# Republic of Panama
# Superintendency of Banks

**RULE No. 001-2015**
(dated 3 February 2015)

**"Whereby Rules for Capital Adequacy applicable to banks and Banking Groups 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 consolidated 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 paragraphs 1 and 2 of Article 5 of the Banking Law, safeguarding the soundness and efficiency of the banking system and strengthening and fostering auspicious conditions for the development of the Republic of Panama as an international financial center are objectives of the Superintendency of Banks;

That pursuant to the provisions of paragraph 1 of Article 11 of the Banking Law, approving general standards for the identification, regulation, and consolidated supervision of banks and banking groups is among the technical duties of the Board of Directors;

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

That according to the provisions of paragraph 3 of Article 91 of the banking Law, all banks must submit reports to the Superintendency using the schedule and format indicated by the Superintendency;

That Article 67 of the Banking Law provides that all banks must comply with the capital funds requirements in the Banking Law and its enabling regulations;

That according to the provisions of Article 67 of the Banking Law, the capital funds of the banks will be made up of tier 1, tier 2 and tier 3 capital;

That in accordance with Article 70 of the Banking Law, all general and international license banks under the home supervision of the Superintendency will maintain capital funds equivalent to at least eight percent of the risk-weighted total of all assets and contingent off-balance sheet operations, as well as tier 1 capital equivalent to no less than four percent of the risk-weighted total of all assets and contingent off-balance sheet operations;

That given the development of the prudential regulations, best banking practices and accounting and auditing standards, it became necessary to update the general regulatory framework governing the International Banking Center;

That Basel Principle 16 on Capital Adequacy establishes that banks must have minimum capital requirements that reflect the risks undertaken by banks;

That during the Board of Directors' working sessions, the Directors determined that it was necessary and advisable to bring the regulatory framework governing capital requirements in line with international standards, in order to keep strengthening the solvency of the banking system, limiting leverage and fostering sustainable growth strategies in banks to maximize the financial stability of the banking center.

## RESOLVES:

## CHAPTER I
## GENERAL PROVISIONS

**ARTICLE 1. SCOPE OF APPLICATION.** This Rule is applicable to:

1. State-owned banks.
2. General license banks.
3. International license banks whose home supervisor is the Superintendency of Banks.
4. Bank holding companies of banking groups consolidating their operations in Panama and to which the Superintendency of Banks acts as home supervisor.

Each of the above entities will be hereinafter referred to as the “regulated entity.”

Notwithstanding the above, the Superintendency of Banks may apply this Rule to banking institutions that are not covered in the above list but are considered of importance to the financial stability of the banking system.

This Rule will be applied on a consolidated and an individual basis using International Financial Reporting Standards (IFRS). However, the rules in Article 12 will be used to determine which entities within the Group will be consolidated for the application of the provisions of Article 14.

**ARTICLE 2. REQUIRED CAPITAL FUNDS.** For the calculation of capital requirements and capital adequacy indexes, capital funds must be composed of:

1. **Tier 1 capital,** which will be comprised of:

   a. Common tier 1 capital
   b. Additional tier 1 capital

2. **Tier 2 capital**

3. **Dynamic provisions**, as defined in Rule 4-2013

**ARTICLE 3. COMMON TIER 1 CAPITAL.** Common tier 1 capital is composed of the following elements:

1. Capital Stock, including stock from the capitalization of retained earnings.

2. Share premiums resulting from instruments included in common tier 1 capital (capital overpayments).

3. Declared reserves, i.e. those reserves classified by the regulated entity as Capital Reserves to reinforce its financial situation and coming from earnings retained on their books and subject to the provisions of Article 69 of the Banking Law.

4. Non-distributed retained earnings from the current and previous periods.

   The regulated entity may include the earnings for the current period in the common tier 1 capital before it has adopted a formal decision confirming the results, as long as it ensures that all foreseeable expenses, interests and dividends have been deducted from these earnings.

   The regulated entity may include the earnings from previous periods in the common tier 1 capital as long as its accounts were verified by external auditors to ensure all foreseeable expenses, interests and dividends have been deducted from these earnings.

5. Holdings representing minority interests, held in capital accounts of consolidating subsidiaries and complying with the criteria for inclusion in common tier 1 capital.

6. Other accrued items in comprehensive (total) income, specifically, unrealized net profits or losses from the assets available for sale portfolio.

7. Other reserves authorized by the Superintendency.

8. Regulatory adjustments in Article 9 of this Rule applied to common tier 1 capital calculations.

**PROVISO.** Considering the regulated entity's financial situation, the Superintendency may order it to refrain from reducing its capital by ordering it to suspend the distribution of dividends..

**ARTICLE 4. COMMON STOCK CHARACTERISTICS.** To be considered as common tier 1 capital, common stock must meet the following criteria:

1. They represent the most subordinate right to collect in case of the regulated entity's liquidation (i.e. they are in the last order of precedence).

2. They grant rights on the residual assets proportionate to their share of the issued capital once all main rights to the liquidation have been attended to (i.e. they represent unlimited and variable rights, not fixed or limited rights).

3. They are perpetual in nature and will not be returned, except in the case of liquidation or a discretionary repurchase or other means of effective capital reduction authorized by relevant legislation.

4. They must not contain an expectation of repurchase, rescue or amortization, and their legal and contractual terms cannot include a clause that could support such an expectation.

5. There are no conditions requiring the distribution of dividends. Therefore, the lack of payment of a distribution does not constitute a breach or noncompliance.

6. Dividend distributions are made only as long as all legal and contractual obligations are up to date and after distributions to those capital instruments that have preference regarding the payment of dividends.

7. They are the issued capital that first covers any losses, as well as covering a proportionately higher percentage of the losses as they arise. Within the higher quality capital, each instrument absorbs losses equally (pari-passu) and in proportion to the others while the company is solvent.

8. The amount issued and paid will become part of the banks' own funds, i.e. it is not considered an obligation for the purposes of determining insolvency on the balance sheet.

9. The amount paid will be classified as bank resources under the applicable accounting standards.

10. The amount has been directly subscribed and paid, and the regulated entity may not have financed the purchase of the instrument directly or indirectly.

11. The amount paid is neither secured nor guaranteed by the issuer or by a related entity, nor is it subject to any other rule that legally or economically improves the precedence of the corresponding right.

12. Will only be issued with the approval of the relevant corporate authority or by other persons authorized by that authority.

13. Are clearly and separately reflected in the balance sheet of the regulated entity,

14. The distribution of dividends will be charged against distributable earnings. The level of distributions is not in any way linked or connected to the amount paid on issue, nor is it subject to a fixed limit. At the same time, the regulated entity may not pay dividends over and above accumulated, distributable funds.

**ARTICLE 5. ADDITIONAL TIER 1 CAPITAL.** Additional tier 1 capital is composed of the following elements:

1. Instruments issued by the regulated entity having the characteristics to be included in additional tier 1 capital and not included as common tier 1 capital.

2. Share premiums resulting from instruments included in additional tier 1 capital.

3. Instruments issued by consolidated affiliate companies of the regulated entity held by third parties, having the characteristics for their inclusion in additional tier 1 capital and not included as common tier 1 capital.

4. Regulatory adjustments applied to the additional tier 1 capital calculations covered in Article 9 herein.

**ARTICLE 6. CHARACTERISTICS OF FINANCIAL INSTRUMENTS FOR ADDITIONAL TIER 1 CAPITAL.** To be considered as additional tier 1 capital, financial instruments must meet the following criteria:

1. Be subscribed and paid for.

2. Be subordinated to depositors, creditors in general and the subordinated debt of the regulated entity.

3. Are neither insured nor guaranteed by the issuer or by a related entity, nor the object of any other rule that legally or economically improves their precedence relative to the creditors of the regulated entity.

4. Are perpetual: i.e. they do not have a date of expiration nor are there clauses for gradually-increasing compensation or other incentives for their early amortization.

5. They could be redeemable at the initiative of the issuer after five years, as long as the following conditions are met:

    a. The regulated entity must receive an authorization from the Superintendency of Banks and

    b. The regulated entity must replace the amortized instrument with capital of equal or greater quality or show that its capital position far exceeds the minimum capital requirements after the purchase option is exercised.

6. The regulated entity may pay dividends and interest at its own discretion.

7. The accrual of dividends or interest is not allowed, nor is any type of deferred payment, including paying in other common or preferred shares. The regulated issuer may eliminate the payment of dividends.

8. The conversion to another type of share differing from the tier 1 capital —i.e. common stock— either automatically or at holder's option, is not allowed.

9. The yield must not depend on the issuer's financial condition or profits.

10. The yield is fixed or based on an independent market index.

11. There are no clauses with potentially unfavorable conditions that could encourage the regulated entity to redeem the instrument early.

12. The instrument may not have been purchased by the regulated entity nor by any related party controlled by the entity or on which the regulated entity exercises

significant influence, nor can its purchase have been directly or indirectly financed by the regulated entity.

**ARTICLE 7. TIER 2 CAPITAL.** Tier 2 capital is composed of the following elements:

1. Instruments issued by the regulated entity meeting the criteria to be included as tier 2 capital and not included in tier 1 capital.

2. Share premiums resulting from instruments included in tier 2 capital.

3. Instruments issued by consolidated affiliates of the regulated entity, held by third parties, meeting the criteria to be included in tier 2 capital and not included in tier 1 capital.

4. Reserves against future losses not currently identified can be classified as tier 2 capital. Provisions assigned to the identified deterioration of specific assets assessed individually or jointly are excluded. The above reserves will not exceed the maximum of 1.25 basis points of credit risk-weighted assets. Dynamic reserves defined in Rule 4-2013 are excluded.

5. Regulatory adjustments applied to tier 2 capital calculations covered by Article 9 herein.

**ARTICLE 8. CHARACTERISTICS OF FINANCIAL INSTRUMENTS FOR TIER 2 CAPITAL.** To be considered tier 2 capital, financial instruments must meet the following criteria:

1. Be subscribed and paid for.

2. Be subordinate to depositors and creditors in general of the regulated entity.

3. Are neither insured nor guaranteed by the issuer or by a related entity, nor the subject of any other rule that legally or economically improves their precedence relative to the creditors of the regulated entity.

4. The original term of expiration must be no less than five years.

5. Recognition for tier 2 capital within five years of expiration will be reduced by straight-line depreciation at twenty percent (20%) for each year elapsed according to the following table:

| Remaining years | Computable percentage of tier 2 capital |
|---|---|
| Over 5 years | 100% |
| Over 4 years up to 5 years | 80% |
| Over 3 years up to 4 years | 60% |
| Over 2 years up to 3 years | 40% |
| Over 1 year up to 2 years | 20% |

6. There are no clauses providing increasing income or other incentives for early amortization.

7. They could be redeemable at the initiative of the issuer after five years, as long as the following conditions are met:

   a. The regulated entity must receive an authorization from the Superintendency of Banks and

   b. The regulated entity must replace the amortized instrument with capital of equal or greater quality or show that its capital position far exceeds the minimum capital requirements after the purchase option is exercised.

8. The holder will not have any right to accelerated return of planned future payments (coupons or principal), except in the case of bankruptcy or liquidation.

9. The instrument may not have been purchased by the regulated entity nor by any related party controlled by the entity or on which the regulated entity exercises significant influence, nor can its purchase have been directly or indirectly financed by the regulated entity.

**ARTICLE 9. REGULATORY ADJUSTMENTS.** The regulatory adjustments below will be taken into consideration in the calculation of the Capital Funds:

1. **Losses.** Losses for the current fiscal year and accrued losses from previous fiscal years will be deducted from common tier 1 capital.

2. **Goodwill.** Goodwill will be deducted when calculating common tier 1 capital, including any goodwill in the value of significant investments in stock of banks, finance companies and insurance companies outside the regulatory consolidation perimeter. Significant investments are those over 10% of common tier 1 capital owned by the entity subject to investment or those defined as such by the Superintendency.

3. **Other intangible assets.** Will be deducted from common tier 1 capital. The definition of intangible assets given by IFRS must be used in their identification.

4. **Deferred tax assets.** When calculating common tier 1 capital, deferred tax assets whose realization depends on the future profitability of the regulated entity must be deducted. According to the definition given by the International Financial Reporting Standards, deferred tax assets include:

   a. Deductible temporary differences,

   b. Tax losses from previous fiscal periods that can be compensated with future tax earnings and

   c. Unused tax credits

   When these deferred tax assets refer to temporary differences (e.g. provisions for deteriorated credits), the deduction or excess amount is defined as the amount over 10% of common tier 1 capital after regulatory adjustments have been applied.

5. **Cash flow coverage reserves.** In the case of cash flow coverage reserves related to the coverage of items whose net realizable value is not entered on the balance sheet when calculating common tier 1 capital, positive amounts must be deducted and negative amounts must be included.

6. **Profits and losses resulting from changes in own credit risk on financial liabilities at net realizable value.** In the case of unrealized profits and losses resulting from changes in own credit risk on financial liabilities at net realizable value that must be reincorporated due to accrued variations in the regulated entity's own credit risk, positive amounts must be deducted from tier 1 capital and negative amounts must be included.

7. **Investing in own shares (Treasury).** All investments in the common stock of the regulated entity will be deducted when calculating common tier 1 capital. Any shares of the regulated entity which it could be contractually obligated to acquire must also be deducted from the common tier 1 capital calculation. This process will be applied regardless of whether the exposure is registered on the investment or trading portfolio of the regulated entity. Shares of the regulated entity held by any entity subject to consolidation must also be deducted.

8. **Reciprocal cross holdings in banks, finance companies and insurance companies.** Those reciprocal capital cross holdings designed to artificially increase the bank's own resources must be deducted in their entirety. The deduction will be applied to the relevant capital component according to the nature of the cross holding.

9. **Shares in nonfinancial entities included in the consolidated accounting perimeter.** The value of shares in nonfinancial entities included in the Article 12

consolidated accounting perimeter in accordance with IFRS and exceeding 10% of the consolidated common tier 1 capital after applying the remaining regulatory adjustments will be deducted from common tier 1 capital.

10. **Significant shares in banks, finance companies and insurances outside the consolidation perimeter.** A participation exceeding 10% of the capital of the invested entity is considered a significant share. If the significant share is composed of common stock, the amount of the investment exceeding 10% of the common tier 1 capital of the regulated entity once the remaining regulatory adjustments are applied must be deducted from common tier 1 capital. The value of the non-deducted shares will receive a risk weight of 250%.

    Regulatory capital instrument investments that are not common stock but involve a significant share will be deducted in their entirety from the same type of capital in which they would have been calculated had they been issued by the regulated entity. If the regulated entity must make a deduction from a particular type of capital (additional tier 1 capital or tier 2 capital) but lacks sufficient capital of that type to make the full deduction, the difference will be deducted from the next higher type.

**ARTICLE 10. CAPITAL ADEQUACY INDEX FOR AN INDIVIDUAL BANK.** The capital adequacy index for an individual bank is defined as the ratio of capital funds, as established herein, to risk-weighted assets, using the criteria set by the Superintendency for different types of risk.

At no time can the capital adequacy index of an individual bank be less than 8% of the sum of its risk-weighted assets.

Common tier 1 capital cannot be less than four and a half percent (4.5%) of its risk-weighted assets, and tier 1 capital cannot be less than six percent (6%) of its risk-weighted assets.

**ARTICLE 11. CAPITAL ADEQUACY INDEX OF THE BANK AND FINANCIAL SUBSIDIARIES (CONSOLIDATED).** The capital adequacy index of a bank and its subsidiaries is defined as the ratio of capital funds, as established herein, to risk-weighted assets, using the criteria set by the Superintendency for the different types of risk.

At no time can the capital adequacy index of a bank and its subsidiaries be less than 8% of the sum of its risk-weighted assets.

Common tier 1 capital cannot be less than four and a half percent (4.5%) of its risk-weighted assets, and tier 1 capital cannot be less than six percent (6%) of its risk-weighted assets.

The calculation of the capital adequacy index required herein will be made using the common tier 1 capital and additional tier 1 capital components in Articles 3 and 5, respectively, the tier 2 capital components in Article 7 and the additional rules.

**ARTICLE 12. MINIMUM CONSOLIDATED CAPITAL REQUIREMENT.** Only entities of a financial character, including insurance companies, will be considered consolidating entities for the calculation of the minimum consolidated capital requirement for banking groups.
Risk-weighted assets will be established according to the criteria set by the Superintendency of Banks for each type of risk, considering the exposure indicated in the consolidated financial statements and within the consolidation perimeter above. In the case of risk exposures subject to prudential regulations other than those in force in Panama, the criteria of the Superintendency shall prevail.

For the purposes of this Rule, financial entities are understood to be those engaged in financial intermediation or auxiliary financial activities (e.g. banks, leasing, factoring, insurance companies, reinsurance companies, finance companies, trust companies, investment management companies, stock exchanges and stock brokerages, among others).

**ARTICLE 13. ADDITIONAL RULES.** The prudential requisites and requirements herein are additional to, and do not replace, those established by specific Panamanian

regulations or local regulations applicable to banks and finance entities of the banking group domiciled abroad. This means that banks and finance entities belonging to the banking group must comply with the domestic legislation requirements applicable to them at all times.

**ARTICLE 14. CAPITAL ADEQUACY INDEX OF A BANKING GROUP.** The capital adequacy index of a banking group will be calculated as the ratio of the capital funds on the consolidated balance sheet of the banking group to the risk-weighted assets obtained from the consolidated financial statements, using the consolidation perimeter defined in Article 12. At no time can this index be less than eight percent (8%) of the sum of the risk-weighted assets for the banking groups referred to in Article 1.

The Common tier 1 capital [adequacy index] is the ratio of the common tier 1 capital on the consolidated balance sheet of the banking group and the risk-weighted assets obtained from the consolidated financial statements, using the consolidation perimeter defined in Article 12. At no time can this index be less than four and a half percent (4.5%) for the banking groups referred to in Article 1.

The tier 1 capital [adequacy index] is the ratio of the tier 1 capital on the balance sheet of the banking group and the risk-weighted assets obtained from the consolidated financial statements, using the consolidation perimeter defined in Article 12. At no time can this index be less than six percent (6%) for the banking groups referred to in Article 1.

The calculation of the capital adequacy index required herein will be made using the common tier 1 capital and additional tier 1 capital components in Articles 3 and 5, respectively, the tier 2 capital components in Article 7 and the additional rules.

**ARTICLE 15. CAPITAL ADEQUACY REPORT.** The individual and consolidated capital adequacy reports of the bank or banking group must be submitted following the schedule and the format the Superintendency may determine to that end. Information must be reported to the Superintendency by the regulated entity domiciled within the jurisdiction. This regulated entity will be responsible for all communications between the Superintendency and the banking group and for the timely submittal of all required information.

**ARTICLE 16. REPORT ON FUTURE CAPITAL NEEDED TO EXECUTE THE ENTITY'S BUSINESS MODEL.** The entities referred to herein must submit a report on the future capital needed to execute the entity's business model to the Superintendency of Banks according to the schedule determined. The report will take a strategic perspective covering at least three years and providing an assessment of foreseen risks and the sources of additional capital needed to achieve the proposed strategic objectives.

**ARTICLE 17. LEVERAGE RATIO.** The leverage ratio of a regulated entity is defined as the ratio of the common tier 1 capital to the total exposure to the non-risk-weighted assets in and off-balance sheet established by the Superintendency. To determine off-balance sheet operations exposure, the criteria for credit risk and counterparty risk will be used. Derivative exposure will be the reasonable value registered on the entity's books.

At no time can the leverage ratio be less than 3%. The regulated entity will inform the Superintendency of its compliance with the leverage ratio according to the schedule determined.

**ARTICLE 18. BRANCH OFFICES OF FOREIGN GENERAL LICENSE BANKS AND INTERNATIONAL LICENSE BANKS SUBJECT TO HOST SUPERVISION.** Branch offices of foreign general license banks and international license banks that are subject to host supervision will meet the consolidated capital adequacy requirements of their home legislation with their parent companies at all times. For these purposes, they must provide the Superintendency an external auditor certification or a home supervisor certification annually, detailing the home regulatory index and the consolidated index of the bank or banking group at the closing of the period.

## CHAPTER II
## SANCTIONS

**ARTICLE 19. SANCTIONS.** Failure to comply with the provisions herein will be penalized according to the provisions of Title IV of the Banking Law.

## CHAPTER III
## FINAL PROVISIONS

**ARTICLE 20. REPEAL.** With the enactment of this Rule, Rule 5-2008 dated 1 October 2008 and all its amendments, and Rule 3-1999 dated 11 May 1999 are rescinded.

**ARTICLE 21. VALIDITY AND ADJUSTMENT PERIOD.** This Rule shall become effective on 1 January 2016. However, compliance with the minimum capital adequacy index will be subject to the calendar below, taking 1 January of each year as the compliance date.

| Type of Capital | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|
| Common tier 1 capital | 3.75% | 4.00% | 4.25% | 4.50% |
| Tier 1 capital | 5.25% | 5.50% | 5.75% | 6% |
| Tier 2 capital | 8% | 8% | 8% | 8% |

Furthermore, the Superintendency has deemed it appropriate to establish an additional adjustment period through 1 January 2017 for those banks and/or banking groups maintaining instruments in their tier 1 and/or tier 2 capital whose characteristics do not meet the conditions specified in Articles 4, 6 and 8 herein.

Given in the city of Panama on the third (3rd) day of February, two thousand fifteen (2015).

**FOR COMMUNICATION, PUBLICATION AND ENFORCEMENT.**

**THE CHAIRMAN,** **THE SECRETARY,**

L.J. Montague Belanger Luis Alberto La Rocca