Republic of Panama
Superintendency of Banks

RULE N°. 7-2018
(dated 8 May 2018)

"Whereby the provisions on country risk management are prescribed"

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

WHEREAS:

Due to the issuance of Decree Law 2 dated 22 February 2008, the Executive Branch re-edited Decree Law 9 dated 26 February 1998 and all its amendments as a consolidated text, and this text was approved by means of Executive Decree 52 dated 30 April 2008, hereinafter referred to as the Banking Law;

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 favorable conditions for the development of the Republic of Panama as an international financial center are objectives of the Superintendency of Banks;

Pursuant to subparagraph 1, paragraph I of Article 11 of the Banking Law, approving general standards for the identification, regulation and consolidated supervision of banks and banking groups is a technical duty of the Board of Directors;

According to subparagraphs 3 and 5, [paragraph I] 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 risks and establishing the administrative interpretation and scope of the legal provisions and regulations on banking matters are technical duties of the Board of Directors;

In accordance with subparagraph 10, [paragraph I] of Article 11 of the Banking Law, issuing technical standards required for compliance with the Law is a technical duty of the Board of Directors;

Article 72 of the Banking Law provides that for determining the capital adequacy ratio, the Superintendency may take into account the presence of other risks that may serve to evaluate the need for capital funds, including market risks, operating risks, and country risks;

Pursuant to paragraph 3 of Article 91 of the Banking Law, banks must send to the Superintendency any other information required by it according to a timetable it may determine;

Given the evolution of prudential regulations, best banking practices and auditing and accounting standards, it became necessary to update the overall regulatory framework governing the international banking center in accordance with best international standards and the specific characteristics of the Panamanian banking system;

The economic, social, political and geographic condition of the country of domicile of banking debtors may prevent these debtors from fulfilling their financial obligations, constituting losses in the banks' international portfolio;

During its working sessions, the Board of Directors determined it necessary and advisable to update the regulatory framework governing the minimum criteria around the appropriate policies and procedures for the identification, verification and control of country risks in the activities conducted by banks related to all assets, risk contingencies and derivatives operations for the proper constitution of provisions.

RESOLVES:

CHAPTER I
GENERAL PROVISIONS

ARTICLE 1. SCOPE OF APPLICATION. The provisions herein are applicable to:

1. state-owned banks;
2. general license banks;
3. international license banks for whom the Superintendency is the home supervisor;
4. banking subsidiaries abroad that consolidate operations in a bank established in Panama or with a bank holding company established in Panama and for which the Superintendency of Banks is the home supervisor.

Each of which will hereinafter be referred to as a “reporting entity.

ARTICLE 2. TERMS AND DEFINITIONS. For the purposes of the provisions herein, the following will be understood as:

1. **Country risk management:** The process that consists on identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating country risk;
2. **Country risk:** The possibility of incurring in losses resulting from negative situations in the economic, social or political context or due to natural disasters in countries where the regulated entity or their customers conduct business. The country risk includes transfer risk, political risk and sovereign risk, among others:

    a. **Transfer risk:** The overall inability of debtors in a given country to meeting their financial obligations due to a lack of availability of the currency in which the obligation is denominated, regardless of the specific debtor’s particular financial condition;

    b. **Political risk:** Refers to the potential of war, civil riot and other clearly political situations, among others;

    c. **Sovereign risk:** The possibility that the sovereign debtor cannot or is not willing to meet its financial obligations.

CHAPTER II
COUNTRY RISK MANAGEMENT AND RESPONSIBILITIES

ARTICLE 3. POLICIES FOR COUNTRY RISK MANAGEMENT. Any and all reporting entities must exercise an efficient management of resources abroad, including effective policies and procedures for identifying, evaluating, quantifying, controlling and mitigating the risk taken.

The policies and procedures for managing this risk must be approved by the Board of Directors of the reporting entities and documented in the manual including the methodology of country classification, internal exposure limits, stress testing and contingency plans, among other aspects, according to the degree of complexity and volume of exposure to the country risk. This manual must be available to internal auditors, external auditors and the Superintendency at all times.

ARTICLE 4. BOARD OF DIRECTORS RESPONSIBILITY. The Board of Directors is responsible for ensuring that the reporting entity has an appropriate, efficient, viable and duly documented framework for country risk management, in accordance with the Rule on comprehensive risk management issued by the Superintendency. The framework for country risk management must match the reporting entity's risk profile, risk appetite and systemic importance.

The Board of Directors must ensure the existence of appropriate internal controls to protect the integrity of country risk management. The board of directors will approve any exceptions to the established internal policies and procedures and will supervise the level of country risk taken by the reporting entity to ensure it is proportional to its regulatory capital funds and other significant variables.

The Board of Directors will be responsible for ensuring that the different areas of the entity adopt the necessary measures to manage country risk. Similarly, the board of directors must approve the country risk management manuals and ensure that they are updated at least once (1) every year.

The Board of Directors must make sure that stress tests exist and are applied at least once (1) a year and that the reporting entity has contingency plans that are effective and appropriate for its country risk profile.

ARTICLE 5. TOP MANAGEMENT RESPONSIBILITY. Top management is responsible for implementing a strategy for country risk management, as well as the policies and procedures approved by the Board of Directors to manage this risk.

ARTICLE 6. RISK COMMITTEE. The Risk Committee of the reporting entity must manage country risk following the guidelines provided in the Rule on comprehensive risk management issued by the Superintendency.

PROVISO: If the bank holding company of a banking group does not have a Corporate Risk Committee, the Board of Directors will determine to which group committee this duty will be assigned. The members of this committee must have the necessary knowledge and experience to properly fulfil its duties.

ARTICLE 7. RISK MANAGEMENT UNIT RESPONSIBILITY. Pursuant to the provisions of the Rule on comprehensive risk management and the Rule on consolidated supervision of banking groups, both issued by the Superintendency, the risk management unit will have country risk management as one of its duties. In addition to the responsibility established in the abovementioned Rules, the unit must:

1. Design country risk management policies along with the Risk Committee, simultaneously informing the general manager or his/her equivalent;

2. Follow up on meeting the country risk exposure limits and sub-limits and informing the Board of Directors of the results;

3. Design and submit the country risk management methodologies for the approval of the Risk Committee;

4. Implement the country risk management methodology, along with top management and all other areas involved in managing assets or resources subject to country risk;

5. Design an information system based on objective and timely reports and submit it to the Risk Committee for approval. This system must reflect the levels of country risk exposure and compliance with the limits set, as well as the provisions for country risk determined by the reporting entity.

6. Develop and maintain a stress-testing methodology to identify country risk effects.

ARTICLE 8. INTERNAL AUDIT UNIT RESPONSIBILITIES. The Internal Audit Unit will conduct an independent assessment of the policies, procedures and internal control mechanisms used for country risk management, in accordance with the provisions herein.

CHAPTER III
OPERATIONS SUBJECT TO COUNTRY RISK

ARTICLE 9. COUNTRY RISK EXPOSURE. [The following items] are subject to country risk:

1. Assets, risk contingencies and derivatives trading resulting from transactions with individuals or legal entities domiciled abroad.

2. Assets, risk contingencies and derivatives trading resulting from transactions with individuals or legal entities domiciled in Panama whose main source of payment comes from abroad.

3. Assets, risk contingencies and derivatives trading resulting from transactions with individuals or legal entities domiciled in Panama, when these have collateral registered abroad, as long as that collateral has been decisive for loan approval.

The following operations will be considered in measuring country exposure:

- Allocations
- Loans and repo operations
- Securities investment
- Derivative financial instruments
- Irrevocable contingencies
- Any other the Superintendency may determine

Transactions conducted by reporting entities that are backed up by collateral issued by the International Monetary Fund (IMF), the International Bank for Reconstruction and Development, the International Development Association (IDA), the International Finance Corporation (IFC), the Inter-American Development Bank (IADB), the European Investment Bank (EIB), the Asian Development Bank (ADB), the African Development Bank (AFDB), the International Fund for Agricultural Development (IFAD), the Development Bank for Latin America (CAF) or any other multilateral development organizations approved by the Superintendency will not be subject to country risk, as long as the collateral covers the country risk as defined herein. . Additionally, the financial structures provided by these multilateral organizations that, in the Superintendency's opinion, mitigate this risk will not be subject to country risk.

PROVISO: For bank holding companies whose (banking) subsidiaries abroad consolidate operations in Panama, the provisions herein will be applicable, as long as the country source of repayment and/or domicile of the debtor are other than the subsidiary's country.

CHAPTER IV
COUNTRY RISK ASSESSMENT METHODOLOGY

ARTICLE 10. COUNTRY RISK ASSESSMENT ELEMENTS. Reporting entities must conduct an overall assessment of each country with which they have exposures when the total sum of the individual exposures by country are equal or greater than 30% of the total operations subject to country risk as described in Article 9 herein.

When the sum of the country exposures total less than 30% of the total operations subject to country risk as described in Article 9 herein, but one of them by itself is equal or greater than 5%, the reporting entities should also conduct an overall assessment of each country with which they have an exposure.

To conduct the assessment, the following aspects must be considered, as a minimum:

1. **External financial condition:** The country's capacity to face its commitments abroad will be considered. For this, indicators such as total foreign debt, short-term

foreign debt, debt service associated with Gross Domestic Product (GDP), exports and international reserves will be analyzed.

2. **Access to funding:** Whether the country has access to the voluntary credit market or not and the degree of compliance with agreements with multilateral organizations will be considered.

3. **Macroeconomic condition:** An analysis of the country's macroeconomic balances will be conducted while observing key indicators such as GDP growth, inflation rate, savings, investment and tax condition. Indicators related to monetary aggregates, budgetary aggregates, financial sector and balance of payments, restrictions on capital flow and other aspects considered necessary for the analysis will also be analyzed.

4. **Credit risk ratings:** Sovereign risk ratings assigned by internationally recognized credit risk rating agencies will be considered. When there are two or more ratings issued by internationally recognized credit risk rating agencies and different risk ratings are presented, the more conservative rating should be considered.

5. **Political, social and institutional stability.** Situations that could jeopardize the stability of the country will be analyzed, for which the existence of internal turmoil, the possibility of interruptions to the rule of law, problems of governance, possibility of conflicts with other countries that may endanger the stability of the country's economy or affect the return of resources invested in it will be considered.

ARTICLE 11. COUNTRY CLASSIFICATION CATEGORIES. Taking into consideration the elements described in Article 10 herein, reporting entities will classify the exposures subject to country risk into the following groups:

Group 1. Low-risk countries. Countries with a high capacity for paying their obligations, without problems in funding foreign trade, without significant restrictions on international financial transactions and with an economic, political, social and institutional performance that demonstrates stability and credibility.

Countries whose sovereign risk rating issued by an internationally recognized risk rating agency is below Standard & Poor's AA- rating or its equivalent as described in the table attached hereto cannot be included in this group.

Group 2. Normal risk countries. Countries that without being low risk comply with their international financial obligations in a timely manner, comply with the financing of their foreign trade activities and do not show significant deterioration in their economic, political, social and institutional performance in the medium term.

Countries whose sovereign risk rating issued by an internationally recognized risk rating agency is below Standard & Poor's BBB- or its equivalent as described in the table attached hereto cannot be included in this group.

Group 3. Moderate risk countries. Countries without significant macroeconomic imbalance but evincing doubts on meeting their international financial obligations. They can also present one or more of the following conditions:

a. There are reasonable doubts as to its continuing to maintain macroeconomic balance in the medium term.
b. The country's debt level makes it difficult to acquire new loans under normal conditions.
c. There has been an interruption in its amortization of its debts in the last five years; however, the payment of interest was made normally.
d. During the last five years it has partially or completely renegotiated its debt, extending the maturity date.

Countries whose sovereign risk rating issued by an internationally recognized risk rating agency is below Standard & Poor's BB- or its equivalent as described in the table attached hereto cannot be included in this group.

Group 4. Countries with difficulties. Countries with recurrent internal and external imbalances, with a poorly diversified export base, with fluctuations in export income, with delays in the payment of international financial commitments and with the obvious need to enter an international credit organization adjustment program. They can also present one or more of the following conditions:

a. Failing to comply with goals associated with loans granted by international organizations.
b. Renegotiations agreed on do not necessarily improve payment capacity.
c. There has been an interruption in its amortization of its debts in the last two years; however, the interest payments were made.
d. The debt was renegotiated in the last two years, extending the terms, or there is an interest in doing so.
e. Funding in the last two years of a substantial part of the interests with new loans.

Countries whose sovereign risk rating issued by an internationally recognized risk rating agency is below Standard & Poor's B- or its equivalent as described in the table attached hereto cannot be included in this group.

Group 5. Doubtful countries. Countries with significant internal and external imbalances, high inflation rates, very low or negative Gross Domestic Product (GDP) growth, difficulty in financing its balance of payments, increasing rescheduling of foreign commitments or little possibility of payment. They also can present one or more of the following conditions:

a. They have not accepted adjustment programs from international credit organizations.
b. There has been a total or partial interruption in its payment of loan interest in the last two years.
c. They have unilaterally rescheduled debts in the last two years.

Countries whose sovereign risk rating issued by an internationally recognized risk rating agency is below Standard & Poor's C or its equivalent as described in the table attached hereto cannot be included in this group.

Group 6. Countries with serious problems. Countries that have not recognized their debts or have not complied with the amortization of their debts during the last two years.

This group includes countries whose sovereign risk rating issued by an internationally recognized risk rating agency is D according to Standard & Poor's or its equivalent as described in the table attached to this Rule.

PROVISO. The countries for which the reporting entity has not conducted the country risk assessment following the elements of Article 10 herein, should be placed in Group 6 until the reporting entity conducts the assessment and assigns the country to the risk category determined as a result of the analysis.

Without prejudice of the above, the countries without a risk rating issued by an internationally recognized risk rating agency will be placed in group 5 or 6, i.e. the group with the highest risk.

CHAPTER V
LIMITS AND PROVISIONS

ARTICLE 12. EXPOSURE LIMITS BY COUNTRY. Pursuant to the conditions of the Rule on comprehensive risk management, the reporting entity's Board of Directors will approve the limit structure for country risk management. The limits must avoid the reporting entity having excessive concentrations with a given country that may risk its solvency or business viability. To this end, limits by country and sub-limits by product, counterparty, term of operations or other relevant dimensions must be set. These limits must be established based on the regulatory capital funds and other relevant variables.

ARTICLE 13. PROVISIONS FOR COUNTRY RISK. The reporting entity will determine the percentages for establishing the provisions for country risk corresponding to the risk categories in Article 11.

These provisions will be subsequently assessed by the reporting entity's Internal Audit Unit and the Superintendency.

The Superintendency may ask for an adjustment to the provisions set by the reporting entity when the former deems it appropriate.

The reporting entity must document the methodology used for the calculation of the provisions for country risk. The characteristics to be documented are:

1. Detailed description of the methodology used to calculate provisions: theoretical basis and assumptions for its development.

2. Variables considered in determining the provisions for each country risk category, such as: recorded loss rates, estimated loss rates, noncompliance probability estimation and recovery rates, among others.

3. Description of sources of information used.

4. Temporary horizon taken into consideration to calculate provisions, with a minimum of one (1) year.

5. Frequency that percentages for provisions by country risk are reviewed. As a minimum, the percentages for provisions must be reviewed annually or when there are relevant developments in a country that could modify the expected losses from exposures in that country.

6. Estimated results describing the percentages for provisions corresponding to each country category.

7. Analysis of the soundness of the methodology used to calculate provisions. This analysis must contain, as a minimum, a description of the process for reviewing the methodology, in which its proper functioning is evaluated and predictions are matched to actual losses. As a result of this process, the necessary adjustments will be made to correct identified weaknesses.

ARTICLE 14. OPERATIONS EXEMPT FROM PROVISIONS FOR COUNTRY RISK. The following categories are exempt from provisions for country risk:

1. Foreign trade operations with a term of less than one year.
2. Investments in countries included in groups 1 and 2, traded in deep markets that are highly liquid, assessed at fair value and whose valuation is made on a daily basis.
3. Trading with derivatives conducted in centralized trading mechanisms demanding the constitution of deposits or collateralized margins adjusted daily, located in countries included in groups 1 and 2.
4. Exposures with multilateral development organizations listed in the Rule on credit and counterparty risk-weighted assets.

ARTICLE 15. FEATURES TO CONSIDER WHEN CALCULATING PROVISIONS FOR COUNTRY RISK. As a general rule, reporting entities must set provisions as the greater of those resulting from comparing the nature of the operations in question and the provisions for country risk. The final provision for country risk will be calculated after determining the provisions required by the nature of the operation in question.

ARTICLE 16. CHANGES IN CLASSIFICATION. When a country is reclassified in a higher or lower risk category, the reporting entity will make the necessary adjustments in the provisions, without prejudice to subsequent revisions the Superintendency may conduct.

ARTICLE 17. STRESS TESTING. Reporting entities must conduct stress testing at least once a year.

Stress testing will be conducted based on the methodology developed by reporting entities. Therefore, several extreme but plausible scenarios must be simulated, including, as a minimum:

1. Deterioration of the main macroeconomic variables, such as GDP, Unemployment rate and/or Fiscal deficit, among others.

2. The worsening of the contagion effect between countries.

3. Restrictions in capital markets and financial systems liquidity.

4. Alterations in the relationship between market and credit risks.

5. Negative events in funding sources available abroad.

The results obtained must be informed to the Board of Directors of the reporting entity, must be duly documented and be considered when reviewing management policies, procedures and country risk exposure limits. Depending on the results, the reporting entities must evaluate the specific measures to take for each case. These measures must be written down in the contingency plan and will determine the increase in provisions produced as a result of changes in the risk classification of each country and the impact on capital adequacy.

The analysis should also take into consideration the reporting entity's sources of funding and liquidity, particularly when the reporting entity has significant funding concentrations in some countries.

CHAPTER VI
INFORMATION REQUIREMENTS

ARTICLE 18. COUNTRY RISK INFORMATION. Reporting entities must maintain the following information, as a minimum, at the disposal of the Superintendency:

1. A file for each country where an exposure is maintained, as applicable, pursuant to the provisions of Article 10;

2. The method of analysis for each assessed country, as well as the report containing all of the relevant information and concluding remarks determining the classification assigned to the relevant country;

3. The methodology used for calculating provisions for country risk;

4. Any other information the Superintendency deems opportune to solicit.

ARTICLE 19. DISCLOSURE OF INFORMATION. Reporting entities must record and reveal in their audited financial statements the information that will permit the user to evaluate the country risk profile related to the assets, risk contingencies and trading with derivatives maintained abroad, based on the criteria established in this Rule and the International Financial Reporting Standards (IFRS).

Reporting entities must include in their annual report the information that will permit determining their country risk exposure, as defined herein, the amount of provisions for country risk and the main aspects of the risk management framework.

ARTICLE 20. INFORMATION TO THE SUPERINTENDENCY. Reporting entities must submit the information referred to in this Rule to the Superintendency in the format and according to the timetable it may determine .

CHAPTER VII
PENALTIES

ARTICLE 21. PENALTIES. Failing to comply with the provisions in this Rule will be penalized according to the provisions of Title IV of the Banking Law.

CHAPTER VIII
FINAL PROVISIONS

ARTICLE 22. REPEAL. This Rule repeals General Resolution 7-2000 dated eight (8) September two thousand (2000) in all its parts and amendments.

ARTICLE 23. ENACTMENT. This Rule shall become effective on 3 June 2019.

Given in the city of Panama on the eighth (8th) day of May, two thousand eighteen (2018).

FOR COMMUNICATION PUBLICATION AND ENFORCEMENT.

THE CHAIRMAN,	**THE SECRETARY,**
L. J. Montague Belanger	Nicolás Ardito Barletta

APPENDIX

Equivalency table for long-term foreign exchange international credit ratings

S&P	Fitch	Moody's
AAA	AAA	Aaa
AA+	AA+	Aa1
AA	AA	Aa2
AA-	AA-	Aa3
A+	A+	A1
A	A	A2
A-	A-	A3
BBB+	BBB+	Baa1
BBB	BBB	Baa2
BBB-	BBB-	Baa3
BB+	BB+	Ba1
BB	BB	Ba2
BB-	BB-	Ba3
B+	B+	B1
B	B	B2
B-	B-	B3
CCC	CCC	Caa
CC	CC	Ca
C	C	C
D	D	-