

TRANSLATION

Republic of Panama Superintendency of Banks

RULE No. 008-2010¹
(dated 1 December 2010)

**“Whereby the provisions on
Comprehensive Risk Management are provided”**

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

WHEREAS

Due to the issuance of Law 2 of 22 February 2008, the Executive Branch systematically ordered in the form of a Sole Text the Decree Law 9 of 1998 and all its amendments, which was approved by means of Executive Decree 52 of 30 April 2008, hereinafter referred to as the Banking Law;

Number 1 of Article 5 of the Banking Law, established that the objectives of the Superintendency are, to safeguard the soundness and efficiency of the banking system;

According to number 3 of Article 5 of the Banking Law it is the duty of the Superintendency of Banks to promote public trust in the banking system;

In accordance with number 5 of article 11 of the Banking Law, it is the duty of the Superintendency to establish, within the administrative sphere, the interpretation and reach of the legal provisions or regulations on banking matters;

According to number 10 of article 11 of the Banking Law, it is the duty of the Board of Directors to issue the technical standards required for compliance with this Decree Law;

Article 72 of the Banking Law establishes that in determining the capital adequacy ratio, the Superintendency may take into account the presence of other risks, among which are market risks, operating risks, and country risks, that may serve to evaluate the need for capital funds to achieve an adequate risk management;

In order to preserve the capital of banks, as well as proper protection to depositors of the banking system, this Office considers it advisable to establish a general regulatory framework containing sufficient elements for an appropriate risk management by the banks;

The seventh principle of Basel Committee for an effective banking supervision establishes that banks and banking groups must have in place a comprehensive risk management process to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution;

Pillar 2 of the Capital Agreement emphasizes the relation between the capital level of the entity to cover its risks and the soundness and efficiency of its risk management and internal control processes;

In the working sessions of this Board of Directors was mentioned the need and convenience of establishing the parameters and guidelines related to comprehensive risk management in banks.

RULES:

ARTICLE 1. SCOPE OF APPLICATION. The provisions of this Rule shall be applied to state-owned Banks, general license Banks and international license Banks to which the Superintendency of Banks is home supervisor.

In case of international license banks, which the Superintendency of Banks is the host supervisor, the Superintendent may ask to the local management of a given bank, when it deems convenient, the compliance with the risk management requirements of this Rule.

¹ Amended by Rule 9-2017 dated 7 November 2017.

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ARTICLE 2. DEFINITION OF THE COMPREHENSIVE RISK MANAGEMENT. It is understood as comprehensive risk management the process in which the Bank identifies, measures, monitors, controls, mitigates and reports to the operating areas of the bank, the different kinds of risks to which it is exposed to according to the size and complexity of its operations, products, and services.

ARTICLE 3. COMPONENTS OF THE COMPREHENSIVE RISK MANAGEMENT. Each bank is responsible for having policies, rules and procedures, structures, and manuals for comprehensive risk management designed to identify potential events that may affect it, which shall be congruent to the bank's business risk profile, considering the complexity and volume of its operations.

ARTICLE 4². TYPES OF RISK. For the purposes of this Rule, without prejudice to what have been provided for in other rules, these terms are defined as follows:

1. **Credit risk.** The possibility that the bank may incur in losses and a decrease in the value of its assets as a result of its debtors failing to meet the agreed terms of the credit agreement on time or in full;
2. **Counterparty risk.** The possibility that in a financial contract in which the bank is a party, any counterparty is unable to meet its financial obligations, making the bank incur in a loss;
3. **Liquidity risk.** The possibility of a bank facing an economic loss due to difficulty in liquidating assets or obtaining financial resources under normal conditions;
4. **Market risk.** The risk of loss arising from adverse movements in commodity prices in financial markets on commodities in which the entity maintains positions in its trading portfolio. It is comprised mainly of price risk, interest rate risk, and exchange rate risk;
 - 4.1. **Price risk.** The possibility of economic loss due to adverse movements in the market price of a financial instrument or due to the indeterminacy of the price at a given moment;
 - 4.2. **Interest rate risk.** The possibility of economic loss due to adverse movements in interest rates;
 - 4.3. **Exchange rate risk.** The possibility of economic loss due to changes in the exchange rate.
5. **Operating risk.** The possibility of incurring losses due to deficiencies, failures, or inadequacies in human resources, processes, technology or infrastructure, or by the occurrence of external events. This definition includes the legal risk associated with such factors;
 - 5.1. **Legal risk.** The possibility of financial loss resulting from breaches of rules, regulations, or procedures, as well as due to contractual stipulations. Legal risk also arises from malicious, negligent or unintentional acts affecting the execution, effectiveness or performance of contracts or transactions.
6. **Reputational risk.** The possibility that the bank may incur in economic losses due to deterioration of the bank's reputation. This includes, among others, the impact of money laundering.
7. **Country risk.** The possibility of incurring in losses due to adverse effects in the economic, social or political environment, or natural disasters, in countries where the bank or its customers do business. Country risk includes, among others, transfer risk, political risk, and sovereign risk;

² Amended by Article 1 of Rule 9-2017.

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- 7.1. **Transfer risk.** The general inability of debtors in a given country to meet their financial obligations due to a lack of availability of the currency in which the obligation is made, regardless of the financial condition of the debtor concerned;
- 7.2. **Political risk.** Refers to, among others, the possibility of war, civil disturbance, and other situations of a purely political nature;
- 7.3. **Sovereign risk.** The possibility that the sovereign debtor of a given country cannot or is unwilling to meet his financial obligations.
8. **Contagion risk.** The possibility of loss that the bank may suffer directly or indirectly because of adverse circumstances in companies of its own economic group or companies performing similar activities in their location or in the financial system of another country;
9. **Strategic risk.** The possibility of incurring in losses due to decisions made by the top management of the bank associated with the creation of sustainable competitive advantages. It is related to failures or weaknesses in the market analysis, trends, and uncertainties of the environment, the bank's core competencies, and in the process of value generation and innovation;
10. **Information technology risk.** The possibility of economic losses resulting from an event related to the technological infrastructure, or the access or use of technology, which affects the development of business processes and risk management of the bank, in threatening the confidentiality, integrity, availability, efficiency, reliability, performance, or timeliness of the information;
11. **Concentration risk.** High levels of exposure that could cause losses in the bank which could affect the solvency or ability to maintain its operations. Risk concentration can arise in assets, liabilities, and off-balance operations;
12. **Social and environmental risk.** Refers to the possibility that the bank will incur in losses due to negative social and environmental impacts resulting from granting loans to fund projects, as well as from environmental activities in which the projects are conducted, significantly affecting the economic, social, or environmental system.

ARTICLE 5. COMPREHENSIVE RISK MANAGEMENT STRUCTURE. In line with Corporate Governance standards, the bank must apply policies, rules and procedures, and internal control structures to ensure the integrity and efficiency of risk management processes. Besides, the bank shall establish manuals providing how the comprehensive risk management process will be governed.

The purpose of the above is to foster a risk management culture to flow into all levels of the organization according to the size and complexity of its operations and services.

Banks must have policies for managing each one of the risk that it is exposed to with timely mechanisms to cope with the changing business environment.

The structure used for supporting the comprehensive risk management process should consider at least the following aspects:

- a. A clear separation between the business areas and risk unit areas.
- b. Mechanisms for communication and dissemination of scopes and results of the process.
- c. Staff with necessary knowledge and skills to perform their tasks.
- d. Information technologies in line with the sophistication of methodologies and activities.

ARTICLE 6. RESPONSIBILITIES OF THE BOARD OF DIRECTORS. The board of directors is responsible for compliance with all provisions of the preceding article. In addition, it is also responsible for:

- a. Establishing acceptable risk profile of the bank, for which is required having knowledge and understanding of the risks to which the bank is exposed to.
- b. Appointing the members of the Risk Committee.

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- c. Approving the necessary resources for the proper performance of comprehensive risk management in order to have the appropriate infrastructure, methodology and staff.
- d. Assessing and approving business plans taking into consideration the associated risks.
- e. Ensuring that the bank maintains its capital adequacy level consistent with its risk profile.
- f. Approving limit risks policies, procedures and structure for the operational and business areas of the bank.
- g. The board of directors and top management of the bank should grant to the risk management unit the authority, hierarchy and independence from the other bank employees and veto power in the decisions related to comprehensive risk of the bank.

ARTICLE 7. BOARD OF DIRECTORS COMPLIANCE CERTIFICATION. Annually, the bank shall send to this Office a certification, signed by the chairman and the secretary of the board of directors, to bear the following:

- a. The board of directors meets the standards set out in this rule and its responsibilities.
- b. The bank has a comprehensive risk management according to the criteria established in this rule and to the size and complexity of its operations and services.
- c. The board of directors has been made known to the information provided by the top management, reports of the audit committee, risk committee, and external auditors related to comprehensive risk management and corrective actions are contained in the records concerned.

This certification may be presented in a collective or individual document and the signatures must be notarized. This certification should be signed and submitted within sixty (60) days following the fiscal closure.

In case of banks which are branches of foreign banks, the compliance statement stipulated in this Article shall be evidenced by an annual certification of the risk management unit of its parent company and shall be submitted to the Superintendency of Banks within the period prescribed in the preceding paragraph.

ARTICLE 8. RESPONSIBILITY OF TOP MANAGEMENT. Top management is responsible for the following duties:

- a. Ensure consistency between operations and risk tolerance levels defined.
- b. Know the risk levels taken by the bank.
- c. Establish review programs to be carried out by the risk management unit and business unit, in regards to meeting the objectives, procedure and controls when carrying out operations, as well as exposure limits and risk tolerance levels.
- d. Ensure that the risk management unit has sufficient budget to carry out its duties.
- e. Ensure the existence of adequate storage, processing and information management systems.
- f. Ensure that training and updating programs addressed to risk management unit staff and personnel involved in risk operations are established.
- g. Establish procedures to ensure an appropriate flow, quality and timeliness of information between the business unit and comprehensive risk management unit, and anyone involved in operations that involve risk to the bank.

ARTICLE 9. RISK COMMITTEE. The board of directors of banks must form a risk committee which will respond to it, whose main duties will be determining the objectives and policies for comprehensive risk management, as well as the risk exposure limits approved by the board of directors. Additionally, it will have the duties specified in article 10 of this Rule.

The risk committee shall meet at least every three (3) months to achieve its goals and the contents of each of the meetings must be documented in detail in the respective minutes together with the reports that fairly reflect the discussions and decisions made, or by other electronic means, as long as the latter have for all purposes the same legal validity.

The risk committee must comprise of at least two board members, one of whom must be a member of the audit committee. The person in charge of risk management unit, the persons responsible of business areas and any other officer appointed by the board of directors will be part of the committee.

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For organizational reasons, a bank may ask the Superintendent total or partial waiver of compliance with this article. The Superintendent will evaluate each individual case and will decide the action to take by the bank, but in any case, the duties of the risk committee must be covered by a body responsible for risk management. It will be mandatory for the banks to have a risk management unit.

ARTICLE 10. DUTIES OF THE RISK COMMITTEE. The risk committee will have, among others, the following duties:

- a. To monitor the risk exposures and compare those to the tolerance levels approved by the board of directors. Among other aspects deem convenient, the risk committee shall refer to the impact of those risks on the stability and solvency of the bank.
- b. To evaluate the performance of the risk management unit, this must be duly documented.
- c. To inform to the board of directors the results of its assessments on the bank's risks exposure.
- d. To guarantee limits, strategies and policies that contribute to effective risk management and define the scenarios and temporary horizon in which excess of limits or exceptions of policies can be accepted, which must be approved by the board of directors and the possible courses of action or mechanisms by which the situation is regularized.
- e. To develop and propose procedures and methodologies for risk management.
- f. To propose risk contingency plans that will be subject to the approval of the board of directors.
- g. The duties and requirements that will be established by the board of directors.

ARTICLE 11. RISK MANAGEMENT UNIT. Banks should have a risk management unit, independent of business units responsible for risk identification and management faced by the institution, and may incorporate in turn specialized units for specific risks, according to the nature of the operations and structure of the bank. This unit will be under the supervision and management of the risk committee or body responsible for risk management.

The proper coordination to a comprehensive risk management should be carried out through a risk assessment unit or other similar body established for that purpose.

The members of the risk management unit must have the experience and technical knowledge that allow them to properly perform their duties.

The risk management unit will not perform, process or approve transactions. Its main function is to monitor risks, assist in the design of policies and procedures, monitor compliance, and alert the risk committee or body responsible of any risks that may require additional controls.

In the substantive part of its functions, the risk management unit will report to the risk committee. The administrative aspects of its functions will be supervised by the top management. The evaluation of the risk management unit duties will be the joint responsibility of the risk committee and general manager.

ARTICLE 12: PROFILE OF THE RISK MANAGEMENT UNIT. Staff responsible and in charge of the risk management unit of the bank will report to the risk committee and at least meet the following requirements:

- a. Extensive experience in areas related to the financial sector.
- b. Extensive technical knowledge of comprehensive risk management.
- c. Experience in financial operations in general.

ARTICLE 13. DUTIES OF THE RISK UNIT. The risk management unit shall perform the following duties:

- a. Identify, assess and control fully all risks that are relevant to the entity. For this purpose it may:
 - i. Have models and risk measurement systems consistent to the complexity degree and scale of its operations, which accurately reflect the value of the positions and their sensitivity to various risk factors.
 - ii. Ensure that the information to be used in models and risk measurement systems are provided by the responsible areas and is available in a timely manner.
 - iii. Continuous assessment of models and systems concerned, whose results must be submitted to the risk committee.
 - iv. According to the complexity and scale of its operations, implementing a regular

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- back testing program, in which are compared the estimates of exposure by risk of the internal models to the actual results observed for the same measurement period and perform the necessary corrections by changing the model when there are deviations plus the proper documentation of such.
- v. Ensure that any weaknesses identified regarding the quality, timeliness and completeness of the information used by the risk management unit to be reported to the areas responsible for processing and control.
 - b. Conduct exposure estimates by risk.
 - c. Present, at least quarterly, to the risk committee or the body responsible for its consideration the tools and techniques to identify and analyze risks and methodologies, models and parameters to measure and control the various types of risk to which the bank is exposed to.
 - d. Verify compliance with global and specific limits, as well as the acceptable tolerance levels by risk, broken down by business unit or risk factor, their cause or origin, using for this purpose the models, parameters and scenarios for risk measurement and control duly approved by the aforementioned committee. In case of risks that are not amenable to quantification, information must be obtained to assess the probable detriment of these risks on the stability and solvency of the bank.
 - e. Provide to risk committee or body responsible the information on:
 - i. Exposure to various risks which are relevant to the bank, at determined intervals.
 - ii. The impact on the capital adequacy that involves risk-taking by the entity, considering the sensitivity analysis in different scenarios (stress testing), including extreme events.
 - iii. The deviations that occur in respect to the exposure limits and risk tolerance levels set. This information must be delivered immediately to top management and the persons responsible for the business areas involved and the risk committee or body responsible.
 - iv. Suggestions for corrective actions that can be implemented as a result of a deviation from the exposure limits and risk tolerance levels allowed.
 - v. The historical evolution of the risks taken by the entity.
 - f. Investigate and document the causes of deviations from the limits of risk exposure, identify if those deviations are repeatedly and report in timely manner these results to the risk committee or body responsible, the manager or administrator and the responsible of internal audit functions of the entity.
 - g. Provide instructions in order to decrease the observed exposures and changes to the global and specific risk exposure limits and risk tolerance levels, as appropriate.
 - h. Prepare and submit to the risk committee or body responsible for the methodologies for evaluation, measurement and control of risks in new operations, products and services, as well as identifying the risks involved in them.
 - i. Constantly analyze and evaluate the assumptions and parameters used in the analysis required.
 - j. Any other function to be required to the risk committee or body responsible.

ARTICLE 14. REPORTS OF THE RISK UNIT. Risk management unit is responsible for reporting and presenting, at least quarterly, to the risk committee or body responsible for the risk management, to the general manager and the concerning decision-making areas, on the effectiveness of the mechanism related to risk measurement, the degree of exposure, limits and risk management according to the policies and procedures established by the bank.

ARTICLE 15. SANCTIONS. Non-compliance with the preceding articles shall be punished according to the provisions of title IV of the Banking Law.

ARTICLE 16. PERIOD OF ADAPTATION. Banks will have a period of adaptation of nine (9) months from the promulgation of this rule.

ARTICLE 17. ENACTMENT. This rule shall come into effect since its promulgation.

Given in the city of Panama, on first (1st) December, two thousand ten (2010).

LET IT BE KNOWN, PUBLISHED AND ENFORCED

THE CHAIRMAN, a. i.

THE SECRETARY, a. i.

Arturo Gerbaud De La Guardia

Nicolás Ardito Barletta