Republic of Panama
Superintendency of Banks

RULE No. 8-2014
(dated 16 September 2014)

"Whereby Articles 9, 11, 18, 30 and 41 of Rule 4-2013 are amended"

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 Paragraphs 1 and 2 of Article 5 of the Banking Law, safeguarding the soundness and efficiency of the banking system and strengthening and fostering favorable conditions for the development of the Republic of Panama as an international financial center are objectives of the Superintendency of Banks;

That pursuant to Paragraph 2 of Article 11 of the Banking Law, the Board of Directors is responsible for approving generally applicable standards for the definition and identification of credits to clients related among themselves or related to banks or to banking groups;

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

That pursuant to Paragraph 5 of Article 11 of the Banking Law, the Board of Directors is responsible for establishing the administrative interpretation and scope of the legal provisions and regulations on banking matters;

That Rule 4-2013 dated 28 May 2013 sets forth provisions on credit risk management inherent in credit portfolio and off-balance sheet transactions;

That during the Board of Directors' working sessions it became obvious that it was necessary and advisable to amend Articles 9, 11, 18, 30 and 41 of Rule 4-2013.

RESOLVES:

ARTICLE 1. Article 9 of Rule 4-2013 shall be read:

> **ARTICLE 9. 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 2. Article 11 of Rule 4-2013 shall be read:

ARTICLE 11. 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.
15. Management system for exceptions to policy.
16. Documentation.

ARTICLE 3. Article 18 of Rule 4-2013 shall be read:

ARTICLE 18. 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.

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 4. Article 30 of Rule 4-2013 shall be read:

ARTICLE 30. 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 5. Article 41 of Rule 4-2013 shall be read:

ARTICLE 41. 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 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 6. ENACTMENT. This Rule shall become effective upon its promulgation, but subject to the parameters set forth in Articles 49 and 50 of Rule 4-2013.

Given in the city of Panama on the sixteenth (16th) day of September, two thousand fourteen (2014).

FOR COMMUNICATION, PUBLICATION AND ENFORCEMENT.

THE CHAIRMAN,	**THE SECRETARY,**
L.J. Montague Belanger	Luis Alberto La Rocca