REPUBLIC OF PANAMA
SUPERINTENDENCY OF BANKS

RULE N°. 2-2021
(dated 11 June 2021)

“Whereby the parameters and guidelines that will be applicable to modified loans are established”

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 Article 5 (1) and (3) of the Banking Law, safeguarding the soundness and efficiency of the banking system and promoting public trust in the banking system are objectives of the Superintendency of Banks;

Pursuant to Article 11 (I)(5) 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;

By means of Rule 4-2013 dated 28 May 2013, the provisions on credit risk management and administration inherent to loan portfolio and off-balance sheet operations were established;

The Superintendency of Banks issued Rule 2-2020 dated 16 March 2020 by means of which additional, exceptional, and temporary measures to comply with the provisions contained in Rule 4-2013 were established, which permitted banks to modify the conditions originally agreed on for corporate and consumer loans, to provide a financial relief to customers whose payment capacity was affected by the situation triggered by COVID-19;

According to Rule 3-2020 dated 26 March 2020, Article 3 (7) of Rule 2-2020 was amended to specify and make more flexible the modifications that could be accepted by the debtor through any means or method;

By means of Rule 7-2020 dated 14 July 2020, Article 4 of Rule 2-2020 was amended to extend until 31 December 2020 the period banks will have to evaluate the loans affected by the COVID-19 situation and make the relevant modifications. Likewise, it was established that these loans will maintain the risk classification registered at the entry into force of Rule 2-2020, until the Superintendency establishes the criteria for classification and determination of the provisions that will be applied to modified loans;

Rule 9-2020 dated 11 September 2020 amended Rule 2-2020 to establish, among other aspects, the treatment that the modified loans will have and define the creation of provisions that will allow protect the interest of depositors and preserve financial stability;

Rule 13-2020 dated 21 October 2020 amended Rule 2-2020 to establish an additional term until 30 June 2021 so that banks can provide financial relief measures to the modified loans of the banking system;

The harsh financial situation the country is still going through, triggered by the COVID-19 health crisis, has led to a significant number of people and companies still economically affected to be under the financial relief conditions and that, as of the end of May 2021, a third of the total domestic loan portfolio was in this situation; therefore, it is necessary to establish a regulation that allows banks to separate loan portfolios, according to their financial viability, to identify those that may be renegotiate new terms and conditions;

During its working sessions, the Board of Directors determined it necessary and advisable to establish new guidelines and parameters that will be applicable to modified loans classified as modified special mention, as well as those modified loans that were returned to their originally agreed on conditions in accordance with Rule 4-2013.

RESOLVES:

ARTICLE 1. PURPOSE. The provisions herein are intended to establish guidelines and parameters for managing credit and counterparty risk of the loans modified in accordance with the measures established by Rule 2-2020.

ARTICLE 2. SCOPE. This Rule will be applicable to banks that maintain loans that were modified in accordance with Rule 2-2020, as well as those modified loans that have been returned to their originally agreed on conditions in accordance with the guidelines of Rule 4-2013.

ARTICLE 3. MODIFIED LOANS. For the purposes of this Rule, a modified loans will be understood as those loans on which the bank has made, until 30 June 2021, changes in their terms and conditions, including grace periods for principal and/or interests, and that are classified in the modified special mention category.

ARTICLE 4. GENERAL TERMS AND CONDITIONS TO RETURN TO RULE 4-2013 THE LOANS MODIFIED ACCORDING TO RULE 2-2020. To return the loan portfolio, modified according to Rule 2-2020, to the terms and conditions of Rule 4-2003, banks will follow the parameters listed below:

1. The loans on which banks made modifications, in accordance with the parameters of Rule 2-2020 and whose debtors, as of the entry into force of this Rule, are in compliance with the terms and conditions originally agreed on (prior to the financial relief measures due to COVID-19), the provisions established in Rule 4-2013 on Credit risk will be applicable, classifying the loans in the pass category. Likewise, the bank must remove them from the modified loan category and any future changes to the terms and conditions will be governed by Rule 4-2013.

2. The loans that as of 30 June 2021 are classified in the modified special mention category may be returned to the application of Rule 4-2013, after complying with their new terms and conditions and provided that they demonstrate compliance of their payments consecutively during the six-month period, in accordance with the payment plan agreed on with the client. In these cases, these loans may be classified in the pass category.

3. The loans that as of 30 June 2021 are classified in the modified special mention category that their new terms and conditions included grace periods for principal and/or interests or others, which are still under this modality, may not be returned to the application of Rule 4-2013 and will remain in the modified special mention category until the agreed grace period is completed. These loans may be returned to the application of Rule 4-2013 after complying with their terms and conditions, if they demonstrate compliance with their payments consecutively during the six-month period, in accordance with the payment plan agreed on with the client. In these cases, these loans may be classified in the pass category.

4. The restructured loans, in accordance with Rule 4-2013, on which the bank has modified their terms and conditions and that were up to date in their payments, will maintain the classification they had at the time of modification. Likewise, they will maintain the provision equivalent to the higher value between the provision originally established under Rule 4-2013 and the provision established in accordance with Rule 2-2020. The provisions of Article 19 of Rule 4-2013 will be applicable to them and consequently they will no longer be considered modified loans.

5. The restructured loans, in accordance with Rule 4-2013, on which the bank has modified their terms and conditions and which have breached these new terms, will be returned to the provisions of Rule 4-2013 and will be classified based on the category they were before their modification, adding up the corresponding days of arrears. Likewise, they will maintain the provision equivalent to the higher value between the provision originally established under Rule 4-2013 and the provision established in accordance with Rule 2-2020.

6. The loans classified as substandard, doubtful, and loss that were modified in accordance with Rule 2-2020 and complied with their payments during the first half of 2021, will remain in the classification in which they were at the time of modification. Likewise, they will maintain the provision equivalent to the higher value between the provision originally established under Rule 4-2013 and the provision established in accordance with Rule 2-2020. The provisions of Rule 4-2013 will be applicable to these loans and consequently they will no longer be considered modified loans.

7. The loans classified as substandard, doubtful, and loss that as of 1 January 2021 were modified in accordance with Rule 2-2020 and partially or totally defaulted on their payments during the first half of 2021 will be returned to Rule 4-2013 and will be classified based on the category in which they were before their modification, adding up the corresponding days of arrears. Likewise, they will maintain the provision equivalent to the higher value between the provision originally established under Rule 4-2013 and the provision established in accordance with Rule 2-2020.

PROVISO. All modified loans that were returned to the provisions of Rule 4-2013 and any other loan classified in accordance with Rule 4-2013 may not be moved, as of 1 July 2021, to the modified special mention category.

ARTICLE 5. CLASSIFICATION OF THE MODIFIED PORTFOLIO. For the purposes of this Rule, the existence of the classification category of modified loans called modified special mention is recognized, within which the modified loans are included until 30 June 2021.

As part of the follow-up and control processes of the modified special mention category, banks must ensure that they apply the guidelines and parameters provided by the Superintendency regarding the reporting of modified loans.

ARTICLE 6. PERIOD FOR RESTRUCTURING MODIFIED LOANS. Banks will have until 30 September 2021 to restructure modified loans that are classified as modified special mention and that as of 30 June 2021 had not been able to agree on new terms and conditions. For these purposes, these restructurings must comply with the characteristics provided in Article 7 herein.

Modified loans that have been restructured as of 1 July 2021 may not be subject to further restructuring except in the case of a reduction in the interest rate.

ARTICLE 7. CHARACTERISTICS FOR RESTRUCTURING MODIFIED LOANS. As of 1 July and until 30 September 2021, the bank may restructure modified loans, if the banks meet the following characteristics:

1. The new terms and conditions must meet the financial viability criteria, taking into consideration the debtor’s payment capacity and the bank’s loan policies.

2. The debtor proves with reasonable financial data and/or documents that he has the precise, current and/or prospective payment capacity.

3. The viability assessment must be based on the debtor’s financial characteristics and the restructuring measure must be in accordance with his financial situation.

4. The debtor has agreed to catch up on the arrears and a significant reduction in the outstanding balance is expected within the agreed period.

Restructured modified loans may not be aimed at the successive application of several restructuring measures. Periods without debt payment, i.e. payments to principal and/ interest, may not exceed, for the same loan facility, a period of up to six (6) months for consumer loans and up to twelve (12) months for corporate loans, subject to the debtor’s payment capacity.

This measure may not become a “one-size fits all” rule to regularize the behavior of the loan portfolio. Likewise, restructured modified loans will be subject to special monitoring by the bank.

ARTICLE 8. PROVISION REQUIRED FOR THE MODIFIED SPECIAL MENTION CATEGORY. To hedge credit risk, banks must establish provisions on the modified loan portfolio classified as “Modified Special Mention,” ensuring compliance with the International Financial Reporting Standards (IFRS) and the prudential standards set herein.

For such purposes, banks will establish a provision equivalent to the higher value between the IFRS provision of the modified special mention portfolio and a generic provision equivalent to three percent (3%) of the gross balance of the modified loan portfolio, including uncollected accrued interest and capitalized expenses; modified loans secured with deposits pledged in the same bank up to the secured amount may be excluded from this calculation. For this, the following scenarios will be considered:

1. In cases where the IFRS provision is equal to or higher than the generic provision of 3% established herein, the bank will register the corresponding IFRS provision in the results of the year.

2. In cases where the IFRS provision is below than the generic provision of 3% established herein, the bank will calculate said IFRS provision in results and the difference must be recorded in results or in a regulatory reserve in capital, taking into consideration the following aspects:

   a. When the IFRS provision is equal to or higher than 1.5%, the bank must register said IFRS provision in the income statement. Likewise, the difference to complete the 3% of the generic provision established herein must be recorded in the regulatory reserve in capital.

   b. When the IFRS provision is below than 1.5%, the bank must ensure that this percentage is completed and recorded in the income statement. Likewise, the difference to complete the 3% of the generic provision established herein must be recorded in a regulatory reserve in capital.

The foregoing, without prejudice to the authority of the Superintendency to modify the provision percentages and the form and frequency to reverse generic provisions and regulatory reserves, based on the new circumstances derived from COVID-19.

PROVISO 1. Although banks are required to use IFRS when preparing accounting records and reporting financial statements, as provided for in Rule 6-2012, exceptionally and only for those banks where there is an excess of generic provision on the IFRS provision, as indicated in (2)(b) herein, and that difference is material, they will temporarily use the accounting base, as follows: “International Financial Reporting Standards as they have been modified by prudential regulations related to the provisions of the modified special mention portfolio, issued by the Superintendency of Banks of Panama for supervisory purposes.”

PROVISO 2. In the case indicated in (2) herein, the excess of generic provision that must be recorded in capital will be accounted for in a regulatory reserve that is paid or credited to the retained earnings account. For purposes of calculating the capital adequacy ratio, concentration limits in a single debtor or related parties and any other prudential relationship, the balance of regulatory reserve will be not be considered as regulatory capital funds.

PROVISO 3. As of 1 July 2021, banks must generate the necessary provisions for the modified loans that have breached their terms and conditions, taking into consideration the provisions herein and the significant increase in risk or impairment. The foregoing shall be applied without prejudice to the Superintendency regulating its additional provision.

ARTICLE 9. DISCLOSURES IN THE FINANCIAL STATEMENTS. For the purposes of preparing and reporting the audited annual financial statements (EFA), revised financial statements (EFS), and interim financial statements (EFT), banks should ensure that the explanatory notes disclose qualitative and quantitative information on loans classified in the modified special mention category and their impact on determining the provision for expected losses, as well as on the bank’s current and future cash flows. The notes must disclose the following information, as a minimum:

1. Amount of loans in the modified special mention category.

2. Characteristics of these modifications, risks to which the bank is exposed and their effect on the bank’s cash flow.

3. Method for determining the significant risk increase, amounts classified in stage 1, 2 or 3 of IFRS and the amount of the provision for each of the stages.

4. Risk management of this portfolio if it is not included in another explanatory note to the financial statements.

ARTICLE 10. FINANCIAL SUBSIDIARIES ESTABLISHED ABROAD. In the case of banks maintaining financial subsidiaries established abroad, for the sake of consolidation, the provisions of Rule 4-2013 will be applicable.

ARTICLE 11. USE OF THE DYNAMIC PROVISION. For the purposes of Article 37 (c) of Rule 4-2013, which provides restrictions on the amount of the dynamic provision, it is established as an exceptional and temporary measure that banks may use up to eighty percent (80%) of the dynamic provision only to offset the retained earnings decreased by the establishment of IFRS and generic provisions on the modified special mention portfolio. The use of the dynamic provision will be made in the accounting terms established in Circular 124 dated 15 April 2020.

In cases where the bank requires to use more than eighty percent (80%) of the amount of the dynamic provision, it must obtain prior authorization from the Superintendency of Banks.

Banks may only pay dividends once they have restored the amount of the dynamic provision that corresponds to them in accordance with their loan portfolio, with the exception of dividends on preferred shares, whose payment can be made provided there are sufficient earnings, prior notification to the Superintendency.

ARTICLE 12. CONTAGION. During the term of this Rule, the provisions of proviso 1 of Article 18 of Rule 4-2013 shall not apply.

ARTICLE 13. TRANSPARENCY AND BANK CUSTOMER PROTECTION. Banks must comply with the provisions established herein and ensure they are fully transparent in the information provided to the customer on the changes made to the terms and conditions of their contracts, so that they can know the details of the balances owed and the amounts charged for principal and/or interests and others.

Banks must make sure to strengthen the procedures, mechanisms and methods of their claim management system to respond to all requests, claims, complaints, questions and controversies lodged by customers on the application of the provisions established herein and other provisions related to the matter, in accordance with the provisions of Article 206 of the Banking Law.

Furthermore, the Superintendency of Banks will have its Bank Customer Service Office at the disposal of bank customers and consumers so that they may be able to lodge these claims through any of the communication means and channels available nationwide, in order to ensure proper compliance with the aforementioned provisions and guarantee the protection of the rights of bank customers.

ARTICLE 14. PROHIBITIONS. The provisions of this Rule may not be interpreted by banks or debtors as automatic grace periods, i.e. without the client contacting the bank and managing to restructure their loans.

ARTICLE 15. SUBROGATION. With the entry into force of this Rule, Rule 2-2020 dated 16 March 2020, and all its modifications, is subrogated.

ARTICLE 16. REPEAL. With the entry into force of this Rule, the Board of Directors' General Resolution SBP-GJD-0010-2020 dated 29 December 2020 is repealed.

ARTICLE 17. EFFECTIVE DATE. This Rule shall become effective as of 1 July 2021.

Given in Panama City on the eleventh (11th) day of June, two thousand twenty-one (2021).

FOR COMMUNICATION, PUBLICATION AND ENFORCEMENT.

THE CHAIRMAN,	**THE SECRETARY,**
Luis La Rocca	Nicolás Ardito Barletta