy (270) days.

d. **Doubtful:** Loans one hundred twenty-one (121 days) in arrears but not exceeding one hundred eighty (180) days. In the case of loans with real property as collateral and for which the current value of the loan is less than 50% of the value of the collateral the period will be extended to up to three hundred sixty (360) days.

e. **Unrecoverable:** Loans in arrears over one hundred eighty (180) days. In the case of loans with real property as collateral and for which the current value of the loan is less than 50% of the value of the collateral, the period will be greater than three hundred sixty (360) days.

Occasional personal overdrafts no more than thirty (30) days in arrears will be considered within the normal category. After this period, overdrafts will be classified in the substandard category for up to thirty (30) days. After thirty (30) days in the substandard category, the bank must classify the loan as unrecoverable.

2. **Personal loans (mortgages):**

These loans must be classified according to the following criteria:

a. **Normal:** Loans without arrears or with arrears of less than sixty (60) days.

b. **Special mention:** Loans sixty-one (61) days in arrears but not over ninety (90) days. In the case of loans with real property as collateral and for which the current value of the loan is less than 70% of the value of the collateral, the period will be extended to up to one hundred eighty (180) days.

c. **Substandard:** Loans ninety-one (91) days in arrears but not over one hundred eighty (180) days. In the case of loans with real property as collateral and for which the current value of the loan is less than 70% of the value of the collateral, the period will be extended to up to two hundred seventy (270) days.

d. **Doubtful:** Loans one hundred eighty-one (181) days in arrears but not exceeding three hundred sixty (360) days. In the case of loans with real property as collateral and for which the current value of the loan is less than 70% of the value of the collateral, the period will be extended to up to three hundred sixty (360) days.

e. **Unrecoverable:** Loans over three hundred sixty (360) days in arrears.

PROVISO 1. Regardless of whether the loans are corporate, consumer or mortgages, the number of days elapsed since full or partial payment was due will be sufficient reason for their classification in any of the categories previously provided, with the proviso 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.

All operations by the same client will be classified in the category for the obligation that is most deteriorated. In the case of operations of the same economic group, when one or more companies of the same economic group is classified in a higher risk category and those operations represent twenty-five (25%) of the economic group's total, the group's entire exposure will be classified in the higher risk category and, therefore, their maturity profile (past due or delinquent) must be adjusted according to loan portfolio classification. However, in particular cases, and with justification, the bank may request a waiver of this requirement from the Superintendency of Banks. The Superintendency may grant the waiver on its merits, as long as the delay is not due to a weakness in the client's ability to pay.

The files for clients with operations classified as substandard, doubtful and unrecoverable will clearly contain the recovery strategy and the outcome of the actions taken.

Pursuant to the provisions of this Rule, the risk committee will ensure that the whole portfolio is classified appropriately and in a timely manner.

PROVISO 2. To summarize, the terms previously established for corporate and personal loans are:

Portfolio Classification	Corporate		Personal			
			Consumer		Home Mortgage loans	
	-	(with real property as collateral) Loan value less than 50% of collateral value	-	(with real property as collateral) Loan value less than 50% of collateral value	-	(with real property as collateral) Loan value less than 70% of collateral value
Normal	From 0 to 30 days	From 0 to 30 days	From 0 to 60 days	From 0 to 60 days	From 0 to 60 days	From 0 to 60 days
Special mention	From 31 to 90 days	From 31 to 180 days	From 61 to 90 days	From 61 to 180 days	From 61 to 90 days	From 61 to 180 days
Substandard	From 91 to 180 days	From 181 to 270 days	From 91 to 120 days	From 181 to 270 days	From 91 to 180 days	From 181 to 270 days
Doubtful	From 181 to 270 days	From 271 to 360 days	From 121 to 180 days	From 271 to 360 days	From 181 to 360 days	From 271 to 360 days
Unrecoverable	Over 270 days	Over 360 days	Over 180 days	Over 360 days	Over 360 days	Over 360 days

ARTICLE 19. CONDITIONS FOR RECLASSIFYING A RESTRUCTURED LOAN. Restructured loans will be classified within the category in which they were before their restructuring or higher, and will remain in that category for a reasonable period of not less than six (6) months, after which they may be classified in a lower risk category depending on the evaluation of their payment capacity and compliance with their obligations.

The balance of a restructured loan may be placed in the normal category only if it complies with the above, and the following conditions are met:

1. That within the restructuring process the bank has not granted the debtor terms and conditions that are more favorable than those stipulated in the bank's credit policy and normally granted for this kind of loan.

2. That the financial condition of the debtor and projections based on realistic objectives indicate that the debtor will have the capacity to comply with the new payment plan; and

3. That collateral backing up the transactions is appropriate.

The bank will follow-up on the restructured loans, adding quarterly reports on the behavior and transactional development of the loan to the debtor's file.

If as a consequence of a review of the classification of the restructured loans, the bank finds noncompliance with the new conditions set in the restructuring, the bank will proceed with the appropriate reclassification.

All loans that were classified under the normal category at the moment time they were restructured must be reclassified, as a minimum, in the “special mention” category.

ARTICLE 20. CLASSIFICATION CATEGORIES FOR THE LOAN PORTFOLIO OF MICROFINANCE BANKS, MFB: For the purpose of determining specific provisions, microfinance banks must classify all of their obligations.

All loans, including occasional personal overdrafts, granted by microfinance banks with collateral accepted by the bank pursuant to the provisions of Article 24 herein or without collateral, will be classified according to the criteria below:

1. **Normal:** Loans that are current or in arrears by no more than thirty (30) days.

2. **Special Mention:** Loans without collateral, in arrears by thirty-one (31 days) but not exceeding forty-five (45) days. In the case of loans with collateral (accepted by the bank or accepted pursuant to Article 42 herein), those in arrears by thirty-one (31) days but not exceeding sixty (60) days.

3. **Substandard:** Loans without collateral, in arrears by forty-six (46) days but not exceeding ninety (90) days. In the case of loans with collateral (accepted by the bank or accepted pursuant to Article 42 herein), those in arrears by sixty-one (61) days but not exceeding ninety (90) days.

4. **Doubtful:** Loans without collateral, in arrears by ninety-one (91) days but not exceeding one hundred eighty (180) days. In the case of loans with collateral (accepted by the bank or accepted pursuant to Article 42 herein), those in arrears by ninety-one (91) days but not exceeding one hundred eighty (180) days.

5. **Unrecoverable:** Loans without collateral, in arrears over one hundred eighty (180) days. In the case of loans with collateral (accepted by the bank or accepted pursuant to Article 42 herein), those in arrears over one hundred eighty (180) days.

To summarize, the terms previously established for loans by microfinance banks MFB are:

Portfolio Classification	Without collateral	With collateral accepted by the bank	With collateral accepted by the bank pursuant to the provisions of Article 42 herein			
				(with real estate as collateral) Loan value less than 50% of the collateral value	Home Mortgage loans	
						(Loan value less than 70% of the collateral value
Normal	From 0 to 30 days	From 0 to 30 days	From 0 to 30 days	From 0 to 30 days	From 0 to 30 days	From 0 to 30 days
Special mention	From 31 to 45 days	From 31 to 60 days	From 31 to 60 days	From 31 to 180 days	From 31 to 90 days	From 31 to 180 days
Substandard	From 46 to 90 days	From 61 to 90 days	From 61 to 90 days	From 181 to 270 days	From 91 to 180 days	From 181 to 270 days
Doubtful	From 91 to 180 days	From 91 to 180 days	From 91 to 180 days	From 271 to 360 days	From 181 to 360 days	From 271 to 360 days
Unrecoverable	Over 180 days	Over 180 days	Over 180 days	Over 360 days	Over 360 days	Over 360 days

Microfinance banks must maintain in their credit manuals, as a minimum, a well-documented section on credit risk management and the control process for loans in which the debtor’s credit quality and its impact on the loans is assessed for each phase of the credit cycle. Pursuant to the provisions of Law 10 dated 30 January 2002, microfinance banks must

maintain a loan portfolio in which more than seventy-five (75%) of its loans are granted to micro and small companies.

ARTICLE 21. ADDITIONAL GENERAL CRITERIA FOR PORTFOLIO CLASSIFICATION. The number of days in arrears indicated for each portfolio classification category shall be an objective and sufficient condition for all their obligations:

The capacity for payment will be presumed impaired when:

1. The payment record of persons in the financial market deteriorates relative to what it was when the loan was originated.

2. Legal entities indicate a deterioration in their latest financial report that could affect their payment capacity, especially in the following indicators: Operating Free Cash Flow, Operating Profits, Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA), Total Indebtedness, and EBITDA Coverage of Interest.

ARTICLE 22. LOAN ADMINISTRATION PROCESSES. Each bank must define and document its loan administration processes and its internal control elements using methodologies based on sound banking practices.

Processes must clearly address the responsibilities of the board of directors, the internal auditor, and senior management in each one of the major credit cycle phases. The loan administration process must be developed based on the best practices established by the Basel Committee on Banking Supervision. Process documentation must be explicit on the methodology used.

Processes must be included in the manuals containing the loan administration system and will constitute the basis for evaluation and supervision by the Superintendency.

ARTICLE 23. CRITERIA FOR THE ORIGINATION PROCESS. It is understood that the origination process begins with the definition of the commercial operation and continues to the criteria for assuming risk. Therefore, each bank must clearly document all activities, from marketing, to the assessment of risk based on the debtor's current and future capacity, to the approval and the basic terms such as rates, terms, amortization, collateral and special conditions.

Particularly, the origination processes must ensure knowing the debtor or counterpart,, his/her payment capacity and the transaction characteristics being entered into, including, among others, loan terms and conditions, collateral, payment sources and the identification and analysis of exogenous conditions to which the debtor's payment capacity may be exposed.

The loan administration manual will contain origination processes ensuring that the bank's policy and strategy with regard to credit risk are consistently applied. Therefore, there must be a methodology defined for each market and business line, in which the strategy can establish qualitative and quantitative indicators objectively. These indicators must be able to determine which clients are creditworthy and the level of risk tolerance of each of them.

ARTICLE 24. POLICIES ON COLLATERAL. Each bank must have a clear policy on what collateral is acceptable, for what type of client, business line or product and t the maximum credit to grant based on the value of the collateral.

The policy on collateral will include, as a minimum, the following:

1. A formal evaluation of the support and reliability of the collateral.

2. 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.

3. The criteria and requirements that evaluation experts must have to be acceptable to the bank.

4. The methodology for assessing intangible collateral and payment sources represented by the cession of economic rights.

5. The risk assessment criteria for counterparts such as trust agents, custodians, issuers and originators of assets granted as collateral.

PROVISO. The provisions established herein envision general guidelines and parameters that banks must take into account for their policy on collateral, regardless of the regulations on credit risk mitigators established by the Superintendency.

ARTICLE 25. MONITORING AND CONTROL PROCESSES. The result of the monitoring and control processes is the proper classification of the portfolio according to its inherent risk. The bank must continuously classify its credit portfolio as long as there are actions being taken.

For the purposes above, each bank must have clear policies and methodologies that, as a minimum, determine:

1. Statistical information related to the historic behavior of portfolios and loans.

2. Updated information on the characteristics of the debtors, their loans and collateral.

3. Information on the debtor's credit behavior with other entities, if known.

4. Updated information that will permit the bank to evaluate the debtors' financial condition and payment capacity at all times.

Once a year, the risk committee will submit to the board of directors 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.

ARTICLE 26. RECOVERY AND NORMALIZATION PROCESSES. Each bank must have processes and procedures to maximize the recovery of loans not being serviced adequately. These procedures must contain, as a minimum:

1. The assignment of responsibilities so that functions are segregated such that there are counterbalances in the portfolio recovery process.

2. The criteria for applying coercive collection processes depending on the delinquency period and seriousness of the expected loss.

3. The criteria, policies and conditions for restructuring loans, clearly defining the level of approval authority. The bank must create a recordkeeping system for the identification of each of the restructured loans and the analysis that led to the decision to restructure them. They must also create indicators for the number, amount and other features of interest about the restructured loans and their progress.

4. The criteria and policies for accepting property in payment.

5. The criteria and policies on auctions and adjudications.

6. The criteria and internal policy on writing off loans pursuant to the provisions of Article 27 herein.

ARTICLE 27. WRITE-OFFS. 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.

ARTICLE 28. DOCUMENTATION. Each bank must have all elements indicated in the previous articles that are part of the credit risk management and loan administration system properly documented in its manuals. These manuals must have the approval of the board of directors, a periodic review by the risk committee and be at the disposal of the Superintendency of Banks.

ARTICLE 29. DISCLOSURE OF INFORMATION. Banks must provide information that will permit users to obtain a full and accurate view of the credit risk profile, risk management practices, and the quality of the loan portfolio and its profitability or the impact of losses on the bank's financial position and compliance with the provisions of this Rule.

On their annual audited reports, the bank must provide clear and concise information on the aspects mentioned above, aligned with the disclosure requirements in the accounting standards the Superintendency requires the banks to follow. The bank must consider, as a minimum, the following aspects:

1. **Accounting policies and practices:** The bank must furnish information on the accounting policies and practices on their loans, the deterioration of those loans and the methods used to apply policies on:

    a. Measurement of unimpaired loans.
    b. Accrual of income from unimpaired loans, including interest and handling fees and expenses.
    c. Basis for moving loans to losses and accounting for recoveries, if any.
    d. When stopping interest accrual on a loan.

2. **Loan administration:** The information furnished must include information on the management and control policies and practices used by the bank to mitigate credit risk, such as policies and practices regarding:

    a. The application and review of loans and collateral.
    b. The system of credit risk classification for loans.
    c. The Analysis of quality and review of past due loans.

3. **Credit risk exposure:** The bank must furnish information on:

    a. Loans according to their type.
    b. Loans by area, including domestic and international loans.
    c. Most important credit risk concentrations.

4. **Credit quality:** The bank must disclose information on:

    a. Balance of delinquent and past due loans by major category and the amount of specific reserves for each category.
    b. Balance on loans whose interest accrual is suspended due to an impairment of the credit quality or for payment noncompliance pursuant to the provisions of Article 30 herein.
    c. A consolidated summary of troubled loans that were restructured during the year.

ARTICLE 30[5]. SUSPENSION OF INTEREST INCOME ACCRUAL. Banks will suspend interest accrual for income from interest receivable and earned interest when any of the following circumstances occur:

1. The bank determines that the client's financial condition is impaired and there is no assurance that the total balance on the loan can be recovered.

2. The debtor has not made payments to capital or interest as originally agreed on:

   a. For more than ninety (90) days for the loans financing trading and/or manufacturing activities, including corporate loans and other loans.

   b. For more than ninety (90) days for consumer loans and for personal loans with real property as collateral.

   c. For more than one hundred twenty (120) days for housing loans (mortgages).

3. In the case of loans whose disbursements were granted with exceptions to credit policies and procedures and whose exceptions have not been duly eliminated, when payments have not been received within sixty (60) from the disbursement.

4. The bank determines that an overdraft is entirely unrecoverable:

   a. With a maturity date, when the debtor has not paid within thirty (30) days following the maturity date.

   b. Without a maturity date or for occasional overdrafts, when the debtor has not cancelled within thirty (30) days from the first date of usage.

In the case of loans under "non-accrual of interest" status, banks must adopt a methodology that includes accounting policies and procedures for the appropriate and consistent recording of the accumulated interest receivable.

ARTICLE 31. INFORMATION REQUIREMENT. Banks must ensure that they maintain the information necessary to understand the credit associated with their clients over the entire credit cycle in an orderly and systematic fashion at all times, especially client payment records with the bank, the information used to determine his/her payment capacity and the financial indicators databases.

ARTICLE 32. MONITORING AND CONTROL PROCEDURES OF THE SUPERINTENDENCY. The Superintendency will regularly review bank compliance with all terms under which they make their assessment and classification of debtors in the loan portfolio. In that review, the Superintendency may require the reclassification of the risk category of those loans that, in its judgment, the bank classified and designated provisions for without conforming to the standards.

To this purpose, banks must maintain their loan files up to date, and their assessment and classification, including the reserves needed to cover potential losses, must be properly justified, In addition, it must maintain its credit manual updated and at the disposal of the Superintendency of Banks.

If, as a result of the review of the classification of loans, the Superintendency of Banks 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 the debtors in question. When the difference in the required reserves determined by the Superintendency is

[5] Amended by Article 4 of Rule 8-2014 dated 16 September 2014.

substantial, the bank must reevaluate the remainder of the loan portfolio. The Superintendency will verify the new data.

Any modification lowering the risk category of a loan made by a bank in applying this Rule, will be made only if the bank considers that the reasons for the original classification were superseded technically.

SECTION III
CREDIT RISK COVERAGE

ARTICLE 33. TYPES OF RESERVES. Banks will create the following types of reserves for credit risk coverage:

1. **Specific reserves:** 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.

2. **Dynamic reserves:** Those established according to the prudential criteria on all loans lacking a specific reserve, i.e. on the loans classified as normal.

ARTICLE 34. AMOUNT OF THE SPECIFIC RESERVES AND THEIR ACCOUNTING TREATMENT. The bank must calculate and maintain, as a minimum, the specific reserves determined by the following criteria at all times:

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.

2. The reserve is calculated by multiplying the weight established in the chart below for each risk category, by the calculation basis.

Reserve Calculation Weight Chart

Category	Weight
Special mention	20%
Substandard	50%
Doubtful	80%
Unrecoverable	100%

PROVISO 1. If, under International Financial Reporting Standards (IFRS), there is a surplus in the specific reserve required by this Rule, it will be registered in a regulatory reserve of equity credited to the retained earnings account. The regulatory reserve will not be considered capital funds for the purpose of the capital adequacy index, concentration limits for a sole borrower or related parties, or any other prudential relationship,.

ARTICLE 35. INTERNAL MODELS. Entities may develop their own models to determine the amount of reserves. These models must be evaluated and approved by the Superintendency of Banks before use. The reserve amount calculated using internal models shall never be less than those resulting from applying the provisions of paragraph 1 of Article 34 and using the following weight chart.

Minimum Reserve Calculation Weight Chart

Category	Weight
Special mention	2%
Substandard	15%
Doubtful	50%
Unrecoverable	100%

ARTICLE 36. DYNAMIC RESERVES. Due to prudential regulatory criteria, banks shall establish dynamic reserves. Dynamic reserves are established on a quarterly basis, based on the data from the last day of the quarter.

This reserve is not applicable to microfinance banks, which shall maintain an additional reserve of one percent (1%) of the normal category loan portfolio.

ARTICLE 37. AMOUNT OF THE DYNAMIC RESERVES. The amount of the dynamic reserves is obtained by calculating the following components:

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 from the chart.

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 from the chart. If the variation is negative, the amount is zero.

3. Component #3: The amount of the variation in the balance of specific reserves during the quarter.

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 negative, it must be added.

Chart for the Calculation of Dynamic Reserves

Alpha	Beta
1.50%	5.00%

The following restrictions apply to the amount of the dynamic reserve:

a. It cannot be greater than 2.5% of the risk-weighted assets of the loans classified under the normal category.

b. It cannot be less than 1.25% of the risk-weighted assets on the loans classified under the normal category.

c. 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.

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.

ARTICLE 38. ACCOUNTING TREATMENT OF THE DYNAMIC RESERVE. The dynamic reserve is a capital account that is paid or credited to the retained earnings account. The credited balance of the dynamic reserve is part of the regulatory capital, but cannot be used

in satisfying current or future capital adequacy requirements established by this Superintendency.

ARTICLE 39. COLLATERAL. The following assets will be considered valid collateral for the calculation of specific reserves:

1. Pledged deposits in the same bank or in other banks.
2. Fixed and variable income securities traded in an active market.
3. Panamanian sovereign debt.
4. Fixed and variable income securities lacking an active market but whose estimated market value is feasible.
5. Sovereign debt traded in an active market.
6. Standby letters of credit, pledges, bonds, warranties, and irrevocable export/import credit letters issued by banks.
7. Promissory notes with a discount code from the Social Security Fund.
8. Residential properties.
9. Commercial properties.
10. Land.
11. Land restricted to agricultural use.
12. Automobiles.
13. Cattle
14. Agricultural products that can be fully identified by the bank.

ARTICLE 40. FORMALITIES. 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.

ARTICLE 41[6]. ASSESSMENT OF COLLATERAL. On the date banks perform the assessment of property given in guarantee as risk mitigators, they must accept the prevailing market value as the basis. Banks granting loans must use conservative criteria (the lesser value showed in the appraisal report) consistently in calculating the liquidation value that would be obtained from disposing of those goods. The assessment must be made according to the type of goods, as described below:

1. **Mortgages on real property.**

   a. In the case of loans granted for new home purchases, the market value of the property will be determined by a technical appraisal or by reference to the sale of a similar home in the development. Resale homes must have an updated appraisal made at the time the loan is established.

   b. Banks must request an appraisal when:

      b.1. The loan value is going to increase.

      b.2. When a loan is classified in the substandard or following categories for the first time and there has not been an appraisal in the past year, the bank must request one.

      b.3. In the foreclosure process on real property used as collateral, the appraisal must be no more than two years old. This term could be reduced if there is evidence of a decrease in real property values.

   c. The mortgage value of real property used as collateral must be supported by an appraisal of the property made by an expert independent of the owner

[6] Amended by Article 5 of Rule 8-2014 dated 16 September 2014.

and acceptable to the bank. Nevertheless, the bank can perform the appraisal on real property (1) whose market value is estimated to be below the maximum value approved for the preferential interest rate or (2) that is the subject of agricultural activities, as long as the bank has appropriate and well-documented methodologies.

d. The provisions of paragraphs b, c and d will be applied to commercial property. However, the appraisal must be renewed at least every 3 years.

e. All restructuring must be accompanied by an appraisal made within the past year and acceptable to the bank. In those cases in which the bank has determined that there has been deterioration in the collateral for a loan, an appraisal must be conducted immediately.

f. With respect to construction loans using the value of the land and improvements as collateral, the initial appraisal will include only the value of the land. The value of the collateral will be increased based on progress in the construction, certified in writing by a building inspector independent of the debtor or construction company and acceptable to the bank.

g. Priority in assigning a value to mortgaged property: second or subsequent mortgages will only be accepted as risk mitigators when the preceding mortgages are registered in favor of the bank granting the financing or any of the companies in its economic group. The residual value of the collateral must cover the entire amount being financed. The residual value is the value resulting from deducting the balance of credit on the preceding mortgages from the market value established by the most recent appraisal.

Property listed in Article 42 herein with a second mortgage in other banks will be accepted as collateral as long as the collateral has a residual value and twenty (20) basis points are deducted from the coefficient established on the chart in Article 42.

2. Personal property:

The value of personal property pledged as collateral will be equivalent to the value established in the insurance policy covering the property.

3. Bank deposits:

The value of pledged bank deposits will be the lesser of the loan balance and the pledge deposits.

4. Securities:

a. Sovereign debt, as well as financial instruments from commercial and state entities, will be accepted at their market value.

b. The assessment of collateral on cattle must be backed by an appraisal or certification of the value of the property given in guarantee, conducted by persons independent of the debtor and acceptable to the bank. Nevertheless, the appraisal of cattle can be conducted by the bank itself, as long as it has appropriate and well-documented methodologies.

c. No secondary warranties will be permitted on the use of agricultural property or cattle as collateral.

5. Other collateral:

a. Standby letters of credit, warranties, sureties and endorsements, as well as irrevocable letters of credit issued by banks, insurance or reinsurance companies, and the assignment of promissory notes with discount codes will be accepted at market value. For the purpose of this Rule, these warranties will not be accepted if they are issued to the bank by an entity in its own economic group to guarantee obligations of a third entity of the same group.

b. Warranty trust funds will be considered as risk mitigators as long as they are among the assets established in Article 42.

c. Promissory notes with deduction codes from the Social Security Fund will be acceptable from retirees and pensioners to cover the balance of the obligation they are guaranteeing.

ARTICLE 42. CURRENT PLEDGE VALUE. For the calculation of the specific reserves under the international financial reporting standards and the principles of prudential valuation, it is necessary to take into consideration the time value of cash 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:

	Pledge	Current Value
1.	Deposits in the bank itself or in other banks, be they pledged or given as trust funds.	100% of the pledge amount
2.	Fixed or variable income securities traded in active markets.	70% of market value
3.	Panamanian sovereign debt.	90% of market value
4.	Fixed or variable income securities lacking an active market.	50% of market value
5.	Sovereign debt traded in an active market.	70% of market value
6.	Standby letters of credit, warranties, sureties, endorsements and irrevocable export/import letters of credit issued by banks.	90% of nominal value
7.	Cession of promissory notes with a discount code from the Social Security Fund.	85% of promissory note value
8.	Residential real property.	70% of market value
9.	Commercial real property.	60% of market value
10.	Land.	50% of market value
11.	Land used exclusively to agricultural purposes.	50% of market value
12.	Personal property (mortgages on private automobiles).	50% of market value
13.	Cattle.	75% of market value
14.	Agricultural products properly identified by the bank.	40% of market value

ARTICLE 43. INFORMATION ON COLLATERAL. For credit assets with real or personal property as collateral, banks must maintain, as a minimum, the following documentation in their respective files:

1. Deed or ownership certificate for the car, issued by the Municipality.

2. Property certificate issued by the Public Registry of Panama, in which any tax or lien on the property is indicated.

3. Appraisals and update reports of them.

4. Photocopy of the current insurance policies, with the conditions and coverage required, when applicable.

5. Reports of periodic inspections of collateral received by the bank for loans classified in any category, as well as those with extensions or refinancing.

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.

ARTICLE 45. SUBMITTAL OF INFORMATION. Banks must submit information on the classification status, maturity profile and reserves for loans in their loan portfolio to the Superintendency as it may determine.

CHAPTER III
PENALTIES

ARTICLE 46. PENALTIES. Failure to comply with the provisions stated herein will be penalized pursuant to the provisions of Title IV of the Banking Law.

ARTICLE 47. INACCURACIES WHEN CLASSIFYING THE PORTFOLIO. Omissions and/or errors in the classification of the portfolio, creating potentially significant insufficiencies in the level of reserves for the credit portfolio will be considered serious breaches of the provisions herein and the regulations related to credit risk.

CHAPTER IV
FINAL AND TRANSITORY PROVISIONS

ARTICLE 48. REPEAL. This Rule will repeal all of Rule 6-2000 dated 28 June 2000 and all of its amendments, Rule 6-2002 dated 12 August 2002 and Article 7 of Rule 2-2003 dated 12 March 2003.

ARTICLE 49. ENACTMENT. This Rule shall enter into force on June 30, 2014.

ARTICLE 50. ADJUSTMENT PERIOD. Banks will have an adjustment period for the establishment of the specific and dynamic reserves required herein. To this purpose, the bank must ensure compliance with all these provisions on the following dates:

1. The provisions in Article 34 on the amount of specific reserves and their accounting treatment will be applicable for the calculation and creation of the reserves as of the monthly closure on December 31, 2014.

2. By September 30, 2014, the bank must comply with the provisions of Article 36 on the dynamic reserves and their respective creation. To this purpose, the bank must ensure is has at least the 1.25% of its risk-weighted assets referred to in Article 37, paragraph b. As of December 31, 2014, the bank must ensure compliance with the provisions of Articles 37 and 38 herein.

   Notwithstanding the above, the Superintendency has deemed it convenient to provide a graduated schedule for the entry into force of the calculation of the dynamic reserves, beginning on December 31, 2014. This does not preclude the bank's deciding to apply the full amount determined from Article 37.

   The percentages established in the chart below may be used by the bank, even when the amount they should be applying is higher. This gradation will be applied until the bank reaches the percentage resulting from the calculation established in Article 37.

QUARTER	APPLICABLE PERCENTAGE
Quarter ended on December 31, 2014	1.50%
Quarter ended on March 31, 2015	1.75%
Quarter ended on June 30, 2015	2.00%
Quarter ended on September 30, 2015	2.25%
Quarter ended on December 31, 2015	2.50%

Given in the city of Panama on the twenty-eighth (28th) day of May, two thousand thirteen (2013).

LET IT BE KNOWN, PUBLISHED AND ENFORCED.

THE CHAIRMAN,

Félix B. Maduro

THE SECRETARY,

Nicolás Ardito Barletta