

Republic of Panama Superintendency of Banks

RULE N°. 9-2020
(dated 11 September 2020)

“Whereby Rule 2-2020, by means of which additional, exceptional and temporary measures to comply with the provisions of Rule 4-2013 on credit risk, is amended”

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 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 (5) of the Banking Law, establishing the administrative interpretation and scope of the legal provisions and regulations on banking matters is a technical duty of the Board of Directors;

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

As a consequence of the global Coronavirus outbreak, and in compliance with international recommendations issued by the World Health Organization and the Pan-American Health Organization, the National Government, through the Ministry of Health, issued Executive Decree 64 dated 28 January 2020, whereby the necessary essential and urgent measures were adopted, contained in the National Plan for the threat of the novel Coronavirus (2019-nCoV) outbreak, as well as extraordinary measures necessary to prevent the introduction and spread of this public health problem;

In the face of the threat of an emergency situation in the territory due to the risk of spread of the coronavirus outbreak, by means of Cabinet Resolution 6 dated 28 January 2020, the Cabinet Council declared the threat of high-risk of spread of the Novel Coronavirus (2019-nCoV) outbreak in the national territory;

That later, in order to expand Cabinet Resolution 6 of 2020 and to redouble surveillance measures to contain the epidemic, by means of Cabinet Resolution 10 dated 3 March 2020, the Cabinet Council raised to very high the threat of spread of the Novel Coronavirus (2019-nCoV) outbreak in the national territory and prescribed other provisions;

As the global health threat situation of the Novel Coronavirus (2019-nCoV) has collaterally affected different economic sectors, including the financial sector, it became important to protect the financial stability of the Panamanian banking system;

The Superintendency of Banks issued Rule 2-2020 dated 16 March 2020 that provided additional, exceptional and temporary measures to comply with the provisions of Rule 4-2013, which allows banks to modify the originally agreed on conditions for corporate and consumer loans, in order to provide financial relief to customers whose payment capacity is affected by the situation caused by Covid-19;

By means of Law 156 dated 30 June 2020, financial and economic measures to counteract COVID-19 effects in the Republic of Panama were established for those whose employment

contract has been suspended or terminated, self-employed or freelancers and entrepreneurs whose activity has been affected by the measures the National Government has established;

Article 2 of Law 156 of 2020 provides a payment standstill until 31 December 2020 on loans granted by banks, cooperatives and finance companies to individuals or legal persons financially affected by the COVID-19 pandemic;

The Superintendency of Banks issued Rule 7-2020 dated 14 July 2020, by means of which Article 4 of Rule 2-2020 was amended in order to extend until 31 December 2020 the period for banks to assess the loans affected by the COVID-19 situation and to make the corresponding modifications. Likewise, the Rule provided that these loans will maintain the risk rating registered upon the entry into force of Rule 2-2020, until the Superintendency establishes the rating and provisioning criteria that will be applied to modified loans;

In view of the impact the loan portfolio has suffered as a result of the crisis caused by the COVID-19 pandemic and, in order to maintain the transparency of the current status of such loans, it became necessary to establish a methodology for the evaluation, classification and provisioning for modified loans that adjusts to the new, current reality and that permit appropriate credit risk management;

Given the implications that the COVID-19 pandemic has triggered for the financial statements of banks and taking into consideration the current health situation, it is appropriate that the use of accounting treatment in accordance with the International Financial Reporting Standards (IFRS) be applied in addition to prudential standards that allow for a qualitative and quantitative assessment and visualization of the expected losses of the loan portfolio impacted by COVID-19 within the system;

The International Financial Reporting Standards (IFRS) 7 called "Financial Instruments: Disclosures," requires banks to comply with the purpose of disclosing information that allows users to evaluate, among others, the nature and scope of risks arising from the financial instruments to which the entity is exposed, as well as the way to manage them;

Taking into consideration the disclosure of information referred to in IFRS 7, it is important for stakeholders to understand the current and potential effects of the modified loan portfolio in regards to the bank's financial soundness, the Superintendency deems it convenient to emphasize that banks are required to disclose this information in the notes attached to the audited annual financial statements;

During its working sessions, the Board of Directors determined it necessary and advisable to amend Rule 2-2020, in order to establish among other aspects, the treatment that modified loans will have and define the constitution of the corresponding provisions that make possible the protection of the interest of depositors and preserving financial stability.

RESOLVES:

ARTICLE 1. Article 2 (3) of Rule 2-2020 shall read:

"ARTICLE 2. MODIFIED LOANS CHARACTERISTICS. In order to allow the debtor appropriate attention to their obligation in the face of potential or real deterioration of their payment capacity, as a result of COVID-19 crisis, banks may modify the originally agreed on loan conditions without these adjustments being considered as a loan restructuring, according to the provisions of Rule 4-2013. These modifications may be made at debtor's request or by bank's own initiative.

These loans will have the following characteristics:

1. The new terms and conditions must meet financial viability criteria, taking into consideration the debtor's payment capacity and the bank's credit policies;
2. They will be subject to special monitoring by the bank;
3. The loans included in the modified category must follow the parameters established in Article 4-A herein."

ARTICLE 2. Article 3 (4) of Rule 2-2020 shall read:

“ARTICLE 3. RULES RELATED TO MODIFIED LOANS. The modifications of the loans according to the provisions herein, should not become a general practice to regularize the behavior of the loan portfolio. Additionally, banks must ensure that the following rules are applied:

1. Loans classified as pass and special mention, as well as restructured loans without arrears, may be modified in accordance with the parameters established herein;
2. The loans modified during the period in which the exceptional and temporary measures are in force must be clearly identified by banks, in order to be widely monitored by the Superintendency of Banks;
3. During the validity of the exceptional and temporary measures, at the time of agreeing on the terms and conditions of the modified loan (mainly in terms and interest), the banks will procure to take into consideration the current macroeconomic situation the country is going through;
4. The modification of loans will be exempt from the application of charges and surcharges by the bank, with the exception of legal, notarial and registry expenses paid to third parties and the agreed insurance premiums (life insurance policy, fraud and others). In the event the bank incurs in these exceptional chargers, the bank may capitalize them;
5. The modification of loans will be exempt from appraisal update;
6. The bank will establish specific policies and procedures for the management and follow-up of requests to modify the conditions of these loans, in accordance with the aforementioned criteria;
7. The modification date will be considered as the date on which the debtor has accepted the modifications by any means or modality (including, without implying any limitation, electronic means, tacit acceptance, presumed acceptance by silence, etc.) and from that date, the bank may consider the loan as a modified loan for the purposes of this Rule and Rule 4-2013.”

ARTICLE 3. Article 4 of Rule 2-2020 shall read:

“ARTICLE 4. ASSESSMENT PERIOD TO GRANT MODIFIED LOANS. Banks will have until 31 December 2020 to reassess the loans of those debtors whose cash flow or payment capacity has been affected by the COVID-19 situation and who at the original time of its modification were in arrears of up to 90 days.

Similarly, banks may make modifications to those loans that have not been previously modified, whose cash flow or payment capacity has been affected by the COVID-19 situation and who are not in arrears of over 90 days.

These loans may be subject to review of their terms and conditions, therefore the bank may agree on and/or grant grace periods, ensuring that the loan classification is maintained in accordance with the provisions of Article 4-A herein, maintaining the provision accounted for in books at the time of modification.

In case of modified restructured loans that were listed in special mention, they will be classified in accordance with the provisions of Article 4-A. The modified restructured loans that were classified as substandard, doubtful or loss will maintain the loan classification they had at the time of their modification with their respective provision.”

ARTICLE 4. Article 4-A is added to Rule 2-2020 as follows:

“ARTICLE 4-A. CLASSIFICATION CATEGORY OF MODIFIED LOANS. For the purposes of determining the provisions that will be applied to modified loans, banks will classify the personal loan portfolio, corporate loan portfolio and other loan portfolio under a new risk category called “modified special mention,” which is defined as follows:

MODIFIED SPECIAL MENTION

The loans classified within this category will comprise the entire loan portfolio that has been modified, as a result of the economic crisis triggered by COVID-19 pandemic.

Banks when classifying the portfolio for the calculation of IFRS provisions should take into consideration the following aspects, among others:

1. For the personal loan portfolio, customers affected by the suspension or termination of contracts, reduction of their working hours with a decrease in salary, or by a decrease in cash flow or other source of payment in the case of classified self-employed/freelancers within the personal loan or consumer loan portfolio.
2. For the corporate loan portfolio and other loan portfolio, customers whose general status of their businesses has been affected by negative situations that have impacted the economic sector in which they run their operations and that operating cash flow tends to weaken due to uncertain expectations about economic conditions.

PROVISO: For proper credit risk management that includes the process of monitoring the behavior of loans identified as modified loans and classified within this category, banks must ensure that they maintain a record that evidences the different modifications made to the same loan. Banks must also identify whether the debtor's condition is the result of a temporary credit or liquidity situation."

ARTICLE 5. Article 4-B is added to Rule 2-2020 as follows:

“ARTICLE 4-B. CLASSIFICATION CATEGORIES OF LOANS ACCORDING TO THE PROVISIONS OF LAW 156 OF 2020 (PAYMENT STANDSTILL LAW). Loans classified in the pass and special mention categories of those debtors who have availed themselves to the provisions of Law 156 dated 30 June 2020 that establishes economic and financial measures to counteract the effects of COVID-19 in the Republic of Panama, will be included in the modified special mention category referred to in Article 4-A herein.

In the case of debtors who have availed themselves to the provisions of Law 156 of 2020 and whose loans were classified in the substandard, doubtful or loss categories, will maintain the same loan classification as provided for in Rule 4-2013.”

ARTICLE 6. Article 4-C is added to Rule 2-2020 as follows:

“ARTICLE 4-C. GENERAL CONDITIONS TO RESTORE MODIFIED LOANS AND LOANS AVAILED TO LAW 156 OF 2020 IN ACCORDANCE WITH RULE 4-2013. For restoring the application of Rule 4-2013 to the modified loan portfolio according to Rule 2-2020 and Law 156 of 2020, banks will follow the parameters listed below:

1. The loans of customers that were modified by banks according to the parameters established herein and whose debtors, as of 21 September 2020, are in compliance with the terms and conditions originally agreed on, the provisions established in Rule 4-2013 on Credit Risk will be applied to them. Likewise, the bank must exclude them from the modified loan category and any change to the terms and conditions will be governed by the provisions of Rule 4-2013. In these cases, the provisions of the first paragraph of Article 4 herein will not be applicable, i.e. this loan may not be modified again.
2. The loans of customers that, as of 31 March 2021, have met their modified payment conditions and are up to date during the first quarter of 2021, may be restored to the pass category, in accordance with the application of Rule 4-2013, as of 1 April 2021.
3. The loans of customers that, as of 31 March 2021, have partially complied with the originally or modified payment conditions during the first quarter of 2021, will remain in the modified special mention category for the next three months (April, May and June), after said period, the provisions of Rule 4-2013 will be applicable, according to the days in arrears since the last payment made.
4. The loans of customers that, as of 30 June 2021, have failed to comply with the originally or modified payment conditions, the provisions of Rule 4-2013 will be apply to them and

must be included in the corresponding category, according to the days in arrears that these loans maintain as of 1 January 2021.

5. The restructured loans on which the bank has modified their terms and conditions and that as of March 2021 are up to date in their payments, will maintain the classification they had at the time they were modified. Similarly, they will keep the provisions that had already been established.
6. The provisions of (2), (3) and (4) herein will be applicable to the loans classified as pass and special mention of debtors that availed themselves to Law 156 of 2020, as appropriate.
7. The loans classified as substandard, doubtful or loss of debtors that availed themselves to Law 156 of 2020, the bank must make ensure of maintaining their risk classification and as of 1 January 2021 to continue with the application of Rule 4-2013, in regards to their displacement, provisioning and punishment of operations.”

ARTICLE 7. Article 4-D is added to Rule 2-2020 as follows:

“ARTICLE 4-D. PROVISIONING FOR THE MODIFIED SPECIAL MENTION CATEGORY. To hedge credit risk, banks must create provisions on the modified loan portfolio listed in the “Modified Special Mention” category, ensuring compliance with the International Financial Reporting Standards (IFRS) and the prudential standards provided for herein.

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

1. In cases where the IFRS provision is equal to or greater 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 less than the generic provision of 3% established herein, the bank will register said IFRS provision in the results and the difference must be registered in the results or in a regulatory reserve in equity, taking into consideration the following aspects:
 - (a) When the IFRS provision is equal to or greater than 1.5%, the bank must register said IFRS provision in the results account. Likewise, the difference to complete the 3% of the generic provision established herein must be registered in a regulatory reserve in equity.
 - (b) When the IFRS provision is less than 1.5%, the bank must ensure that this percentage is completed and registered in the results account. Likewise, the difference to complete the 3% of the generic provision established herein must be registered in a new regulatory reserve in equity.

All of the above, without prejudice to the Superintendency’s authority to modify the provision percentages and the way and opportunity to reverse the generic provisions and regulatory reserves, based on the new circumstances derived from COVID-19.

PROVISO 1: Although banks are required to use IFRS for preparing accounting registries 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 stated in 4-D (2)(b) 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 stated in 4-D (2), the excess of generic provision that must be registered in equity will be accounted for in a regulatory reserve that is paid or credited with

a charge to the retained earnings account. For the purposes of calculating the capital adequacy index, concentration limits in a single debtor or related parties and any other prudential relationship, the balance of the regulatory reserve will not be considered as regulatory capital funds.”

ARTICLE 8. Article 4-E is added to Rule 2-2020 as follows.

“ARTICLE 4-E. DISCLOSURES IN THE AUDITED ANNUAL FINANCIAL STATEMENTS. For the purposes of preparing and reporting the audited annual financial statements, banks must ensure that they disclose in the notes to the financial statements the qualitative and quantitative information on the loans classified in the modified special mention category and their impact on the determination of the expected losses provision, as well as current and future cash flows of the bank. The notes must disclose at least the following information:

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 the IFRS and the amount of the provision for each of these stages.
4. Risk management of this portfolio if it is not included in another note to the financial statements.”

ARTICLE 9. Article 4-F is added to Rule 2-2020 as follows:

“ARTICLE 4-F. OPERATIONS OF FINANCIAL SUBSIDIARIES ABROAD. In the case of banks that maintain financial subsidiaries abroad, for consolidation purposes, the provisions of Rule 4-2013 will be applicable.”

ARTICLE 10. Article 5 of Rule 2-2020 shall read:

“ARTICLE 5. USE OF THE DYNAMIC PROVISION. For the purposes of the provisions of Article 37 (c) of Rule 4-2013 that provides restrictions on the amount of the dynamic provision, as an exceptional and temporary measure it is established that banks may use up to eighty percent (80%) of the dynamic provision only to compensate the diminished retained earnings due to constitution of the IFRS and generic provisions for the modified special mention portfolio. The use of the dynamic provision will be made according to the accounting terms established in Circular 124 dated 15 April 2020.

In the event the bank requires using more than eighty percent (80%) of the amount of the dynamic provision, it must obtain the Superintendency of Bank’s prior authorization.

Banks may only pay dividends once they have restored the corresponding amount of the dynamic provision in accordance with their loan portfolio, with the exception of dividends on preferred shares, the payment of which can be made as long as there are sufficient profits, prior notification to the Superintendency.”

ARTICLE 11. ENACTMENT. This Rule shall take effect as of 21 September 2020.

Given in the city of Panama on the eleventh (11th) day of September, two thousand twenty (2020).

FOR COMMUNICATION, PUBLICATION AND ENFORCEMENT.

THE CHAIRMAN,

THE SECRETARY,

Luis La Rocca

Nicolás Ardito Barletta