Republic of Panama
Superintendency of Banks

RULE No. 5-2023
(10th October 2023)

"Establishment of Capital Conservation Buffers"

THE BOARD OF DIRECTORS
in the exercise of its legal powers and,

WHEREAS:

Upon the issuance of Decree Law 2, dated 22nd February 2008, the Executive Branch re-edited Decree Law 9 of 1998 and all its amendments as a consolidated text, which was approved by means of Executive Decree 52, dated 30th April 2008. This consolidated text is hereinafter referred to as the Banking Law,

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

Under Article 11(3) and (5) of the Banking Law, the technical duties of the Board of Directors include approving general criteria for the classification of assets at risk and establishing the administrative interpretation and scope of the legal stipulations and regulations on banking matters,

Under Article 67 of the Banking Law, banks are required to comply with the capital funds mandated by the law and its regulations,

Under Rule 1-2015, dated 3rd February 2015, regulations pertaining to capital adequacy applicable to banks and banking groups were established,

Under Articles 10 and 11 of Rule 1-2015, an individual bank's capital adequacy ratio must not be less than 8% of the sum of its risk-weighted assets. Additionally, common tier one capital cannot be less than 4.5% of its risk-weighted assets, and tier one capital cannot be less than 6% of its risk-weighted assets,

Rule 3-2016, dated 22nd March 2016, establishes the rules for determining credit risk and counterparty risk-weighted assets,

According to the provisions established by the Basel Committee on Banking Supervision, the introduction of a capital conservation buffer aims to strengthen regulatory capital beyond the minimum required, thereby providing greater coverage for banks' exposure to risk and preventing non-compliance with the minimum capital requirements during periods of solvency deterioration,

During its working sessions, the Board of Directors determined that it was both necessary and advisable to adopt a regulatory framework that outlines guidelines for establishing and managing capital conservation buffers. This framework, in addition to regulating capital, allows for the preservation of tier one capital in stressful conditions and enhances the stability of the banking system.

RESOLVES:

ARTICLE 1. PURPOSE AND CRITERIA. This Rule establishes the principles, general criteria, and minimum procedures for banks to adhere to with the aim of establishing and managing capital conservation buffers.

ARTICLE 2. SCOPE. The provisions outlined here will be applicable to the following entities, as defined in Article 1 of the Rule on Capital Adequacy Ratio issued by the Superintendency:

1. State-owned banks.
2. General license banks
3. International license banks under the home supervision of the Superintendency of Banks.
4. Bank holding companies of banking groups consolidating their operations in Panama, under the home supervision of the Superintendency of Banks.

However, the Superintendency of Banks may extend the application of this Rule to banks not covered in the above categories if they are deemed crucial for the stability of the banking system.

This Rule will apply at the individual bank level, as well as for banks with a financial nature and their subsidiaries (on a consolidated basis), and at the level of banking groups.

PROVISO: Branch offices of foreign general license and international license banks, subject to host supervision, shall comply with the provisions of Article 18 of Rule 1-2015 on Capital Adequacy. They must continue to submit the certification confirming the home regulatory capital ratio. If required by the home supervisor, they must also include information regarding the capital buffer established.

ARTICLE 3. CAPITAL CONSERVATION BUFFER DEFINITION. For the purposes of this Rule, the capital conservation buffer is the capital intended to ensure that entities accumulate reserves that can be used in case of incurring losses. The capital conservation buffer is designed to prevent banks from failing to comply with the minimum requirements established during solvency deterioration episodes, without considering the conservation buffer.

ARTICLE 4. CAPITAL CONSERVATION BUFFER ESTABLISHMENT. Banks must maintain a capital conservation buffer above the minimum regulatory capital requirements, in accordance with the criteria and guidelines established herein.

ARTICLE 5. CAPITAL CONSERVATION BUFFER NATURE. The capital conservation buffer is designed to accumulate common tier one capital above the regulatory minimum requirements outlined in Articles 10, 11, and 14 of Rule 1-2015 on Capital Adequacy. Once the buffer is established, it must be maintained permanently, except during systemically stressful periods, as determined by the Superintendency of Banks.

ARTICLE 6. CAPITAL CONSERVATION BUFFER AMOUNT. Banks are required to establish a capital conservation buffer equivalent to 2.5% of their risk-weighted assets (encompassing credit, market, and operating risks). This buffer should be composed of common tier one capital, in addition to all other minimum regulatory capital requirements that are established.

In accordance with the guidelines provided in this Rule, the table below illustrates the capital adequacy ratio considering the 2.5% capital conservation buffer:

Capital Adequacy Ratio (in percentages)

	Common tier one capital	Total tier one capital	Total minimum (regulatory) capital
Minimum	4.5	6.0	8.0
Conservation buffer	2.5		
Minimum plus conservation buffer	7.0	8.5	10.5

ARTICLE 7. CAPITAL EXPANSIONS. If the percentage of retained earnings is insufficient to establish a reasonable pace, as determined by the Superintendency of Banks, to build the required capital conservation buffer, the Superintendency of Banks will mandate that the bank develops a plan to secure the necessary capital expansion to comply with this Rule.

ARTICLE 8. RESPONSIBILITIES OF THE BOARD OF DIRECTORS. The Board of Directors of banks holds the responsibility for enforcing this Rule. As such, they must ensure that:

a. Internally assess the level of compliance with the capital conservation buffer and formulate policies to ensure future compliance with this Rule.

b. If a bank falls short of meeting the requirements of the capital conservation buffer, as outlined in the table in Article 6, the Board of Directors must promptly develop and implement suitable strategies to rectify the deficit. For this purpose, the bank must submit to the Superintendency an adjustment plan approved by the Board of Directors. This plan should outline the mechanisms for replenishing the conservation buffer deficit and specify the timeline for doing so. The adjustment plan will undergo evaluation by the Superintendency, which reserves the right to make comments and objections. The Superintendent will establish a deadline for the bank to submit the adjustment plan through a Circular.

ARTICLE 9. RESTRICTIONS ON THE DISTRIBUTION OF EARNINGS. Once the percentages specified in the table in Article 12 for the establishment of the capital buffer have been completed, the bank must ensure that before making the declaration of dividends, considering the amount to be distributed, the common tier one capital ratio is recalculated for meeting the table established in Article 6.

In the event of a deficit in the capital conservation buffer, the bank is prohibited from both repurchasing its own shares and distributing earnings.

A bank desiring to make a distribution must first rectify the buffer deficit.

ARTICLE 10. REPORTING REQUIREMENTS. For the purposes of this Rule, banks must notify the Superintendency of the frequency at which they will provide the analysis conducted by the Board of Directors regarding Rule compliance and the policies formulated for compliance.

ARTICLE 11. EFFECTIVE DATE. This Rule will take effect on the 1st of July 2024.

ARTICLE 12. ADJUSTMENT PERIOD (TRANSITIONAL). Banks will be granted an adjustment period for the implementation of the capital conservation buffer outlined in this Rule. To fulfill this requirement, banks must ensure compliance with the following provisions on the specified dates:

Phases	Applicable percentage/ Capital Conservation Buffer	Minimum Common Tier One Capital + Conservation Buffer
1 July 2024	0.50%	5.00-5
1 July 2025	0.75%	5.75%
1 July 2026	1.25%	7.00%

Should the bank meet the percentages detailed in the gradual table indicated above, it will be allowed to distribute accumulated profits from any period. However, the distribution must not reduce the minimum percentage required on each specified date.

Given in Panama City this tenth (10th) day of October, twenty twenty-three (2023).

FOR COMMUNICATION, PUBLICATION, AND ENFORCEMENT.

THE CHAIRMAN,

Felipe Echandi Lacayo

THE SECRETARY,

David Alberto Davarro