

## Republic of Panama Superintendency of Banks

**RULE N.º 6-2021  
(dated 22 December 2021)**

**“Whereby the parameters and guidelines for determining the provisions applicable to  
“Modified Special Mention” loans are established, and other provisions are  
prescribed”**

**THE BOARD OF DIRECTORS**  
in use of its legal powers and,

### **WHEREAS:**

Upon the issuance of Decree Law 2 dated 22 February 2008, the Executive Branch re-edited Decree Law 9 of 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;

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

Upon 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;

Upon Rule 4-2013 dated 28 May 2013, the provisions on credit risk management and administration inherent to credit portfolio and off-balance sheet operations are established;

Upon Rule 2-2021 dated 11 June 2021, new parameters and guidelines applicable to modified loans granted by banks as a result of the economic effects of COVID-19 are established and the existence of a “Modified Special Mention” loan category, within which modified loans are included as of 30 June 2021, is recognized;

Article 8 of Rule 2-2021 sets forth the provisioning applied to “Modified Special Mention” loans;

Upon Board of Directors’ General Resolution SBP-GJD-0003-2021, dated 11 June 2021, the Superintendency of Banks established the parameters and guidelines for reporting “Modified Special Mention” loans;

Articles 2 and 3 of Board of Directors’ General Resolution SBP-GJD-0003-0221 establish as an identification mechanism for reporting “Modified Special Mention” loans the codes of modified pass, modified special mention, modified substandard, modified doubtful and modified loss, as well as the reporting parameters for each of said encodings;

Upon the foreseeable increase in the impairment of “Modified Special Mention” loans, it is imminent and necessary to update the provisioning of these loans to cover the increase in credit risk or its impairment, making sure to comply with International Financial Reporting Standards (IFRS) as well as the prudential regulations the Superintendency may establish;

The suitable application of the International Financial Reporting Standards (IFRS) allows banks to effectively record, classify and measure the credit risk on the modified loan portfolio, and therefore, a better management of the expected loss of the “Modified Special Mention” loans;

Timely and correct provisioning according to the credit risk classification is a necessary tool for banks to cover potential losses in their assets value and to guarantee the sustainability of their operations, as well as the soundness of the banking system;

During its working sessions, the Board of Directors determined it was necessary and advisable to establish the guidelines and parameters for determining the provisions applicable to “Modified Special Mention” loans.

### RESOLVES:

**ARTICLE 1. PURPOSE.** The stipulations herein are intended to update the parameters and guidelines for determining the provision for losses in the “Modified Special Mention” loans portfolio.

**ARTICLE 2. SCOPE.** This rule shall be applicable to banks having “Modified Special Mention” loans.

**ARTICLE 3. SIGNIFICANT RISK INCREASE IN MODIFIED SPECIAL MENTION PORTFOLIO.** For the credit risk coverage applicable to “Modified Special Mention” loans, banks must ensure that they comply with the International Financial Reporting Standards (IFRS), considering the significant risk increase, as follows:

1. Loans that have had a significant risk increase related to their initial recognition and there is no objective evidence showing the incurred loss;
2. Loans that have had a significant risk increase related to their initial recognition and that there is also objective evidence showing the incurred loss (impaired loans).

Regarding these loans, at each accounting close, banks will measure the value adjustment for losses at an amount equal to the expected loan losses during the asset lifetime.

**ARTICLE 4. PROVISIONING FOR THE MODIFIED SPECIAL MENTION CATEGORY.** To cover credit risk, banks must establish provisions for the modified loan portfolio, including uncollected accrued interest, classified under the “Modified Special Mention” category, ensuring that they comply with the International Financial Reporting Standards (IFRS), as well as the prudential standards established in Article 5 herein. This accounting treatment must be applied to accrued interest receivable that has been transferred to other asset account. Once the bank has written off the principal balance of any loan (principal) classified under the “Modified Special Mention” category, the accrued interest receivable must be also written off, so they cannot be transferred to other asset accounts.

The Top Management and the Board of Directors of banks must ensure that they use appropriate procedures to record sufficient provisions to cover loss risk. Similarly, external auditors will be responsible for being fully satisfied on the provisions accounted for their auditing process. The foregoing, without prejudice for the Superintendency of Banks to make observations or require adjustments to provisioning, because of its supervisory duty set forth in Article 7 herein.

**ARTICLE 5. PROVISION ESTABLISHED IN RULE 2-2021 FOR THE “MODIFIED SPECIAL MENTION” CATEGORY.** For the purposes of this Rule, the stipulations of Article 8 of Rule 2-2021 are rescinded. Taking into consideration the new circumstances triggered by COVID-19 and the significant risk increase derived from the passage of time, banks will not be able to reverse the previously established provisions (for profit or capital) as of November 2021 for the entire modified portfolio as of that date, in accordance with the stipulations of Article 8 of Rule 2-2021.

Notwithstanding the foregoing, in case that a modified loan is returned to the pass category, in accordance with Rule 4-2013, banks may use the corresponding portion of the previously constituted provision to establish the required IFRS provision. This stipulation will be in force

until the Superintendency determines so, based on the future behavior of the modified portfolio.

**PROVISO.** 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 provision previously established as indicated in the first paragraph of this article on the IFRS provision and that difference is material, they will temporarily use the accounting basis as follows: "International Financial Reporting Standards as 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."

**ARTICLE 6. INTEREST RECEIVABLE.** As of January 2022, banks will stop recognizing interests, for income purposes, in interest receivable accounts and interests earned on modified loans that have had a significant risk increase related to their initial recognition and that also have an objective evidence of incurred loss (impaired loans), and those loans included in the modified special mention, modified doubtful, and modified loss categories referred to in Board of Directors' General Resolution SBP-GJD-0003-2021.

Until the Superintendency indicates otherwise for the modified portfolio with these characteristics, the stipulations of Board of Directors' General Resolution SBP-GJD-0003-2013 will not be applicable, and the banks must maintain the interest receivable as of 1 January 2022 in memorandum accounts, being able to recognize them as income only when they are actually paid by the debtor.

**ARTICLE 7. SUPERVISORY DUTIES OF THE SUPERINTENDENCY OF BANKS.** As part of its duties, the Superintendency of Banks will review the provisions accounted for by the banks in compliance with Article 4 herein. For this, inspectors will consider different techniques and reference elements that include, but are not limited to, the following:

1. Selective analysis of the location of loans, in accordance with the guidelines established in Article 3 herein;
2. Inquiries about the factors for calculating provisions (probability of default, exposure to default, loss due to default, overlays and others);
3. Selective review of supporting documentation of modified loans;
4. Comparison of the results with individualized benchmark tables by bank, prepared by the Superintendency based on information available in its databases for the entire banking system, considering the admissible collateral stipulated in Article 42 of Rule 4-2013 and excluding those modified loans secured with deposits pledged in the same bank up to the secured amount.

If the provisions calculated by the Superintendency exceed those accounted for by the bank, it will be determined whether the adjustments should affect the results (objective evidence of non-compliance with accounting standards and prudential regulations) or whether they should be adjusted in a regulatory reserve in equity that is paid or credited against the retained earnings account (difference with the supervisory judgment). For purposes of calculating the capital adequacy ratio, concentration limits on a sole debtor or related parties, and any other prudential relationship, the balance of this regulatory reserve will be not be considered as capital funds.

**ARTICLE 8. DISCLOSURE IN FINANCIAL STATEMENTS.** For purposes of preparing and reporting the annual financial statements (EFA, for its acronym in Spanish), the revised financial statements (EFS, for its acronym in Spanish), and interim financial statements (EFT, for its acronym in Spanish), banks must ensure they comply with the provisions stipulated in Article 9 of Rule 2-2021.

**ARTICLE 9. CAPITALIZATION OF INTEREST ON MODIFIED LOANS.** Banks may offer their clients the alternative of capitalizing interest receivable, with the client's express acceptance and provided that his/her financial situation and present and/or future payment capacity complies with the characteristics for loan restructuring as prescribed in Article 7 of Rule 2-2021.

In these cases, the bank must ensure that it complies with the stipulations of Article 13 of Rule 2-2021 on transparency and protection of banking clients, for which the bank must clearly and in detail explain to the client the implications of interest capitalization with the modalities the bank offers.

In the cases of modified loans returned to Rule 4-2013, the client may request increases to his/her monthly payments to be equal to the pre-modification fees (before the pandemic) without involving bank penalties.

**ARTICLE 10. SANCTIONS.** Failure to comply with the stipulations herein will be sanctioned in accordance with the provisions of Title IV of the Banking Law.

**ARTICLE 11. EFFECTIVE DATE.** This Rule shall become effective upon 27 December 2021.

Given in Panama City on the twenty-second (22<sup>nd</sup>) day of December, two thousand twenty-one (2021).

**FOR COMMUNICATION, PUBLICATION AND ENFORCEMENT.**

**THE CHAIRMAN,**

Rafael Guardia

**THE SECRETARY AD-HOC,**

Joseph Fidanque III

