



Republica de Panamá
SUPERINTENDENCIA DE BANCOS

AGREEMENT No. 5-2001
(of December 3, 2001)

THE BOARD OF DIRECTORS

in its use of its legal authority, and

WHEREAS

That, according to Numeral 1 of Article 5 of Law Decree No. 9 of February 26, 1998, it is a function of the Superintendency of Banks, to watch over the maintenance of the soundness and efficiency of the banking system;

That, according to Numeral 4 of Article 16 of Law Decree No. 9 of February 26, 1998, the Board of Directors must approve the general rating criteria of the risk assets and the guidelines for the constitution of reserves to cover credit risk and market risk;

That the market risk assumes the risk of loss before adverse changes in the product prices in the financial markets, which can affect the positions inside and outside the balance sheet that the Banks maintain, and therefore it is necessary to establish application norms to regulate the supervision of said risk;

That, according to Numeral 27 of Article 17 of Law Decree No. 9 of 1998, it is a function of the Superintendent, to take steps to avoid or correct irregularities or faults in the operation of the Banks that, in his judgment, would put in danger the consumers interests, the Bank's stability or the soundness of the banking system; and

That, in work sessions of the Board of Directors, the need and convenience has been expressed of adopting a norm that regulates market risk management.

AGREES:

FIRST ARTICLE: Concept Of Market Risk. For the effects of applying the present Agreement, "market risk" is defined as the risks of loss derived from adverse movements in the product prices in the financial markets where positions are maintained, related to the operations that appear inside as well as outside the balance sheet.

The Banks' simple as well as multidimensional exposure to market risks is a consequence of variation of the risk factors that affect the market prices. These factors include, but are not limited to, the following:

- a. Interest rate risks;
- b. Equity term risks;
- c. Exchange type risks;
- d. Merchandise price risks and
- e. Derivative instrument risks.

SECOND ARTICLE: Scope. The present Agreement will be applied to Official Banks, General License Banks and International License Banks.

In case of Banks that are branches or subsidiaries of foreign Banks, that can prove the fulfillment of the present Agreement by a certification of the external auditors of its main branch and that must be presented annually to the Superintendency, which must confirm that it has the necessary structures and controls for solid and safe market risk management, of its positions inside as well as outside the balance sheet.

THIRD ARTICLE: Market Risk Management. The Banks must establish adequate policies, procedures and guidelines for identifying and managing market risks. These shall include establishing exposure limits to which the positions affected by market risks are subject. Likewise, effective communication channels must be established so that the areas involved in taking, recording, identifying and managing market risks have knowledge of the assumed risks.

FOURTH ARTICLE: Responsibility of the Banks. The Banks must adequately identify and manage the market risks they face. In this sense, it will be the main responsibility of the Board of Directors and the General Management to establish the policies and procedures to appropriately identify and manage those risks. This responsibility includes the fulfillment of the provisions contained in the present Agreement.

FIFTH ARTICLE: Minimum Requirements. For the identification and management to appropriately cover the market risks, the Bank's must, in the pertinent areas, at least have:

1. Delimited and segregated organization, functions and responsibilities;
2. Procedure and policy manuals;
3. Suitable employees and professionals;
4. Documentation, reports and information delivery;
5. Methods for identifying, preventing, measuring, analyzing and assessing the market risks;
6. Reasonable security records;
7. Controls and limits for exposure to market risks;
8. Adequate information systems;
9. Assignment of effective equity; and
10. Revelations in the Financial Statements required by the IAS or the US-GAAP, and also those that are additionally required by the Superintendency of Banks.

SIXTH ARTICLE: Organization, functions, delimitation and segregation of responsibilities.

The Banks will establish the organizational structure, define, delimit and segregate the functions, authority and responsibilities of the areas involved in performing the operations that affect market risks. This will include the existence of those functions via global assets and liabilities management committee, of investments, and/or risk management, displaying a commitment and a proactive culture in the control of those risks.

SEVENTH ARTICLE: Procedure and policy manuals. The Banks will have and will apply policy, procedure and guideline manuals with respect to performing operations susceptible to market risks, where the organization outline, the functions and responsibilities of the involved areas will also be established.

The Banks must also have policy and procedure manuals which contain the mechanisms used by the Banks for the adequate identification and management of market risks. These manuals will include the investment policies, portfolio selection, portfolio management, security analysis and credit risk, portfolio assessment, and the description of the documentation required for these purposes.

EIGHTH ARTICLE: Suitable employees and professionals. The Bank's employees responsible for the areas involved in performing operations subject to market risks, must have, according to the corresponding area, an adequate technical education, knowledge and experience.

NINTH ARTICLE: Documentation, reports and information delivery. The Banks will document every transaction from the time of their formal consideration, their negotiation, up to their conclusion and reconciliation, including all support and complementary information.

The Banks will make available to the Superintendency the elaborated reports, including the ones from the risk unit which are referred by Agreement 4-2001, for the identification, follow-up and management of the market risks they face.

TENTH ARTICLE: Reasonable security records. The Banks will register the pertinent investments in securities, as also in derived financial instruments, according to what is established in Agreement 7-2000 of July 19, 2000. These registered valuations will be properly documented and will follow the provisions stated in the International Accounting Standards (IAS) or in the U.S. Generally Accepted Accounting Principles (US-GAAP), and will be made available to the Superintendency whenever it requires them.

ELEVENTH ARTICLE: Identification, measurement, analysis and assessment methods.

The Banks will use technically adequate methods that have been validated in the international banking practice, to identify, measure, analyze (risks and markets), assess, follow up and prevent the positions that affect the market risk management process that they face, which must be revised frequently. The Banks must include in the risk measurements, policies and contingencies for the scenarios resulting from a retrospective and stress analysis, and worst case scenario.

TWELFTH ARTICLE: Controls and limits for exposure to market risks. The Banks will establish, according to their own market risk characteristics, internal operating and administrative controls on market risks, including authorized activities, individual, cumulative and global internal limits for gross and net exposure, and for maturity dates, on positions of their assets and liabilities inside and outside the balance sheet, particularly in investment and obligation instruments.

Emphasis must be given to the trading portfolios and selling portfolios, including those in derivatives financial instruments; as also to the financial instruments that constitute their obligations.

These limits will be set by financial instrument type, by amount, by volatility and by market risk type, considering, among other factors, the realized and not realized losses accumulated during a time period.

The limits will also include stop-loss instructions, concentration limits by transmitter, instrument, market, geographical location or economic sector; and presence limits in new markets and new financial instruments. A permanent evaluation must be carried out of the customization and performance of the controls and limits through time.

THIRTEENTH ARTICLE: Adequate information systems. The Banks will maintain adequate information systems to realize and back up the identification, follow-up and management of the market risks they face. These systems must also have the appropriate mechanisms to guarantee security and the physical and functional contingency plans, as also their own data and process integrity.

FOURTEENTH ARTICLE: Equity requirements. The exposure level to market risks that the Banks keep must harmonize with their capital customization, assigning, if necessary, the additional effective equity to cover the market risks they face, based on the adequate care and healthy banking practices, and on the evaluation by each Bank of their particular asset and liability exposure to those risks.

FIFTEENTH ARTICLE: Global limit on losses. Each Bank will inform the Superintendency the maximum accumulated limit that it establishes annually, for the realized and not realized net losses in the investment portfolios and obligations in securities, as a percentage of their consolidated Capital Funds.

In case a Bank accumulates realized and not realized net losses in the annual period, that exceed the percentage referred by the last paragraph, said Bank must adopt the corrective steps the Superintendent gives, in the way, the content and time period he gives.

SIXTEENTH ARTICLE: Internal auditing. The internal auditing function will evaluate the fulfillment of the policies and procedures established by the Banks for the performance of operations subject to market risks, and of the policies and procedures established for identifying and managing those risks, as also what has been established by this Agreement. These evaluations must be included in the permanent activities of the Internal Auditing Annual Plan, and they must be documented by written reports with the recommendations derived from them.

SEVENTEENTH ARTICLE: External auditing. The external auditors will include in their annual reports an opinion on the sufficiency of the internal controls, and of the rationability of the financial record of the operations subject to market risk, and they will determine if the mentioned record and the Notes adequately reflect and reveal the market risks and the equity requirements necessary to cover them, that the Banks face according to this Agreement.

EIGHTEENTH ARTICLE: Sanction for breach. The breach of the provisions on market risk management established in this Agreement, or of any instruction given by the Superintendent for these purposes, can be sanctioned by the Superintendent according to what has been provided in Article 137 of Law Decree No. 9 of February 26, 1998.

NINETEENTH ARTICLE: Validity. The present Agreement will be in force from its own date.

TWENTIETH ARTICLE: Customizing period. The Banks will have a customizing period that will expire on December '31, 2002, to fulfill all the provisions of the present Agreement.

Given in the city of Panama, on December three (3), two thousand one (2001).

THE PRESIDENT

Felix B. Maduro

THE SECRETARY

Jorge W. Altamirano-Duque M.