

FOR OFFICIAL USE ONLY

PANAMA

FINANCIAL SECTOR ASSESSMENT

November 2023

Prepared By
**Finance, Competitiveness,
and Innovation Global
Practice and
Latin America and Caribbean
Regional Vice Presidency**

A joint IMF-World Bank mission visited Panama during January 17 and February 6 as well as during May 24 to June 6, 2023, to conduct an assessment under the Financial Sector Assessment Program (FSAP).¹ This report summarizes the main findings of the mission, identifies key financial sector vulnerabilities, and provides policy recommendations.

¹ The team was led by Richard Stobo (IMF) and Emile Van Der Does De Willebois (WB), and included Marco Gross (IMF Deputy Mission Chief), Oliver Masetti (WB Deputy Mission Chief), Majid Bazarbash, Zhuohui Chen, Romina Kazandjian, Pavel Lukyantsau, Francisco Figueroa, Julian Chow, and Wim Fonteyne (all IMF); Keith Ligon and Chris Wilson (IMF experts); Yasmin De Magalhaes Pinto Almeida, Oya Pinar Ardic Alper, Nepomuk Dunz, Karol Karpinski (all WB) and Alan Ball (WB external expert).

Glossary

AML/CFT	Anti-Money Laundering / Combating the Financing of Terrorism
BCP	Basel Core Principles for Effective Banking Supervision, 2012
BNP	<i>Banco Nacional de Panamá</i> (National Bank of Panama)
CAR	Capital Adequacy Ratio
CCB	Capital Conservation Buffer
CCF	<i>Consejo de Coordinación Financiera</i> (Financial Coordination Council)
CCRIF	Caribbean Catastrophe Risk Insurance Facility
DAR	Detailed Assessment Report
DFS	Digital Financial Services
DGI	<i>Dirección General de Ingresos</i> (Tax Authority)
DIS	Deposit Insurance Scheme
DSTI	Debt-service-to-income
DTI	Debt-to-income
D-SIB	Domestic Systemically Important Banks
DRF	Disaster Risk Financing
ELA	Emergency Liquidity Assistance
EMDE	Emerging Market and Developing Economy
FATF	Financial Action Task Force
FSAP	Financial Sector Assessment Program
FSI	Financial Soundness Indicators
FSSA	Financial System Stability Assessment
FV	Fair Value
GAFILAT	Financial Action Task Force of Latin America
GHG	Green-House Gas
GL	General License
HQLA	High Quality Liquid Assets
HTM	Held-to-Maturity
ICAAP	Internal Capital Adequacy Assessment Process
ICRG	International Co-operation Review Group
IL	International License
IMF	International Monetary Fund
IRB	Internal Ratings-Based
IRRBB	Interest Rate Risk in the Banking Book
KA	FSB Key Attributes of Effective Resolution Regimes for Financial Institutions

KPI	Key Performance Indicators
LAC	Latin American and the Caribbean
LCR	Liquidity Coverage Ratio
LOLR	Lender of Last Resort
LTV	Loan-to-value
MiAmbiente	<i>Ministerio de Ambiente</i> (Ministry of Environment)
MICI	<i>Ministerio de Industria y Comercio</i> (Ministry of Industry and Commerce)
MEF	<i>Ministerio de Economía y Finanzas</i> (Ministry of Economy and Finance)
MP	<i>Ministerio Público</i> (Prosecutors Office)
MSMEs	Micro, Small and Medium-size Enterprises
NDC	National Determined Contributions
NBFI	Non-bank Financial Intermediary
NII	Net Interest Income
NPL	Non-performing Loan
NSFR	Net Stable Funding Ratio
OFC	Offshore Financial Center
PF	Proliferation Financing
RAM	Risk Assessment Matrix
RPP	<i>Registro Público de Panamá</i> (Public Registry Office)
ROA	Return on Assets
ROE	Return on Equity
RTGS	Real-Time Gross Settlement
RUBF	<i>Registro Único de Beneficiarios Finales</i> (Beneficial Ownership Registry)
RWA	Risk-Weighted Asset
SBP	<i>Superintendencia de Bancos de Panamá</i> (Superintendency of Banks)
SMV	<i>Superintendencia del Mercado de Valores de Panamá</i> (National Securities Commission)
SSRP	<i>Superintendencia de Seguros y Reaseguros de Panamá</i> (Superintendency of Insurance and Reinsurance)
SSNF	<i>Superintendencia de Sujetos No Financieros</i> (Superintendency of Non-Financial Entities)
TA	Technical Assistance
TF	Terrorism Financing
TN	Technical Note
VA	Virtual Assets
VASP	Virtual Assets Service Providers
WB	World Bank
WEO	World Economic Outlook

CONTENTS

Glossary	2
Preface	5
Executive Summary	6
Macrofinancial Context.....	11
A. Macrofinancial Environment	11
B. Financial System Structure	12
C. Financial Access and Inclusion	15
Risks and Vulnerabilities	17
A. Systemic Risk Analysis	17
B. Risks from Clearing and Settlement.....	20
C. Climate Risk Analysis.....	21
Financial Sector Oversight.....	21
A. Banking Regulation and Supervision.....	22
B. Macroprudential Framework.....	23
C. Payment Systems Regulation and Supervision.....	24
D. Climate Regulation and Supervision	26
Crisis Management and Financial Safety Nets	26
Financial Integrity	29
Priorities for Financial Development.....	31
A. Digital Financial Services and increasing Access to Financial Services.....	31
B. Greening the Financial Sector.....	33
Authorities' Views	35

PREFACE

An International Monetary Fund (IMF) and World Bank (WB) team visited Panama during January 17 and February 6 as well as during May 24 to June 6, 2023, to conduct an assessment under the Financial Sector Assessment Program (FSAP). The team was led by Richard Stobo (IMF) and Emile Van Der Does De Willebois (WB), and included Marco Gross (IMF Deputy Mission Chief), Oliver Masetti (WB Deputy Mission Chief), Majid Bazarbash, Zhuohui Chen, Romina Kazandjian, Pavel Lukyantsau, Francisco Figueroa, Julian Chow, and Wim Fonteyne (all IMF); Keith Ligon and Chris Wilson (IMF experts); Yasmin De Magalhaes Pinto Almeida, Oya Pinar Ardic Alper, Nepomuk Dunz, Karol Karpinski (all WB) and Alan Ball (WB external expert). Administrative assistance was provided by Marie-Bernadette Amand de Mendieta.

The mission analyzed financial sector risks and vulnerabilities, assessed the quality of financial sector supervision, and evaluated financial safety net arrangements. The mission also looked at issues related to AML/CFT, payments systems and digital financial services, as well as climate risks and opportunities.

The mission met with Vice-Minister Medrano, Minister Castillo de Sanmartin, Superintendent Castillo (SBP), Superintendent Vázquez (SSRP), Superintendent Justiniani (SMV), Superintendent Carrizo (SSNF) and other senior officials at the Ministry of Economy and Finance, the Ministry of Commerce and Industry, the Ministry of the Environment, as well as staff in private and public financial institutions, and a number of other stakeholders.

The FSAP assesses the stability of the financial system as a whole and not that of individual institutions. It is intended to help countries identify key sources of systemic risk in the financial sector and implement policies to enhance its resilience to shocks and contagion. Certain categories of risk affecting financial institutions, such as operational or legal risk, or risk related to fraud, are not covered in the FSAP.

The previous FSAP took place in 2012. The status of implementation of its Key Recommendations can be found in Appendix III.

The team would like to thank the authorities for the excellent cooperation and fruitful discussions.

EXECUTIVE SUMMARY

Panama has a large, internationally connected, and in some respects unique financial sector.

With total assets of more than 200 percent of GDP, mostly concentrated in the banking sector, Panama has one of the largest financial sectors in the Latin American and the Caribbean (LAC) region. It is an important regional banking hub hosting a large number of foreign banks and providing financial intermediation services to international clients. The financial sector faces the unusual backdrop of not having a central bank, as a result of which special functions have been allocated to the state-owned *Banco Nacional de Panamá (BNP)*. In addition to being a commercial bank, it is the fiscal agent of the Panamanian State and plays some of the roles that a central bank would ordinarily assume, such as operating the payments system and managing a liquidity fund. Having a systemically important payment system operated by a commercial bank, which thus can potentially obtain direct access to liquidity information of its competitors may be distortive and create risk in the system as a whole.

The banking system appears well capitalized and liquid, but there are some pockets of weaknesses. While the banking system as a whole appears resilient and system-wide capital ratios rest well above regulatory minimums, some individual banks fall short of them, when assessed against a severe yet plausible adverse macrofinancial scenario. Banks appear solid in terms of liquidity coverage, and only a few banks show weaknesses under a hypothetical stress scenario entailing severe liquidity outflows, for example, of deposits. The system (by design) relies strongly on foreign correspondent bank support. The need for banks to sell held-to-maturity (HtM) bonds under liquidity stress to generate cash inflows is found to be small, and hence the feedback to solvency through realized losses is limited. This is due to available buffers from cash/reserves, foreign correspondent bank credit lines, and other liquid assets, including bonds held in the banks' trading portfolios.

The authorities have strengthened the regulatory and supervisory framework, but further efforts are required. The Superintendency of Banks of Panama (SBP) has adopted key elements of the international regulatory reform agenda, including via significant alignment with Basel III and the implementation of IFRS 9. It introduced new regulations in the areas of corporate governance and risk management and improved its macroprudential toolkit. However, reforms are needed to safeguard the autonomy of the SBP, prioritize safety and soundness, complete the roll-out of capital buffers and strengthen oversight of liquidity and interest rate risk. In particular:

- The current Budget Law should be amended to restore the SBP's independence of action in respect of all budgetary issues, and future Budget Laws should maintain this autonomy.
- The SBP's primary objective should be to safeguard the soundness of the banking system. Currently this is only one of SBP's four objectives and has the potential to conflict with its other objective of fostering Panama as an international financial sector.
- The introduction of a capital buffer framework for internationally active banks aligned with that prescribed in the Basel III capital standards should be a priority.

- The authorities should move to consolidated supervision of liquidity risk and issue formal regulations for interest rate risk in the banking book.

Safety nets should be reformed via an improved bank resolution framework, the introduction of a deposit insurance scheme (DIS) and the establishment of an official lender-of-last-resort (LOLR) facility. Proposed legislation to improve bank resolution does not address key areas necessary for orderly resolution. Most notably, the approach to funding of bank resolutions, both to recapitalize insolvent firms (e.g., via bail-in) and to provide temporary liquidity (employing a viable public backstop) are not addressed. An industry-funded DIS should be established, followed by the removal of the state guarantee for state-owned banks. In the absence of a central bank and a permanent LOLR, Panama should explore alternative mechanisms to put in place such a facility operated by a public authority, not a commercial bank.

Despite recent progress, the large size of Panama's financial sector has not yet resulted in widespread access to and usage of financial services. Access to and usage of more extensive financial products, such as credit, savings, investment, or insurance products, remains relatively low and unevenly distributed with those outside the urban and economic centers, lower income households, lacking access to financial services. No dedicated financial products for MSMEs are available. Recent technological innovations, amplified by behavioral shifts during the Covid-19 pandemic, have boosted the use of digital financial services (DFS) and facilitated bankarization. To continue and broaden this positive trend, authorities should further improve the enabling environment for the provision of DFS and adopt a more coordinated inter-agency approach to Fintech activities, while ensuring consumer protection, competition, and safeguarding prudential and Anti-money Laundering and Combating the Financing of Terrorism (AML/CFT) standards. Concrete steps should also be taken to strengthen the credit information system for MSMEs.

Progress towards financial sector development requires more safe and efficient payment systems. The absence of a central bank causes significant challenges for the oversight and operation of payment systems. The current set-up, with a tenuous legal basis, and a lack of regulation and supervision of payment systems, poses inherent risks and is not suitable to support the development of modern payment systems and services. It is thus recommended to swiftly adopt a law on payment systems and services that establishes the SBP as the regulator and overseer of the national payment system and the licensing authority for payment system operators and providers. Upon enactment of the law, SBP should develop an oversight policy framework reflecting the new mandate. To mitigate the risks and conflicts of interests that the current operational setup for clearing and settlement poses, risk management frameworks need to be revised and BNP should continue the process of separating its clearing and settlement operations from its commercial arm.

Given Panama's past AML/CFT challenges, authorities should remain vigilant and mitigate new AML/CFT risks as they manifest themselves. Its dollarized economy, the open nature of its financial sector and availability of wide-ranging corporate services, and its status as a regional, politically stable, financial hub render Panama vulnerable to foreign money laundering threats. Over the last two decades, Panama has been publicly identified three times by the Financial Action Task Force (FATF) for deficiencies in its AML/CFT regime. These shortcomings and related reputational

PANAMA

aspects have been impediments to deepening financial development, the fear of falling foul of AML/CFT standards resulting in a cautious regulatory and policy approach to financial innovation, for instance to DFS and crypto assets, which in turn has led financial institutions to adopt a risk-averse approach. While it is encouraging that the FATF very recently decided to take Panama off its so-called grey list, the authorities need to continue ongoing efforts to increase the transparency of entities incorporated under Panamanian law, including by abolishing the issuance of new bearer shares, and checking the risk as the environment evolves. Given improved transparency of Panamanian corporate entities, the provision of services administering and managing *foreign* legal entities by Panamanian service providers should be closely monitored.

New challenges for the financial sector stem from looming climate-related risk. Panama is vulnerable to extreme weather events such as hurricanes, floods, and droughts that are expected to increase in intensity and frequency due to climate change. Authorities, especially given the banking sector's high exposure to the potentially vulnerable real-estate and construction sector, thus need to start monitoring and assessing such risks to ensure its ability to withstand worsening climate risks. This will also require building further internal capacity to collect data, improving collaboration among relevant actors, providing ongoing guidance as understanding and knowledge is improved.

Improvements in climate awareness, transparency, and regulation are needed to realize Panama's potential of becoming a regional hub for green finance. The size and relative sophistication of Panama's financial sector coupled with the country's very rich nature and ecosystems and established green credentials present opportunities to transform Panama into a regional center for sustainable finance. However, to realize this potential, several impediments related to climate and environmental awareness, transparency and regulations need to be addressed. This includes fostering greater consistency and transparency of climate-related disclosures by finalizing the green taxonomy and developing an aligned disclosure and reporting framework. Authorities should also conduct a gap analysis to outline financing needs for reaching the country's climate and energy transition goals and assess how private capital can be mobilized.

Among the recommendations below, authorities are urged to prioritize those regarding the payment system and the putting in place of crisis management tools and financial safety nets. Considering the time required for those, these are achievable within the immediate or short term. In addition, action on climate regulation and green finance, given the lack of an existing framework should be taken within the next 1-3 years.

Table 1. Key Recommendations			
		To be adopted by	I/ST/MT²
Financial Sector Oversight			
<i>Banking regulation and supervision</i>			
1.	Amend the Banking Law to make explicit that the SBP's primary objective should be to promote safety and soundness of the banking system (¶122).	MEF	ST
2.	Undertake supervision of liquidity risk on a consolidated basis and implement regulations for interest rate risk in the banking book (¶123).	SBP	ST
3.	Introduce a capital buffer framework for internationally active banks aligned with the Basel III capital standards. Introduce the capital conservation buffer and capital surcharges for systemically important banks (¶124/25).	SBP	MT
<i>Macroprudential oversight</i>			
4.	Establish additional borrower-based macroprudential policy tools, such as caps on mortgage LTVs or on DTI or DSTI ratios to limit the buildup of vulnerabilities in the household segment (¶127).	SBP	ST
5.	Develop the Financial Coordination Council (CCF) member agencies' capabilities for macroprudential analysis and policies. Allocate a role for the MEF in the CCF (¶128).	CCF	ST
<i>Payment systems</i>			
6.	Encourage the urgent adoption of a law on payment systems and services (¶131).	MEF	I
7.	Establish SBP as the regulator, supervisor and overseer of payment systems and payment service providers (¶130).	MEF	I
8.	Develop an oversight policy framework covering payment systems and payment services reflecting the new legal mandate (¶132).	SBP	ST
9.	Continue the separation of the BNP's clearing and settlement functions from commercial banking operations and establish a comprehensive risk management framework (¶117).	BNP	ST
<i>Climate regulation and supervision</i>			
10.	Improve coordination among superintendencies, government entities and private sector stakeholders on climate-related and environmental risks, engage with external partners and join international platforms (¶133).	MiAmbiente, MEF, SBP, SMV, SSRP	I
11.	Build up internal technical capacity, collect relevant data, mobilize dedicated resources within superintendencies, and assign responsibilities for the system-wide assessment and monitoring of climate risks (¶133).	SBP, SMV, SSRP	ST
12.	Provide more detailed supervisory guidance and expectations on the management and disclosure of climate and environmental risks following a risk-based approach (¶134).	SBP, SMV, SSRP	ST
Crisis Management and Financial Safety Nets			

² I—Immediate (within 1 year), ST—Short term (within 1-2 years), MT—Medium term (within 3-5 years)

PANAMA

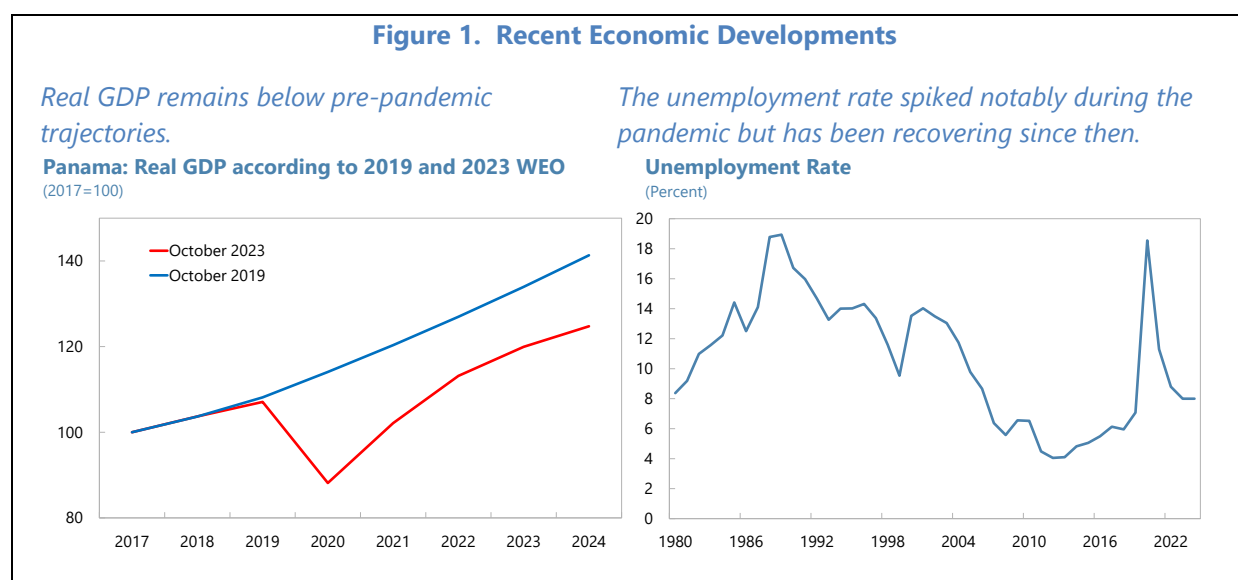
13.	Establish prudential requirements for all banks to develop recovery plans; with tailored requirements for international license banks (¶137).	SBP	I
14.	Establish an explicit industry-funded deposit insurance system (DIS) once sufficient progress has been made on resolution reforms; the DIS should extend protection to certain class(es) of depositor(s) at all general license banks (¶139).	MEF, SBP	ST
15.	Explore and implement mechanisms to establish a LOLR facility provided by a public authority and not a commercial bank (¶140).	MEF, SBP	ST
Financial Integrity			
16.	Reach agreement at the policy level and develop procedures to dissolve and unwind suspended companies that have passed the deadline for reactivation (¶146).	MEF, RPP, SSNF, DGI	ST
17.	Collect information and assess the risk posed by foreign legal persons and arrangements incorporated and/or managed abroad by Panamanian law firms and adopt appropriate and proportionate controls (¶147).	SSNF	MT
18.	Ensure corporations can no longer issue bearer shares, and require custodial arrangements to include collection and verification of beneficial ownership information (¶148).	MEF, SSNF	I
19.	Assess the ML/TF/PF risks emerging from virtual asset service providers (VASPs) and identify measures to prevent or mitigate these risks; regulate and subject VASPs to supervision or monitoring for AML/CFT purposes in line with the FATF Standards (¶149).	SBP	ST
Financial Sector Development			
<i>Digital Financial Services and Financial Inclusion</i>			
20.	Issue secondary regulations ensuring principles of regulatory neutrality and proportionality, and protection of customer funds, covering issuance of e-money, and rules for licensing of non-bank payment service providers (¶151).	SBP	ST
21.	Ensure risk-based access to payment infrastructure by non-bank payment service providers (¶151).	SBP	MT
22.	Establish a comprehensive stand-alone financial consumer protection regulatory framework with a specific focus on the new risks to consumers due to DFS and fintech (¶152).	SBP	MT
23.	Strengthen credit information systems by i) streamlining API access to the public registry data, ii) widening credit bureaus' data access, and iii) encouraging the use of credit scores to determine interest rates (¶154).	SBP, Tribunal Electoral, RPP	MT
<i>Greening the Financial Sector</i>			
24.	Outline private and public finance needs and availability for national climate action plan and national energy transition strategy ("gap analysis") and assess how private capital could be mobilized, focusing on identified barriers and lacking incentives (¶156).	MiAmbiente, MEF, Secretaria de Energia	I
25.	Finalize the green taxonomy making sure it is environmentally sound, well communicated and covers entire financial sector (¶159).	MiAmbiente, MEF, SMV, SBP, SSRP	I
26.	Explore opportunities to increase private sector insurance coverage in the context of strengthening the disaster risk financing strategy (¶160).	MEF, SSRP	MT

MACROFINANCIAL CONTEXT

A. Macrofinancial Environment

1. The Panamanian economy continues to recover from the COVID-19 pandemic.

Panama's economy was hit hard by the COVID-19 pandemic. Real GDP contracted by an unprecedented 17.9 percent in 2020, the unemployment rate spiked to 18.5 percent, and the poverty rate increased by 2.7 ppts to 14.8 percent (US\$ 5.5/day PPP). Economic activity rebounded strongly in 2021 and unemployment and poverty levels fell to pre-pandemic levels. Real GDP is projected to grow 4.3 percent on average per annum until 2025. Potential output growth is uncertain as the construction boom that drove growth in the past two decades may be over. The housing market has stabilized since the pandemic as excess inventory is largely eliminated. House price inflation was already gradually falling since 2017. The public debt-to-GDP ratio increased from 46 percent of GDP in 2019 to 55 percent in 2022 but is projected to decline. Sovereign credit spreads appear long-term stable.



Source: IMF World Economic Outlook

2. Inflation has come down from its peak in mid-2022. Rising domestic inflation, due to accelerating global food and energy prices, triggered protests in July 2022 that prompted the government to introduce temporary fuel price subsidies. Since then, inflation has dropped from a peak of 5.2 percent y-o-y in June 2022 to 2.3 percent y-o-y in September 2023.

3. As a fully dollarized economy and without a central bank, Panama's monetary policy tracks the U.S. Federal Reserve's policies. Panama uses the US dollar as a means of payment and is one of the few countries globally that does not have a central bank. While full dollarization has

helped Panama to maintain macroeconomic stability and fiscal discipline, it deprives the country of monetary sovereignty³, and also complicates its ability to conduct LOLR activities.

B. Financial System Structure

4. Panama's large financial system is dominated by a diverse banking sector. With total assets of 212 percent of GDP, the relative size of Panama's financial sector dwarfs most peers in the LAC region. The largest segment is the banking sector, which consists of 56 banks that jointly account for 90 percent of financial sector assets in 2022. The banking sector is diverse as banks are allowed to operate under various licensing regimes. The largest number of banks operate under a 'general license' (GL), which allows them to engage in banking business both within Panama as well as abroad. Currently, there are 42 banks operating under this general license. Twenty-seven of them are foreign-owned private banks, mainly subsidiaries of Latin American banks (39.5 percent of financial system assets), 13 are domestic-owned private banks (26 percent) and two are state-owned banks (14 percent). In addition to these institutions that are part of the *Sistema Bancario Nacional* there are 10 banks that operate under an 'international license (IL)'. IL banks cannot grant credit to, nor take deposits from persons, or entities domiciled in Panama. Ten GL banks, including the two state-owned banks, are domestic systemically important banks (D-SIBs). Asset concentration is low, with the largest three banks accounting for 32 percent of total assets, lower than in most LAC peer countries). Concentration ratios are slightly higher for domestic credit provision with the three largest banks holding a market share of 41 percent.

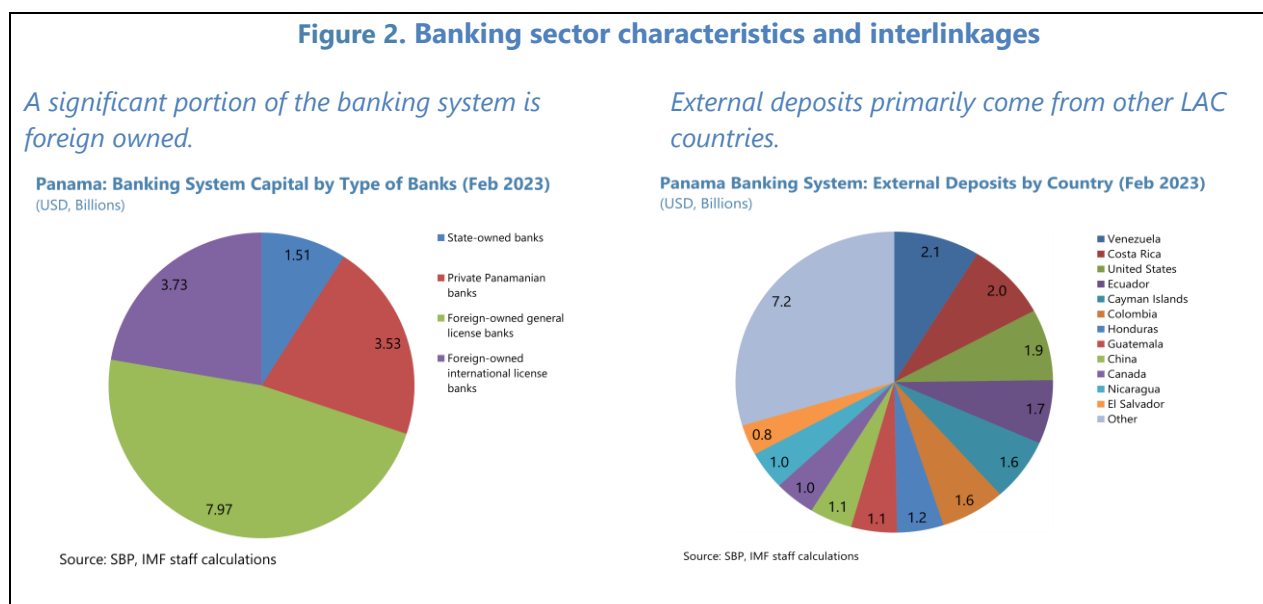
Table 2. Structure of Financial System December 2022

	Number of Institutions	Total Assets (US\$ billion)	Share of Total Assets (%)	Share of GDP (%)
Banks¹	56	135.7	90.1	192
General license banks	42	119.4	79.3	169
<i>o/w State-owned</i>	2	21	14	30
<i>o/w Domestically-owned</i>	13	39	25.8	55
<i>o/w Foreign-owned</i>	27	59.4	39.5	84
International license banks	14	16.3	10.8	23
Non-bank Financial Intermediaries	1,351	14.8	9.9	20
Insurance and reinsurance ²	54	3.6	2.4	5
Securities companies and pension funds	179	5.0	3.3	7
Cooperatives	536	2.4	1.6	3
Other financial entities	582	3.8	2.5	5
Total	1,407	150.5	100.0	212
Source: SBP 1/ Data to June 2022 2/ Data to March 2022				

³ This also implies that no central bank seigniorage income can be generated for the state.

5. Banks operating in Panama are internationally connected but domestic intermediation has gained in importance in recent years.

Both GL and IL banks are linked to debtors and creditors abroad via ownership, lending, and funding channels (Figure 2). Foreign-sourced deposits account for almost one-third of banking sector deposits⁴ and primarily come from other LAC countries (e.g., Venezuela, Costa Rica, Ecuador, Colombia). The foreign-in-total-liability share is highest for IL banks (98 percent) and foreign-owned GL banks (60 percent), while lower for domestic-owned GL banks (20 percent) and state-owned banks (9 percent). International linkages are also significant on the asset side as loans to non-residents -mostly in LAC-and investments in foreign securities holdings account for one-third of total bank assets.⁵ While still high, the share of foreign assets and liabilities has declined over the past decades as domestic intermediation gained in relevance. Credit to domestic borrowers increased by 10 percentage points since 2012 to 68 percent of total credit in 2022 (see Figure 2). This has been part of a broader transformation of the banking sector that also saw a sharp reduction in the number of IL banks due to a combination of closures as a result of the banking group’s own decision, liquidation, and the decision by some banks to move to a general license.

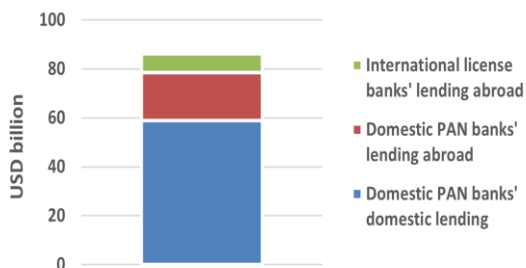


⁴ GL and IL banks.

⁵ All banks are also notably intertwined with foreign banking groups through correspondent bank relationships.

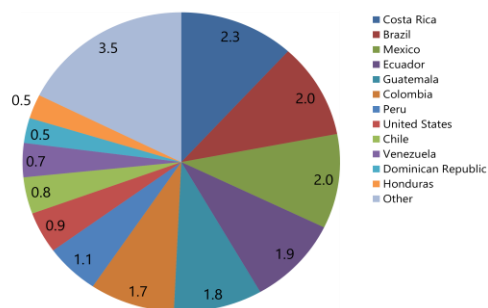
Domestic Panamanian banks have sizeable cross-border asset-side exposures...

Panamanian Banking System: Total Loan Book (Nov-2022)



... and banks lend to numerous countries in the LAC region.

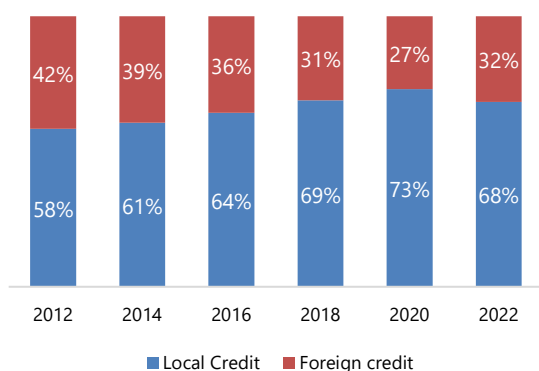
Panama Banking System: External Credit by Country (Feb 2023)
(USD, Billions)



Source: SBP, IMF staff calculations

Importance of domestic credit intermediation increased over the past decade.

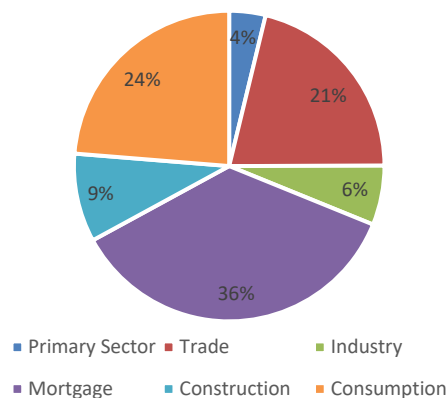
(Domestic and foreign credit by GL and IL banks as % of total credit)



Source: SBP, Data as end-2022

Domestic credit focused on mortgages, consumption, trade, and construction.

(Sectoral credit as a % of domestic credit)



Source: SBP, Data as end-2022

6. The focus of domestic credit intermediation is geared towards housing, consumption as well as the trade and construction sectors. Domestic bank credit to the private non-financial sector stood at 77 percent of GDP in 2022, widely unchanged from 2012. This puts credit depth on par with Chile and ahead of most other LAC countries, even though Panamanian banks lend only a relatively low 41 percent of their total assets to the private sector.⁶ Household lending accounts for about 60 percent of private sector credit, reflecting mortgages and personal consumer lending. Mortgage credit increased significantly over the past decade. A sizeable portion of mortgages are issued by state-owned banks (46 percent of the total mortgage stock). Corporate lending remains concentrated in the trade and construction sectors, but construction credit declined from its peak in 2017 as the real estate boom slowed. Mirroring Panama’s economic structure, credit is heavily

⁶ Other important asset positions include foreign credit (19 percent of total assets), securities holdings (21 percent) and liquid assets (14 percent).

concentrated in Panama City (80 percent of total domestic private sector credit), with little credit extension in the rural parts of the country.

7. Amid the absence of a central bank, a special role is played by the state-owned *Banco Nacional de Panamá (BNP)*. BNP, in addition to being a commercial bank – the second largest by asset size and a D-SIB – is the fiscal agent of the Panamanian state and a key interconnected node in the financial system. BNP plays some of the roles that a central bank would ordinarily assume. For example, it operates the payments system (see ¶ 16) and manages a liquidity fund to which Panamanian banks have recourse if they face liquidity shortages.⁷ However, BNP, as numerous other banks operating in Panama, relies on foreign correspondent banks as its source of US\$ liquidity.

8. Capital market activity is geared towards financial sector issuers with limited participation of domestic insurers or pension funds. More than 260 issuers are registered at Panama’s stock exchange *Latinex*. Market capitalization stood at around US\$ 40bn (56 percent of GDP) and consists to 45 percent of listed equity instruments and 55 percent of debt instruments in mid-2023. The market is dominated by securities issued by banks and other financial sector issuers⁸ (53 percent of issuers) as well as real estate developers (26 percent of issuers). Capital market activity is supported by a large number of investment fund managers, advisors, and brokers. The investor base is split between retail and institutional investors and includes a strong participation of international investors. The domestic insurance and pension fund sectors are small –with assets of 5 percent and 1 percent of GDP respectively- and play no significant role as institutional investors.

C. Financial Access and Inclusion

9. Despite the large size and depth of Panama’s financial sector, micro, small, and medium enterprises (MSMEs) face significant financing gaps. Hardly any banking products address the needs of MSMEs and MSME credit has been trailing credit to other segments. The overall MSME finance gap is estimated at close to US\$ 21.3 billion or 41 percent of the GDP, the largest among regional peers (see Figure 3).⁹ This finance gap is primarily attributed to the limited availability of financing options, particularly for those MSMEs that are in the early stages of development, lack collateral or operate informally. The local MSME association -UNPYME- estimates that for every registered business, there are 1.8 unregistered businesses in Panama.

10. Moreover, challenges persist in expanding financial inclusion to rural and lower income households. While Panama has one of the largest financial sectors in LAC, various indicators for financial inclusion indicate that substantial parts of the population, especially those outside the urban and economic centers and lower income households, lack access to financial services. Financial access points, such as ATMs and point-of-service (POS) terminals, are widely

⁷ The liquidity facility, which is operated jointly by the SBP and BNP, is structured as a revolving, short-term repo facility (up to 6 months), and is collateralized. As of November 2022, no banks had applied for liquidity under the facility, which has a value of USD 500 million.

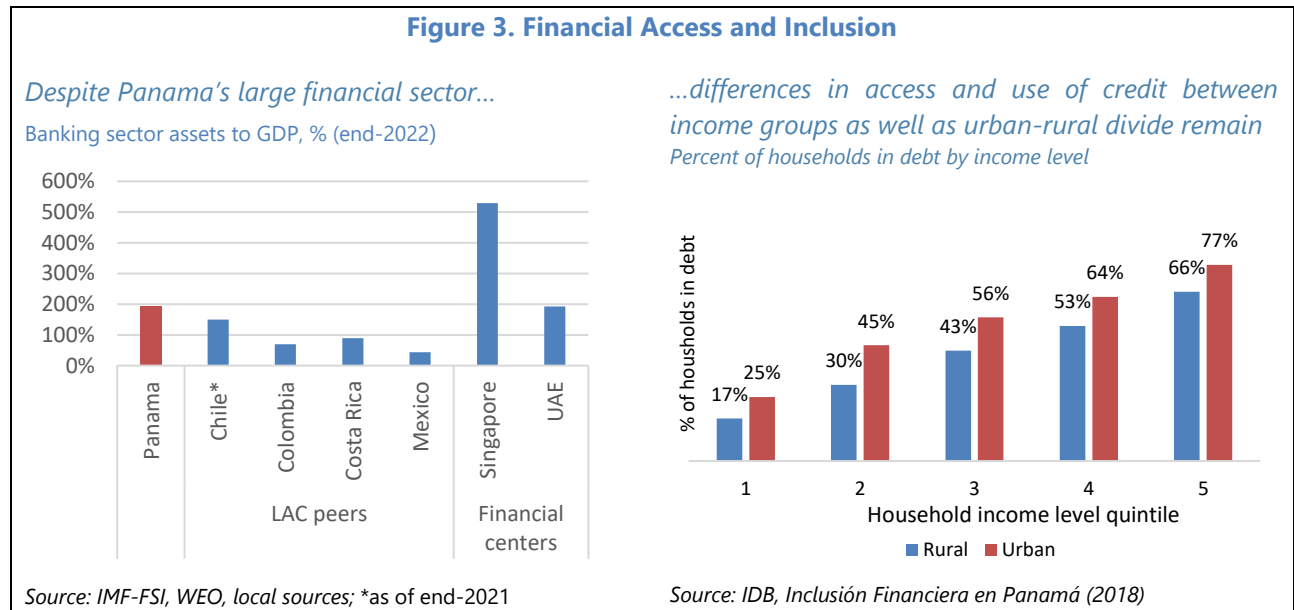
⁸ Mainly REITs and mutual funds.

⁹ Further explanations on calculation in <https://www.smefinanceforum.org/data-sites/msme-finance-gap>

PANAMA

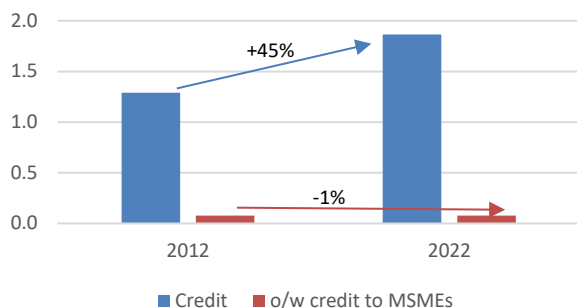
available in urban areas but only few commercial banks have a presence in rural, remote areas, where connectivity issues further constrain the possibility of making and receiving digital payments. Agent-based banking models to reach underserved segments in those areas are not widely used. Most social assistance payments are not disbursed digitally into transaction accounts. Low-cost electronic payment acceptance solutions are not yet widely adopted.

11. Recent technological innovations, amplified by behavioral shifts during the COVID-19 pandemic, have boosted the use of mobile and digital financial services. Until recently, Panamanian banks had not offered products specifically addressing financial inclusion. That changed with the launch of digital account products benefiting from simplified KYC rules, which has helped to expand access to basic transaction accounts to previously unbanked segments and started to reduce the prevalent use of cash and checks for financial transactions. While this represents important progress towards more widespread financial inclusion, micro and small merchants often still face problems in accepting digital payments, and DFS solutions have yet to expand at scale for more sophisticated financial services.



Credit to for MSMEs trails other segments ...

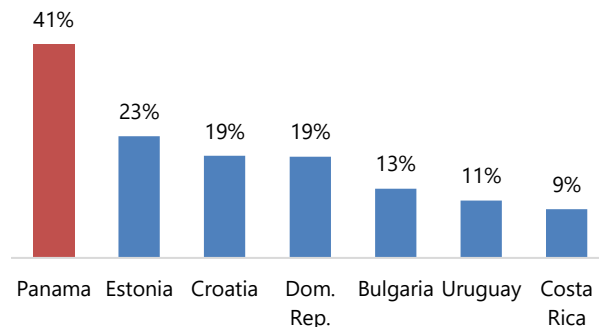
Number of loans to private sector borrowers (mn)



Source: SBP

...as the financing gap for MSMEs remains large

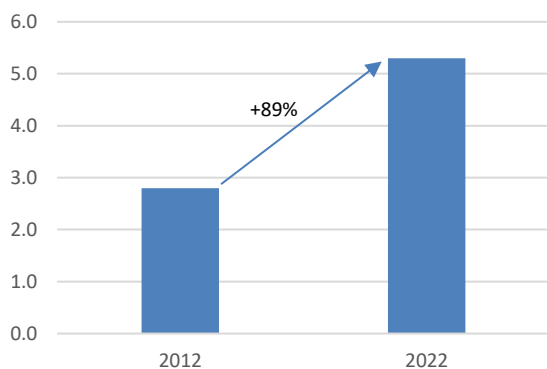
% of GDP



Source: Graph built with data from the [SME Finance forum](#).

Account ownership surged over the past decade...

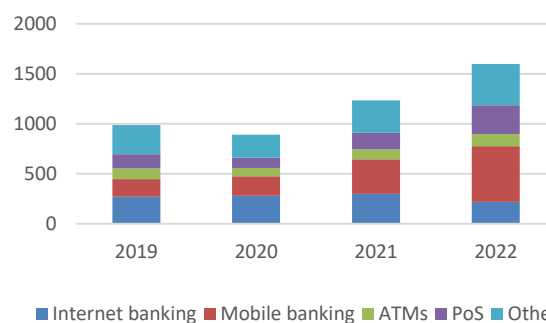
Number of deposit accounts (mn)



Source: SBP

...as technological innovation and the pandemic boosted use of online and mobile banking

Banking transaction by type (mn)



Source: SBP

RISKS AND VULNERABILITIES

A. Systemic Risk Analysis

12. The banking sector has remained resilient during the Covid-19 pandemic. Banks have typically held sizeable liquidity buffers, and the authorities have attached significant weight to the notion that the absence of a well-defined safety net promotes market discipline while lessening moral hazard. Buffers remained widely constant during the pandemic and at end-2022 banks' capital adequacy ratio stood at 15.3 percent (minimum requirement at 8 percent). Profitability has recovered to pre-pandemic levels. Banks faced asset quality pressures as regulatory flexibility

measures¹⁰ were wound down (indicated by an increase in Stage 2 loans), while nonperforming loan (NPL) ratios stood at a relatively low 2.5 percent of total loans at end-2022.

13. Downside risks stem from global tightening and recession scenarios, or a domestic house price correction. A potential further tightening of financial conditions in the U.S. and other countries would imply lower capital inflows, higher financing costs, and weaker private sector credit growth for Panama. Adverse spillovers can be expected for the region if the U.S. were to experience a recession. The further escalation of ongoing regional conflicts -including in the Middle East - could trigger upward pressure on oil prices and a sharp slowdown in trade, the latter of which would affect Panama adversely through reduced Canal activity, falling export revenues, and rising expenses for imports. Domestic risks, which include setbacks in tax information exchange, could lead to reputational damage, reduced external funding and access to international financial services, higher borrowing costs, and increased scrutiny of Panamanian entities and transactions with Panama. Further, domestic house price corrections may materialize in Panama in the future.

14. Stress tests find the Panamanian banking system broadly resilient against severe macrofinancial downturn scenarios, although some individual banks may be vulnerable. The system-wide solvency capital ratios rest well above regulatory minima, but some individual banks fall short of them, when assessed against a severe yet plausible adverse macrofinancial scenario. Banks appear solid in terms of liquidity coverage and only a few banks show weaknesses under a hypothetical stress scenario entailing severe liquidity outflows, for example, of deposits. The system (by design) relies strongly on foreign correspondent bank support. The need for banks to sell held-to-maturity (HtM) bonds under liquidity stress, to generate cash inflows, is found to be small, and hence the feedback to solvency through realized losses limited. This is due to available buffers from cash/reserves, foreign correspondent bank credit lines, and other liquid assets, including bonds held in the banks' trading portfolios. Recent developments in Panama, related to the possible interruption or suspension of mining business in Panama, were not known about or factored in as an adverse scenario component at the time the FSAP risk assessment was designed and conducted. However, the adverse macro-financial scenario considered in the FSAP is deemed to be sufficiently severe to encapsulate such an eventuality, and the results of the bank stress test in that sense remain informative.

15. However, there are weaknesses in the banking regulatory framework that should be addressed. The FSAP recommends the introduction of the capital buffer framework for internationally active banks aligned with the Basel III capital standards, including in particular the capital conservation buffer (CCB) and capital surcharges for domestic systemically important banks (D-SIBs). This is not expected to create additional pressure on the banking system as the systemic risk analysis points to two important conclusions in this context. First, phasing in a CCB is not expected to create notable pressure on banks under a baseline macroeconomic scenario, i.e., all banks' capital ratios would generally trend up and not "consume" the CCB buffer range. Second, the

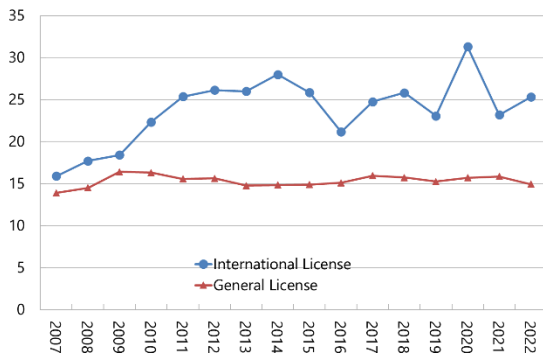
¹⁰ Panama's pandemic support program included a moratorium on loan servicing from March 2020 until June 2021 which successfully alleviated financial pressures on household borrowers. From January 2023, all remaining modified loans were reclassified according to pre-pandemic regulation.

assumed phase-in of D-SIB surcharges suggests that the Panamanian D-SIBs have sufficient capital buffers not to be adversely affected. Further, it should be noted that banks that ranked high regarding their impact in the interconnectedness analysis are already designated D-SIBs.

Figure 4. Selected Bank Soundness Indicators

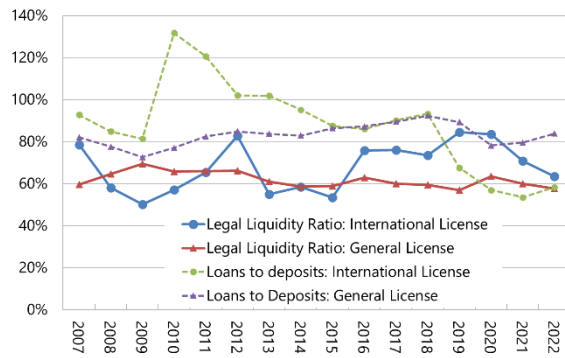
Banks' capital ratios remain high ...

Capital Adequacy Ratio (CAR)
(in percent of risk-weighted assets)



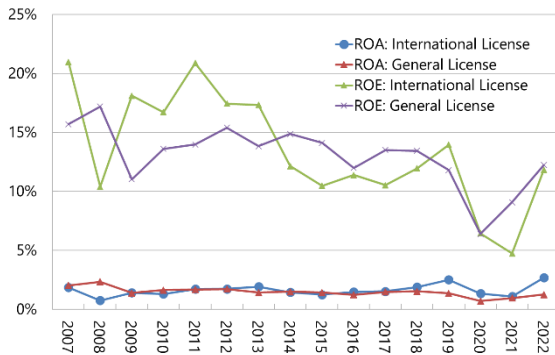
... and banks appear liquid supported by significant deposit funding.¹¹

Liquidity Indicators



Profitability has recovered from its pandemic dip and seems adequate.

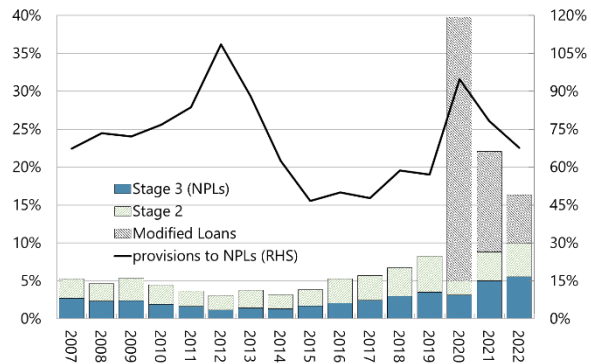
Profitability
Return on Assets (ROA) and Return on Equity (ROE)



The pandemic deteriorated the asset quality of banks, especially general license banks.

Asset Quality

(as a share of gross loans, General License Banks)



Source: SBP and IMF staff calculations.

¹¹ The Legal Liquidity Ratio sets a minimum weekly limit of coverage of eligible liquid assets on net computable deposits within 186 days.

B. Risks from Clearing and Settlement

16. BNP's role as the settlement bank for domestic payment systems is a source of risks for the institution and the broader financial system. As Panama does not have a central bank, BNP plays the role of the main settlement bank and the operator of the country's most important settlement system (BNP clearinghouse). The final settlement of net positions in retail payment systems¹² is effected in commercial bank money, in the books of BNP. Management of settlement risk lacks sophistication and the ability of participants to run potentially unlimited and uncollateralized net debit positions is a concern. While it is not likely to pose an immediate risk due to the existence of sufficient reserves on the books of the BNP, it could create issues in times of market stress as procedures for dealing with failures of participants in the payment system are not clear and the provision of intraday liquidity – usually a facility provided by central banks to reduce liquidity risks in the settlement process in exchange for collateral – is limited.¹³ The tight integration between BNP's commercial banking and the clearinghouse also poses operational risks and bears the potential for conflicts of interest.

17. To mitigate these risks, risk management framework should be reviewed and updated, and BNP should continue the process of separating its clearing and settlement operations from the commercial arm of the bank. It is recommended that BNP and other operators¹⁴ ensure settlement finality through appropriate risk management frameworks compliant with PFMI Principles 3, 4, 7, 8 and 9. They should also institute clear procedures to be followed in the event of participant default (in accordance with PFMI Principle 13). If more transactions are settled in the real-time gross settlement mode, provision of a fully collateralized intraday liquidity facility should be considered. Changes in the system rules should be preceded by an analysis of historical data and may benefit from the use of simulation and network analysis tools. Operational risk management mechanisms (e.g., business impact analysis, business continuity planning) should be systematically tested and reviewed, taking into consideration CPMI endpoint security guidelines. Finally, while recent changes in the organizational structure of BNP, which establish a greater degree of administrative and managerial separation of clearing and settlement operations from its commercial arm, are welcomed and should continue. Based on the subsequent PFMI self-assessment the authorities should determine whether this arrangement sufficiently minimizes risks affecting settlement and, if necessary, decide on further organizational changes.¹⁵

¹² The automated clearinghouse – ACH; the retail instant payment system – ACH Xpress; the domestic debit card scheme – Clave; and two check clearinghouses, as well as the securities settlement system (LATINCLEAR).

¹³ As of 2023, only four banks have signed agreements with the BNP providing them with a collateralized intraday credit line.

¹⁴ Including Telered, a consortium of six banks, which operates a cheque processing system, an automated clearinghouse (ACH) for direct credits and debits, an instant low-value payment system, a local ATM network and debit card scheme, as well as an account-to-account bill payments system.

¹⁵ See the Explanatory Note to PFMI Principle 9 (Money settlements): "One way an FMI could minimize these risks is to limit its activities and operations to clearing and settlement and closely related processes. Further, to settle

(continued)

C. Climate Risk Analysis

18. Panama is exposed to climate-related physical risks, with floods posing the highest risks to the financial sector. Panama is vulnerable to extreme weather events such as hurricanes, floods, and droughts. While the country has been widely spared from hurricanes in recent decades, the disruptions to shipping activity in the Panama Canal stemming from the prolonged drought in summer 2023 serve as a reminder of Panama’s exposure to climate-related hazards.¹⁶ The financial sector impacts of such climate-related risks have been manageable so far, but the expected increase in frequency and intensity of extreme weather events may test resilience in the future. Risk exposure appears highest for floods, as the area around Panama City is especially prone to flooding events with growing climate change, while at the same time over 80 percent of bank lending is concentrated in that area. The bulk of those loans are for housing (34 percent) that are likely to see the strongest impact from flood-related damage. However, a more comprehensive assessment utilizing detailed and spatially granular exposure data, macro-economic feedback loops, and compounding effects is needed to comprehensively assess these physical risks.

19. While recent emission growth threatens Panama’s status as a net negative greenhouse gas (GHG) emitter, transition risks seem currently contained. Panama is currently one of only three countries globally with net negative GHG emissions, but recent emission growth, driven mainly by the power and transport sector, risks reversing its net negative status and may necessitate the phasing in of stricter climate policies. Transition risks from loan exposures to sectors that may be most affected by potential domestic climate policy changes seem relatively low, with loans to the utility sector accounting for 4 percent and industry loans about 6 percent of bank lending.¹⁷ However, if climate policies would also target the real estate sector, banking sector exposure to potential transition risk – for example from the requirement to implement costly energy efficiency measures for buildings – could increase significantly due to the large share of real estate (34 percent) and construction (8 percent) lending. Individual banks could also be impacted if they have significant exposure to high-carbon sectors or are subject to climate spillover risks arising from the implementation of climate policies in foreign jurisdictions, given that Panamanian banks conduct approximately 40 percent of their lending and investment activities abroad.

FINANCIAL SECTOR OVERSIGHT

20. Panama made important progress in strengthening financial oversight since the last FSAP, but gaps remain. The *Superintendencia de Bancos de Panamá* (SBP) updated the regulatory

payment obligations, the FMI could be established as a supervised special-purpose financial institution and limit the provision of cash accounts to only participants”.

¹⁶ In addition to these acute risks, more chronic and slow-moving risks such as sea level rise are a significant threat, especially along its coastal regions and islands, and water scarcity is becoming increasingly problematic in certain regions.

¹⁷ It should be noted that information on those industry loans’ emission profiles is currently limited.

and supervisory framework for the banking sector and strengthened its macro-prudential toolkit. However, as described below, some gaps remain and addressing them is important to further enhance SBP's ability to ensure the safety and soundness of Panama's banking sector. Progress has been more limited in the oversight of payment systems where the continued absence of a legal framework poses significant risks and prevents improvements in market efficiency and functioning. At the same time, emerging risks linked to climate change require increased supervisory oversight to ensure that they do not affect financial stability in the future.

Box 1: Oversight architecture

The supervisory and regulatory architecture of the Panamanian financial system comprises three supervisory bodies and a coordinating council. The *Superintendencia de Bancos de Panamá* (SBP) is the regulatory and supervisory entity of the banks and banking groups authorized to operate in the Panamanian market. SBP conducts macroprudential and microprudential supervision of banks and houses the *Directorate for the Prevention and Control of Illicit Operations*, which is charged with AML/CFT supervision of banks and non-bank financial institutions. It is also in charge of financial consumer protection in the banking sector. The *Superintendencia del Mercado de Valores de Panamá* (SMV) is responsible for regulating and supervising capital market issuers, investment companies, intermediaries, and other market participants. Insurance related activities are regulated and supervised by the *Superintendencia de Seguros y Reaseguros de Panamá* (SSRP). Inter-agency coordination is facilitated by the *Consejo de Coordinación Financiera* (CCF), in which all sector superintendencies are represented.¹⁸ The CCF is chaired by the SBP Superintendent and meets bi-monthly. An additional relevant supervisory entity – outside the core financial sector – is the *Superintendencia de Sujetos no Financieros* (SSNF) which supervises compliance with AML/CFT obligations for non-financial institutions (notably resident agents).

A. Banking Regulation and Supervision

21. The SBP has made significant progress in updating its regulatory and supervisory framework. It has adopted key elements of the international regulatory reform agenda, including via significant alignment with Basel III and implementation of IFRS9, and has introduced comprehensive new regulations in the areas of corporate governance and risk management.

22. Reforms are needed to safeguard the SBP's autonomy and ensure that its objectives focus on the safety and soundness of the banking system. The Banking Law established the SBP with full legal status as an autonomous agency of the government, including administrative, budgetary, and financial independence. However, successive Budget Laws passed since 2019 have required the SBP to seek pre-approval and obtain budget verification and registration from the relevant institutions for all recruitment and other human resource decisions that have a budgetary impact. As a result SBP currently has 96 vacancies. The current Budget Law should be amended to restore the SBP's independence of action in respect of all budgetary issues, and future Budget Laws should maintain this autonomy. The Banking Law sets the SBP four objectives, two of which (namely

¹⁸ CCF also includes representatives from the *Panamanian Autonomous Cooperative Institute* (IPACOOOP) and the *Sistema de Ahorro y Capitalización de Pensiones de los Servidores Públicos* (SIACAP).

safeguarding the soundness and efficiency of the banking system and fostering the Republic of Panama as an international financial sector) have the potential to conflict with each other. The SBP's primary objective should be to safeguard the soundness of the banking system, with the remaining three objectives subordinate to this objective.

23. The SBP's oversight of the banking sector is generally in line with the Basel Core Principles, but there are material shortcomings in some areas of the regulatory framework.

There is no requirement in the law or in regulations for banks or banking groups to notify the SBP of any acquisition or investment below 25 percent of their capital. The lack of such notification hinders the SBP's ability to assess risks that acquisitions of non-banking activities can pose to a banking group. There is no regulation in place to assess interest rate risk in the banking book (IRRBB), and the liquidity coverage ratio (LCR) is calculated and reported on a solo basis only, not group-wide. This means the SBP does not have a consolidated view of liquidity. Similarly, the SBP's framework for credit concentration risk and large exposure limits does not apply to all material sources of concentration risk. Risk management would be enhanced by introducing a formal stress testing requirement across all material risks.

24. The capital framework is largely aligned with the Basel III Accord, yet internationally active banks do not meet Basel III standards. The SBP has developed and implemented a D-SIB supervision framework where enhanced supervision is applied to this cohort of banks, but a systemic risk buffer has not been implemented. A deviation from the Basel Capital Framework is that no formal buffer framework (as envisaged by Basel III, such as the capital conservation buffer and countercyclical buffer) has been implemented. The addition of a formal buffer framework is warranted to allow a structured process to standardize responses to capital deterioration.

25. The SBP's supervisory framework provides an effective methodology for identifying risks that banks are running at the time of assessment, but greater emphasis should be placed in the methodology on forward-looking elements of individual banks' and banking groups' risk profiles. Although banks are required periodically to undertake stress testing of their capital adequacy requirements, this process is not systematically built into the framework. No timetable has been set for the implementation of an Internal Capital Adequacy Assessment Process (ICAAP). In addition, regular engagement with Board members and heads of key control functions should be built into the supervisory framework.

B. Macroprudential Framework

26. The macroprudential framework and toolkit has significantly strengthened and broadly meets the principles of good design, particularly for the banking sector. The SBP has well-developed systemic risk monitoring processes, adequate capacity to conduct macroprudential policy, and broad powers to apply policy tools and collect information. It recently established a dedicated macroprudential policy committee, updated its decision-making process, and drafted a macroprudential policy strategy. Its main policy tools include limits on leverage ratios, dynamic provisioning, and ad-hoc and specific provisioning requirements. SBP's views on systemic risks and

vulnerabilities are well-articulated and regularly communicates publicly on macroprudential issues, notably in its semiannual Financial Stability Report (FSR).

27. Further progress calls for the introduction of additional macroprudential policy tools.

The SBP should establish additional borrower-based macroprudential tools, such as caps on mortgage loan-to-values (LTVs) or on debt-to-income (DTI) and debt-service-to-income (DSTI) ratios to limit the buildup of vulnerabilities in the household sector. In addition, the SBP may consider applying them to nonfinancial corporate lending portfolios.¹⁹ The SBP should also continue building experience in evaluating the effects of its policy measures, continue to develop its stress testing models and close remaining data gaps.

28. The CCF can be strengthened by additional efforts and resources to further develop the capabilities of all its members and allocating a role for the MEF.

The *Consejo de Coordinación Financiera* (CCF) is developing as a forum for system-wide financial stability analysis and coordinated macroprudential policies. However, significant efforts and resources are needed to further develop the capabilities of all CCF members. CCF member inputs should then also be used by SBP to broaden the scope of the FSR to the entire financial system. It is also worthwhile considering a role for the Ministry of Economy and Finance (MEF) in the CCF. Establishing a role for the MEF on the CCF can be useful when changes in legislation are needed to expand the macroprudential toolkit or the regulatory perimeter or when cooperation of the fiscal authority is needed to mitigate systemic risk. At the same time, the independence and autonomy of the participating agencies should be safeguarded.

C. Payment Systems Regulation and Supervision

29. No legal mandate for regulating and overseeing the national payment system exists.

Several existing laws and regulations contain provisions referencing some aspects of payment systems.²⁰ However, these scattered provisions are vague and, as a result, market participants remain confused and licensing processes are opaque. No agency is currently responsible for payment systems oversight—understood as promoting “*objectives of safety and efficiency ... by monitoring existing and planned payment, clearing, settlement and related arrangements, assessing them against these objectives and, where necessary, inducing change.*”²¹

30. In the absence of a central bank, the SBP appears best positioned to become the regulator and overseer of the national payment system, and the licensing authority for

¹⁹ This is less frequently done, due to difficulties with defining various relevant risk metrics for corporates, such as income and others; commercial real estate lending portfolios represent the most feasible application thus far, for considering loan-to-value caps, for example.

²⁰ For example, the Law 81 of 31 December 2009 regulates some aspects of credit card issuance; the Law 48 of 23 June 2003 mandates MICI to license and supervise remittance service providers; the BNP Organic Law bestows upon it the responsibility to operate a clearinghouse, while the Law 23 of 27 April 2015, while focusing on AML/CFT issues, uses a number of terms from the domain of payment and settlement systems, though without properly defining them.

²¹ CPMI (2005). *Central bank oversight of payment and settlement systems*. Bank for International Settlements: Basel.

providers of payment services. In most jurisdictions payment systems are regulated and overseen by central banks, but the Principles for Financial Market Infrastructures (PFMI) permit regulation, supervision and oversight of payment systems to be also discharged by “*a market regulator, or other relevant authority*”.²² It is critical that the institution in charge of payment system oversight discharges its mandate with independence and in a consistent manner across different systems and providers, avoiding conflicts of interest. For that reason, it is not desirable for this function to be performed by a payment system operator, such as BNP. Organizational separation between payment system oversight and payment system operations is also supported by applicable international standards. As the supervising authority, the SBP will be able to leverage its experience as the banking regulator and the data collected in the course of banking supervision to assess and manage systemic impacts of risks stemming from payment systems and market infrastructures. Taking on the role as regulator and overseer of the national payment system might warrant a broadening of SBP’s objective, but ‘safety and soundness’ should remain the primary objective.

31. MEF, together with the SBP, should facilitate the urgent adoption of a law on payment systems and services.²³ Enacting such a law was already recommended by the previous FSAP and the rapid growth of the digital payments industry makes its adoption even more critical. The law should include (i) a clear mandate for the SBP to regulate, supervise and oversee the national payment system, guaranteeing its safety and efficiency; (ii) a clear mandate for the SBP to act as the licensing authority, supervisor and regulator for payment service providers, including remittance service providers and electronic money issuers; (iii) a well-founded, clear, transparent and enforceable legal basis for multilateral clearing, settlement finality, bankruptcy remoteness of collateral, protection of e-money consumer funds and other key legal concepts pertaining to payment and settlement; (iv) recognition of non-bank provision of payment services, which ensures a level-playing field backed by a risk-based approach; (v) inclusion of fostering competition and financial consumer protection among SBP’s mandates (while, in line with the FSAP’s recommendations, retaining financial stability as its primary objective); (vi) repealing or amending older laws.

32. Upon the enactment of the new law on payment systems and services, SBP should develop an oversight policy framework reflecting the new mandate and develop relevant capacity. The framework should cover payment systems and payment services, including innovative digital payment services, and it should be explicit about the objectives, scope, applicable standards and reporting requirements for payments oversight.²⁴ SBP should also consider developing a

²² Please see Responsibilities A-E forming parts of the Principles for Financial Market Infrastructures (PFMIs) by CPMI and IOSCO (https://www.bis.org/cpmi/info_pfmi.htm), which is recognized by the Financial Stability Board (FSB) as one of the 12 key standards (https://www.fsb.org/work-of-the-fsb/about-the-compendium-of-standards/key_standards/) of sound financial systems.

²³ SBP has already been working with technical inputs from IDB on a draft bill that meets most of these requirements. This draft has been made available for consultation with the Panamanian banks.

²⁴ Please refer to Responsibility A of CPMI and IOSCO (2012) PFMIs.

capacity building plan for its staff on payments oversight to ensure effective implementation upon the enactment of the new law.

D. Climate Regulation and Supervision

33. Oversight of climate-related risks is in its early stages and authorities should emphasize data collection, capacity building and coordination. Climate-related initiatives across authorities and the financial sector have so far focused on sustainable finance and ESG issues with little emphasis on risks. Financial institutions are just beginning to assess climate risks²⁵ and no system-wide climate risk assessment has been conducted to date. To gain a better understanding of climate-related risks, it is recommended that the superintendencies – in collaboration with the Ministry of Environment (MiAmbiente) and private stakeholders – start collecting more granular data on the location and the emission profile of assets as well as on potential climate impacts. Concrete steps are needed to enhance internal capacity and knowledge on climate-related risks. This requires adequate resources and improved coordination among relevant stakeholders. Authorities may also engage external partners and international platforms, such as joining the Network for Greening the Financial System (NGFS) and invest in specialized training programs for staff members.

34. A system-wide assessment of climate risks can help to inform the development of more supervisory guidance and expectations. A top-down exposure exercise to assess financial sector vulnerabilities to climate risks can help gain more granular insight into the potential impacts of climate risks and to identify financial institutions, which require closer climate risk management supervision. Such a risk-based approach would assist authorities in developing more concrete supervisory guidance and expectations on governance, risk management, scenario analysis, vulnerability assessment, and disclosure of climate risks.

CRISIS MANAGEMENT AND FINANCIAL SAFETY NETS

35. Key institutional pillars of a financial safety net have not been established in Panama. While state-owned banks benefit from an explicit government guarantee, Panama does not possess a deposit insurance system (DIS), lender-of-last resort (LOLR) or emergency liquidity assistance (ELA) mechanism to preserve financial stability. Panama, as a fully dollarized economy with no central bank, faces constraints on its development of key components of the financial safety net which will need to be overcome.

36. SBP has drafted legislation to strengthen the bank resolution framework and improve compliance with international standards. The legislation is intended to address the identified gaps and expedite the resolution process. The draft law has been submitted to the MEF and remains under deliberation. Should the legislation be approved by the National Assembly, this framework will override the existing legal framework on bank resolution in Panama.

²⁵ As also confirmed by a recent survey conducted by the SBP among its supervised banks.

37. Adopting the reform legislation is encouraging and should be expedited; the proposed legislation should be reviewed, remaining gaps filled, and implementation challenges addressed.

The current reform bill should be intensively reviewed not only in comparison to the KAs, but also with a detailed focus on implementation of new resolution tools in the context of the Panamanian banking, financial, legal, and judicial systems. The new resolution tools to be adopted, such as bridge bank and ‘bail-in’ resolution tools, require the establishment of mechanisms to recapitalize and fund the failed bank during resolution. The resolution tools require the existence of adequate loss-absorbing capacity at relevant banks to work effectively; and thus, there is a need to set minimum requirements for loss-absorbing capital levels. The tools also require an ability to provide adequate liquidity during the resolution period; and thus, resolution plans will need to address banks’ capacity to self-fund and a temporary public backstop funding mechanism should also be considered. Recovery plans should be required of all banks (with tailored requirements for international license banks).

38. Resolution powers and coordination mechanisms should extend adequately across complex financial conglomerates and cross-border banking groups. Panamanian D-SIBs and regional banking groups can have cross-sectoral ownership, organizational, and operational structures that present complex financial and operational interconnections and dependencies. Non-bank financial entities are subject to distinct regulatory and resolution frameworks. These material operating entities, which can include non-bank/non-financial entities, will need to be resolved in a fashion that ensures continuity of critical functions and that minimizes the impact to financial stability. The resolution authorities’ powers, roles and responsibilities, and coordination mechanisms must be fully established.

39. An explicit industry-funded deposit insurance scheme should be established as a key element of an effective financial sector safety net in Panama. Following the adoption of the aforementioned reforms of the bank resolution framework, an explicit industry-funded DIS should be established. Its design should comprehensively consider international principles and tailor a framework effective for Panama. Adopting a DIS would facilitate more prompt payment of deposit claims and serve to facilitate use of new resolution tools intended for adoption in Panama. Concerns about moral hazard can be addressed by effective DIS design.²⁶ Upon the adoption of the DIS, the explicit state guarantee for state-owned banks should be removed.

40. In absence of a central bank, Panama should explore alternative mechanisms to put in place a LOLR facility. The July 2020 facility put in place to address potential liquidity stress at banks resulting from the pandemic is temporary, and is accessed through a commercial bank, BNP. Given the very significant stigma risks that would arise from a commercial bank providing liquidity support, a public authority should assume the LOLR function. Any LOLR facility would need to be designed taking into account the fact that Panama has no monetary sovereignty (i.e., no own currency) and is

²⁶ The foreign-in-total deposits share for GL banks amount to 28 percent by end-2022.

therefore dependent on foreign correspondent banks and other foreign sources of U.S. dollar funding.

41. The authorities should build upon current domestic and regional efforts and develop their internal, interagency, and cross-border coordination and communication mechanisms for bank resolution and crisis management. Authorities will, at a minimum, need to develop internal crisis management plans, develop firm-specific resolution plans, and work to establish an institution-specific memorandum of understanding that sets out the crisis management and resolution information sharing and coordination expectations for D-SIBs and regional banks.

Box 2. Banco Nacional de Panamá—A Unique Financial Institution

BNP’s multiple roles as a quasi central bank, state-owned commercial bank, payment systems operator²⁷, and LOLR give it a unique status within Panama’s financial sector.²⁸

Recommended reforms to Panama’s financial safety net—establishment of a DIS and alternative mechanisms to create a LOLR facility—would impact BNP. Once a DIS is in place, the explicit state guarantee for state-owned banks such as BNP should be removed. Meanwhile, the role of BNP as operator of the liquidity facility put in place in July 2020 should be changed. Given the significant stigma risks that would arise from a commercial bank providing liquidity support, this would likely require a public authority to assume the LOLR function.

BNP would also be impacted by the recommended reforms to the payment systems. The FSAP recommends that BNP, in its role as the clearing house operator, strengthens settlement risk management frameworks and institutes clear procedures in accordance with the results of the Principles for Financial Market Infrastructures (PFMI) self-assessments that the bank has been undertaking. The ongoing operational separation of BNP’s clearing and settlement operations from its commercial arm is welcomed and should continue as it reduces any perception of conflicts of interest. Regarding, the oversight of payment systems, the FSAP recommends that this role is assumed by the SBP as it is not desirable for this function to be performed by a payment system operator, such as BNP.

Given the multiple dimensions through which BNP affects the financial sector in Panama and its importance as both a potential source and conduit of risk, the authorities should prioritize the relevant recommendations arising from the FSAP and approach them in a holistic manner. While the SBP incorporates the unique nature and importance of BNP into its risk-based supervision, the resilience of Panama’s financial sector would be enhanced through the reforms set out above.

²⁷ A number of commercial banks globally act as settlement institutions for one or more payment systems, especially when such payment systems process transactions in foreign currency., but it is much rarer for commercial banks to be also *operators* of those systems.

²⁸ Observations in this box are limited to BNP’s role in payment systems and related to financial safety nets. The FSAP did not conduct an in-depth assessment of other aspects related to BNP.

FINANCIAL INTEGRITY

42. Its dollarized economy, the open nature of its financial sector and availability of wide-ranging corporate services, and its status as a regional, politically stable, financial hub render Panama vulnerable to foreign money laundering threats. Legal persons and legal arrangements established in Panama are particularly at risk of being misused to conceal the origin, beneficial ownership, or purpose of illicit financial flows. Panama’s corporate sector is dominated by corporations, followed by private interest foundations, trusts, and limited liability companies.

43. Panama has struggled to bring its anti-money laundering and combating the financing of terrorism (AML/CFT) regime in line with international standards, resulting in periods of being “grey listed”²⁹ by the international standard-setter, the Financial Action Task Force (FATF). Panama’s AML/CFT regime was last assessed against the FATF standards in 2017 and found to have strategic deficiencies, notably in preventing the misuse of legal persons and arrangements for money laundering purposes. As a result, Panama was grey listed by the FATF in June 2019, at which point it adopted an Action Plan to address the deficiencies. At the FATF October 2023 Plenary³⁰, FATF concluded all items in the Action Plan had been dealt with and decided to remove Panama from its grey list.

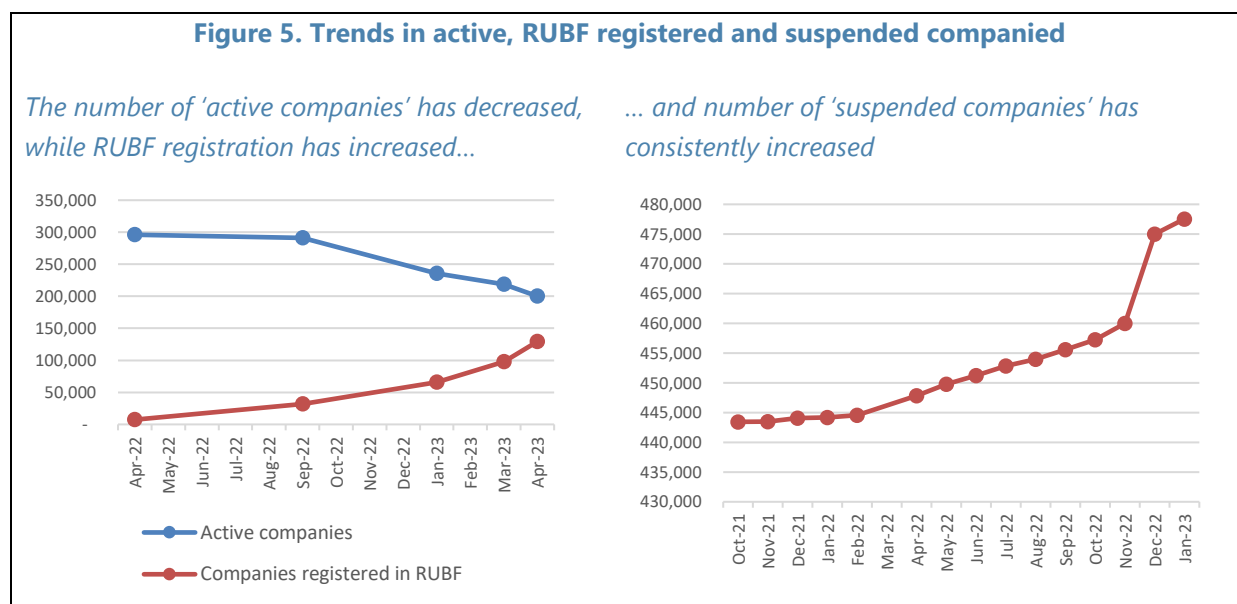
44. Enhancing transparency of legal persons and arrangements established in Panama has been a top priority for the country and remains the subject of ongoing reforms. Key reforms adopted by the authorities include the establishment of a beneficial ownership registry, the *Registro Único de Beneficiarios Finales (RUBF)*, a central repository of information on beneficial ownership of legal persons collected by their resident agents (who must be lawyers) and the creation of an independent authority to supervise non-financial obliged entities, notably resident agents, the *Superintendencia de Sujetos No Financieros (SSNF)*, which also administers the RUBF.

45. While the implementation of the RUBF is a significant step forward, consideration should be given to expanding the scope and use of the registry to ensure it continues to be aligned with the evolving risk landscape. The RUBF was formally launched in April 2022. While implementation was initially slow, it has since picked up following large-scale outreach efforts to promote registration, most recently following a two-month enrollment campaign that took place in March and April 2023. Access to the RUBF has been restricted to “competent authorities” and the registry is only searchable through the name of the legal person or registration number (*folio*). Authorities should consider enabling searches of other data points (e.g., name of ultimate beneficiary), which would enhance the usefulness of the RUBF for investigation and international cooperation purposes. As the corporate sector evolves, notably in response to these reforms, the scope of the RUBF should be reconsidered periodically to reflect evolving risks.

²⁹ The FATF grey list identifies jurisdictions under increased monitoring that are actively working with the FATF to address strategic deficiencies in their AML/CFT regimes through the implementation of a timebound action plan.

³⁰ <https://www.fatf-gafi.org/en/publications/Fatfgeneral/outcomes-fatf-plenary-october-2023.html>

46. As a result of concerted efforts to “clean up” the public registry, Panama currently has a large number of suspended legal persons—close to half a million—that require a path to dissolution. In the past five years, there has been a dramatic reduction in legal persons with *active registration* in the public registry, and a concomitant significant increase in *suspended*³¹ companies. Since 2016, competent authorities have made an ongoing effort to “clean up” the public registry by suspending legal persons that failed to pay their annual registration fee, failed to appoint a resident agent, or failed to comply with obligations for which suspension was a sanction. While there is a legal presumption that suspended companies will be dissolved after a year (unless reactivated), in practice this is not happening. Agreement should be reached to dissolve and unwind suspended companies that have passed the deadline for reactivation.



Source: RUBF

47. In the medium-term, the evolving corporate landscape in Panama should be monitored closely, and risk assessments should be updated to reflect emerging business models and potential exposures to new threats and vulnerabilities. Anecdotal evidence suggests that some law firms reduced their portfolios of legal persons incorporated in Panama significantly while existing and prospective clients are choosing to have legal persons incorporated in other jurisdictions. Some law firms now appear to have larger portfolios of legal persons incorporated abroad than incorporated in Panama. Associated risks are as yet unclear, but the SSNF, as the supervisor, should collect information, assess this risk, and adopt appropriate and proportionate controls accordingly.

48. Notwithstanding controls adopted to prevent misuse of nominee arrangements and bearer shares, more should be done in line with the FATF standards, as revised in March 2022.

³¹ Suspended companies can no longer initiate legal proceedings, conduct business, dispose of their assets, make claims or exercise rights, or perform any corporate action binding on the legal person.

While risks related to bearer shares issued by corporations have been mostly curtailed through custodial requirements, corporations are still able to issue new bearer shares. To eliminate all risk and in compliance with FATF Recommendation 24, Panama should ensure that corporations can no longer issue bearer shares and require custodians to hold beneficial ownership information.

49. Authorities should assess the risks emerging from virtual asset service providers (VASPs) and regulate and supervise these institutions accordingly, in line with FATF Recommendation 15 and international best practices. Anecdotal evidence suggests a very limited volume of digital transactions involving virtual assets within a peer-to-peer environment at this moment. However, considering Panama’s dynamic financial sector, there is a need for conducting sectoral risk assessments of VASPs, and on the basis of which identify measures to prevent and mitigate these risks, including by providing a sound framework for licensing and regulating VASPs.³²

PRIORITIES FOR FINANCIAL DEVELOPMENT

A. Digital Financial Services and increasing Access to Financial Services

50. The banking sector in Panama has undertaken several initiatives to improve the access to and usage of DFS but the legal void hampers further progress. Digitalization has been a priority for the financial sector over the past years, with an increased focus on innovative products, such as those facilitating faster person-to-person payments. This has led to the gradual elimination of the use of checks, improvements in payments clearing, new product offerings in the form of e-wallets, the emergence of basic accounts with remote account opening, and enabling digital payments for several use cases that are important from a financial inclusion perspective, including salaries, pensions, and social assistance payments. While account ownership and use of digital payments have increased recently, especially during the COVID-19 pandemic, the lack of a legal framework for payment systems and services has been impeding further reforms and growth in the sector, restricting opportunities for innovation, competition, and product variety, which would in turn lead to financial inclusion. These challenges have also hampered the development of a vibrant fintech sector, which remains small compared to other countries in the region.

51. To further enable DFS’ potential to enhance access and usage of financial services in a safe and competitive environment, SBP should ensure timely issuance of secondary regulations. Key considerations in this regard include ensuring competition, collaboration, standardization, and innovation, while at the same time managing and mitigating risks and protecting customers’ interests. In addition to financial integrity and financial consumer protection, these regulations should be in line with the principles of regulatory neutrality and proportionality and should ensure protection of customer funds. Upon the enactment of the new law on payment

³² In line with and as established by the legal principles and legislative process of the Republic of Panama.

systems and services (see ¶ 31), SBP should prioritize the issuance of the following secondary regulations in a timely manner:

- **Rules for licensing of non-bank payment service providers.** Such rules have been lacking and several providers have been operating in this area without proper oversight, leading to potential risks.
- **Regulations on issuance of e-money.** The regulations should consider issues including capital requirements and maintenance of own funds, traceability of customer funds, protection of customer funds in case of insolvency, and enable e-money issuers to engage agents.
- **Risk-based access by non-bank payment service providers to payment infrastructure.** In the medium term, SBP should work on enabling risk-based access to payment infrastructure by non-bank payment service providers. Adopting a holistic risk-based approach to non-bank payment service providers' access to payment infrastructure would contribute to increased competition in the provision of payment services and further enhance the use of digital payments.

52. While bringing benefits, the growth of DFS poses also risks to consumers that call for the development of a financial consumer protection (FCP) framework. SBP should develop and implement a comprehensive standalone FCP regulatory framework for banks and non-bank payment service providers.³³ The framework should cover dispute resolution, disclosure and transparency, fair treatment, and business conduct. Specific FCP considerations on DFS include fraud or other misconduct, platform unreliability, lack of transparency, riskier or complex product offerings unsuitable to consumers, algorithmic decision-making, and data privacy issues, among others.

53. A coordinated inter-agency approach to fintech is needed to enable transformative business models, mitigate risks, and make an impact on financial inclusion. As many fintech providers operate across several sectors (e.g., ICT, payments, credit), interaction among different authorities is necessary. A collaborative approach to fintech development can enable further innovation, leading to a higher impact. Such coordination could be facilitated through the establishment of a sub-committee on fintech under the CCF.

54. Further measures are needed to increase the depth and breadth of financial inclusion, especially for MSMEs. Many MSMEs, including informal businesses, benefited from accepting digital payments through their individual mobile wallets. However, there are no specific digital financial products, such as digital credit based on payment history, factoring, e-invoicing, and supply chain finance that would allow them to leverage those flows to secure financing. Part of the impediments are due to underlying gaps in the credit infrastructure that should be mitigated by (i) securing the use of APIs for information retrieval from Tribunal Electoral and the Public Registry of Panama; (ii) amendment to Law 24 of 2002 to enable the credit bureau to access additional

³³ After the enactment of the new payment systems and services law, and based on its new mandate on regulating and overseeing the national payment system.

information on the consumers, within the scope of Law 81 of 2019 on data protection for improved credit scoring; and (iii) encouraging providers of credit to offer differentiated interest rates based on credit scores. MSME access to finance would also benefit from efforts to bring more MSMEs into the formal sector through simplifying the process of business registration. Currently, there are there are six different laws governing the process and registration for small businesses has the same requirements as those for large firms. A simpler unified legislation can potentially help facilitate formalization. Additionally, improving connectivity in remote areas and leveraging institutions such as the Post Office as banking agents can help to ensure that the benefits of DFS for enhancing financial inclusion are more evenly experienced across the entire country.

B. Greening the Financial Sector

55. Panama’s potential as a green finance hub remains underutilized. Panama’s large and internationally connected financial sector together with strong environmental credentials as a carbon negative country could position it as a regional hub for green finance. However, to date this potential has not been realized. Green finance markets are relatively small as only five green corporate bonds have been issued and the uptake of green lending instruments is limited. The main challenges include a lack of incentives, the absence of clear definitions and standards, limited climate-related disclosure practices, and low market awareness and knowledge.

56. Scaling up green finance requires a multi-pronged approach based on a strategic assessment of financing needs. While authorities and private sector stakeholders have taken some initial steps towards developing green finance markets and initiatives, a comprehensive strategy is required to scale up green lending and capital market development. MiAmbiente and the MEF, in coordination with other relevant agencies, should conduct a comprehensive gap analysis to determine the private and public finance needs and their availability for the national climate action plan and national energy transition strategy.³⁴ This analysis would help identify any financing gaps that exist and provide insights into how private capital could be mobilized to fill these gaps.

57. Clear frameworks for green and sustainable financial instruments are needed. The MEF is currently developing a sovereign sustainable bond framework, with the goal of issuing its first sustainable bond in 2023. As a next practical step, the MEF could explore debt instruments beyond green bonds to tap additional pools of investors for both mitigation and adaptation finance. To enable private sector issuances of new types of labeled financial instruments, such as sustainability-linked bonds, SMV needs to develop issuance frameworks and guidance. Establishing measurable key performance indicators (KPIs) is essential to facilitate the utilization of innovative financial instruments, requiring support from authorities to promote their development. SMV, MEF, and MiAmbiente also need to explore how to better incentivize uptake of green and sustainable debt

³⁴ Panama faces significant climate mitigation investment needs to achieve its National Determined Contributions (NDC) targets, estimated at US\$ 4.1bn (6.4 percent of 2021 GDP) until 2025. The country’s adaptation investment needs are even higher, particularly in the water, energy, and agriculture sectors, with estimates ranging from US\$ 7.06 bn to US\$ 9.4 bn by 2030.

instruments and investor participation in these markets and improve the business case for green projects, for instance by establishing reliable revenue streams.

58. Authorities should ensure the transparency of the developing carbon market as well as its compatibility with other green financial instruments. Panama's recently established carbon market generates carbon credits from offset projects that achieve emissions reductions or increased absorptions for international sale. To fully utilize the carbon market's potential for financing the green transition, MEF, MiAmbiente, and SMV should ensure its compatibility with other green financial instruments to reduce investor risk and make climate projects more appealing. The transparency of the developing market can be further strengthened through a review of existing and upcoming instruments to identify potential implementation gaps and ensure seamless interaction with national and international counterparts. This may attract additional investments and position Panama as a model for other countries in the region.

59. Improving data availability and market transparency in the Panamanian financial system are essential for the development of a comprehensive green finance approach. To ensure greater transparency and accountability in the financial sector's environmental and climate-related practices, the authorities should adopt a phased approach to enforce mandatory reporting of climate-related and environmental financial disclosures, considering the varying capacities of firms based on their size. To address the potential risk of greenwashing and ensure consistency in climate-related and environmental disclosures, the authorities should ensure that supervisory guidance is aligned with the green taxonomy that is currently being finalized by MiAmbiente.³⁵

60. While Panama has made progress in disaster risk financing (DRF), certain key challenges remain, and authorities should seek to further strengthen their DRF strategy. Efforts are needed to tackle the lack of granular data on physical climate risk and the insurance protection gap, particularly for low-income households and smallholder farmers who are highly vulnerable to natural disasters. In addition, there are barriers to effective disaster risk finance, such as the unclear financing source for premiums related to the expansion of coverage by the Caribbean Catastrophe Risk Insurance Facility (CCRIF) as well as incentivizing insurance companies to offer more risk resilience products.

³⁵ The green taxonomy classifies economic activities as either green or high carbon is being developed, which is crucial to the development of the green finance market.

AUTHORITIES' VIEWS

61. The authorities appreciated the open and constructive interaction with the FSAP team. They noted that the discussions and meetings, both face-to-face and virtual, were very valuable.

62. The authorities appreciate that the FSAP highlighted progress since the last evaluation in 2012, in line with previous recommendations, with a view to continuing to strengthen the security and soundness of the Panama financial sector. They valued the FSAP's findings and recommendations and committed to making the necessary efforts to implement most of them.

63. The authorities agreed with the systemic risk assessment. They agreed with the importance of developing the SBP's stress testing capabilities further, including through the introduction of a liquidity stress simulation model, and of using the improved framework to calibrate macroprudential tools. There was also consensus on the merits of collecting more data on Panamanian banks' credit lines with correspondent banks abroad. The additional data which can then be used as input for liquidity risk and interconnectedness analysis.

64. The authorities appreciated the FSAP's overall assessment of progress on financial sector oversight, while disagreeing with some of the individual findings. There was agreement that the recent IMF technical assistance on macroprudential policies and framework provided a valuable basis for reforms in this area, and that the macroprudential toolkit could usefully be expanded using additional borrower-based tools. The authorities welcomed the acknowledgement of important progress since 2012 on banking supervision and regulation but disagreed with the specific findings of the BCP assessment with respect to principles 1, 6, 15, 16, 23 and 24. In particular, the authorities felt that the intended outcomes of those BCPs were broadly being achieved in Panama albeit using different approaches and tools than those specified in the BCP assessment methodology.

65. The authorities were grateful for the recognition of the significant efforts made on AML/CFT and reiterated their commitment to maintain progress in this area following completion of the Action Plan. The authorities also saw merit in the recommendations made by the FSAP with a view to addressing remaining risks, including by tackling the issue of suspended companies and developing more comprehensive rules on fintech institutions and VASPs.

66. The authorities appreciated the financial safety net and crisis management assessment, while reiterating the unique nature of Panama's institutional setup. In particular, the authorities highlighted that the absence of a central bank prevented the State from using monetary policy to finance its deficits, as evidenced by Panama's low inflation; that the integration of Panama's banking system with the rest of the world fosters the availability of credit for the private sector; and that the absence of DIS and LOLR facilities not only benefits banks by forcing them to hold ample liquidity and to self-regulate, but also helps explain the lack of banking crises in Panama. Meanwhile, the authorities welcomed the detailed recommendations on improvements to the bank resolution framework and committed to taking the necessary steps to implement them.

67. The authorities appreciated the assessment of the payment system and acknowledge the need to adopt a comprehensive payments systems law and relevant regulations.

Authorities share the concerns with respect to the effect of the present legal and regulatory situation and concur with the recommendation to improve risk management frameworks of payment systems operators. Authorities take note of the recommendation to appoint the SBP as the regulator and overseer of payment systems and financial infrastructures, but at this stage consider that a full and inclusive discussion is required between all relevant stakeholders to come to an agreement on this.

68. Authorities welcomed the analysis of climate related risks and the idea of promoting Panama as a hub for green finance and acknowledge the need to carry out a comprehensive gap analysis to determine the public and private financing needs for the national climate action plan and the national energy transition strategy.

Authorities recognize the benefits of integrating climate risk considerations into financial sector supervision and the need for more granular data to support the initiative and the SBP will be taking concrete steps towards this. Authorities are in the process of developing a framework for the issuance of sustainable sovereign bonds to expedite the financing of green and environmentally sustainable programs.

Appendix I. Selected Economic Indicators

Table 3. Panama: Selected Economic Indicators (2018-28)

	2018	2019	2020	2021	Est. 2022	2023	2024	Projections 2025	2026	2027	2028
Population (millions, 2021)	4,3										
Population growth rate (percent, 2021)	1,4										
Life expectancy at birth (years, 2019)	78,5										
Total unemployment rate (October, 2021)	11,3										
Poverty line (percent, 2019)											21,5
Adult literacy rate (percent, 2019)											95,7
GDP per capita (US\$, 2021)											14.664
IMF Quota (SDR, million)											376,8
					(Percent change)						
Production and Prices											
Real GDP (2007 prices)	3,7	3,0	-17,9	15,3	10,0	5,0	4,0	4,0	4,0	4,0	4,0
Consumer price index (average)	0,8	-0,4	-1,6	1,6	2,9	2,2	2,2	2,0	2,0	2,0	2,0
Consumer price index (end-of-year)	0,2	-0,1	-1,6	2,6	2,1	3,1	2,0	2,0	2,0	2,0	2,0
Output gap (% of potential)	2,1	1,1	-17,9	-7,1	-1,0	0,0	0,0	0,0	0,0	0,0	0,0
Demand Components (at constant prices)											
Public consumption	6,5	4,9	16,2	5,4	-5,4	-0,4	2,0	2,6	2,1	3,1	3,1
Private consumption	2,3	4,9	-15,5	-0,7	17,9	6,0	3,9	3,6	2,6	3,4	3,3
Public investment ^{1/}	6,9	1,0	-62,4	133,7	13,5	13,1	-4,6	-3,4	5,1	8,4	7,7
Private investment	-0,4	-0,9	-45,4	47,4	16,8	5,0	5,9	5,7	3,9	3,2	3,4
Exports	5,3	1,2	-20,6	25,4	12,1	5,1	6,6	5,4	5,8	5,7	6,0
Imports	4,5	-2,5	-34,0	32,3	8,3	3,4	8,7	5,4	4,7	5,8	6,4
Financial Sector											
Private sector credit	4,5	2,4	-2,6	1,5	6,4	6,3	6,1	6,1	6,1	6,1	6,1
Broad money	2,8	2,3	9,5	4,1	-1,9	7,4	6,3	6,1	6,1	6,1	6,1
Average deposit rate (Percent)	1,9	2,0	1,8	1,4	1,8						
Average lending rate (Percent)	7,8	7,8	7,7	7,6	7,7						
					(In percent of GDP)						
Saving-Investment Balance											
Gross domestic investment	41,5	38,3	24,1	32,5	34,3	34,7	34,8	34,8	34,8	34,8	34,8
Public sector	6,2	6,0	2,6	5,2	5,4	5,8	5,3	4,9	5,0	5,2	5,4
Private sector	35,3	32,3	21,5	27,3	29,0	28,9	29,4	29,9	29,9	29,6	29,5
Gross national saving	33,9	33,3	23,7	29,3	30,2	30,4	30,8	31,2	31,7	31,8	32,2
Public sector	4,2	2,6	-4,2	-2,1	0,4	2,4	2,6	3,1	3,6	3,8	4,0
Private sector	29,7	30,8	27,9	31,4	29,8	28,0	28,2	28,1	28,1	28,0	28,2
Public Finances ^{1/}											
Revenue and grants	22,0	20,8	21,5	20,5	22,0	23,0	23,1	23,3	23,4	23,6	23,8
Expenditure	24,9	23,9	30,7	27,1	25,8	25,6	25,0	24,5	24,4	24,6	24,7
Current, including interest	17,2	17,7	25,2	21,9	20,4	19,9	19,7	19,5	19,4	19,4	19,3
Capital	6,6	6,2	5,5	5,2	5,4	5,8	5,3	4,9	5,0	5,2	5,4
Overall balance, including ACP	-2,9	-3,1	-9,2	-6,5	-3,7	-2,6	-1,8	-1,2	-0,9	-0,9	-1,0
Overall balance, excluding ACP	-3,2	-3,4	-10,4	-6,7	-3,9	-3,0	-2,0	-1,5	-1,5	-1,5	-1,5
Total Public Debt											
Debt of Non-Financial Public Sector ^{2/}	37,3	41,9	65,6	58,4	54,9	54,3	53,6	52,7	51,9	51,0	50,3
External	31,1	35,2	54,1	50,6	50,4	50,4	50,6	50,0	49,7	49,0	48,3
Domestic	6,3	6,7	11,5	7,8	4,5	4,0	3,0	2,7	2,1	2,0	1,9
Debt of ACP	4,2	3,8	4,2	3,2	2,5	2,1	1,7	1,3	1,0	0,7	0,4
Other ^{3/}	4,2	4,1	5,1	4,3	3,8	3,6	3,3	3,2	3,0	2,8	2,6
External Sector											
Current account	-7,6	-5,0	-0,4	-3,2	-4,1	-4,3	-4,0	-3,6	-3,2	-3,0	-2,6
Net exports from Colon Free Zone	2,5	2,7	3,1	2,5	2,2	2,1	2,2	2,2	2,4	2,5	2,6
Net oil imports	4,4	3,8	1,7	3,1	4,2	3,1	2,9	2,7	2,6	2,5	2,4
Net foreign direct investment inflows	7,5	5,6	0,1	2,6	4,0	4,3	4,2	4,2	4,0	3,9	3,8
External Debt	153,0	155,0	209,4	188,3	163,4	162,1	161,4	161,1	160,8	159,3	157,3
Memorandum Items:											
GDP (in millions of US\$)	64.929	66.984	53.977	63.605	71.966	77.257	82.145	87.140	92.438	98.058	104.020

Sources: Comptroller General; Superintendency of Banks; and IMF staff calculations.

^{1/} Includes Panama Canal Authority (ACP). Includes Staff adjustment to account for the accrual of previously unrecorded expenditure for 2015-18. These estimates are preliminary.

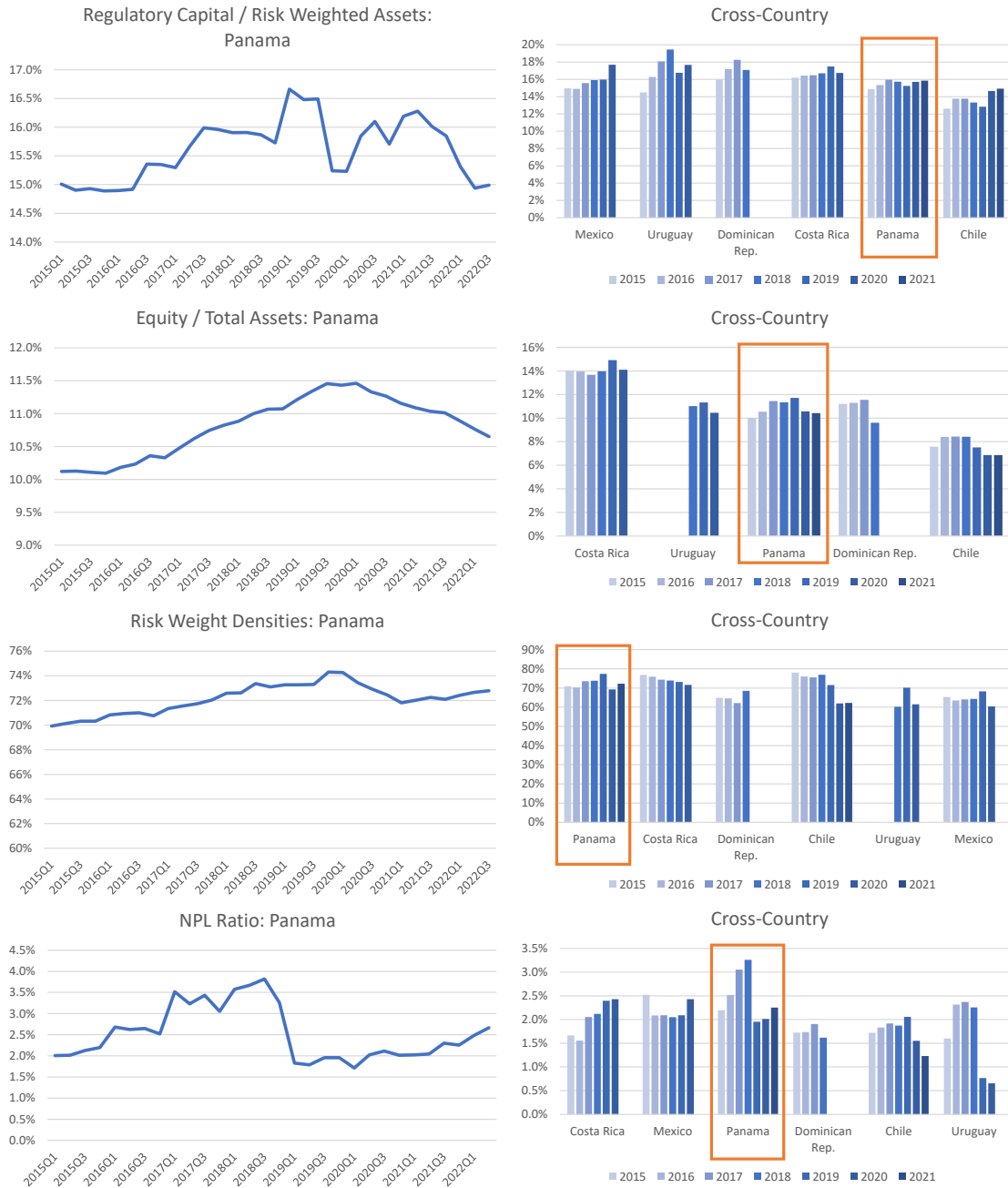
^{2/} Non-Financial Public Sector according to the definition in Law 31 of 2011.

^{3/} Includes debt of public enterprises outside the national definition of NFPS (ENA, ETESA, and AITSA) and non-consolidated agencies.

Source: IMF WEO and IMF staff calculations.

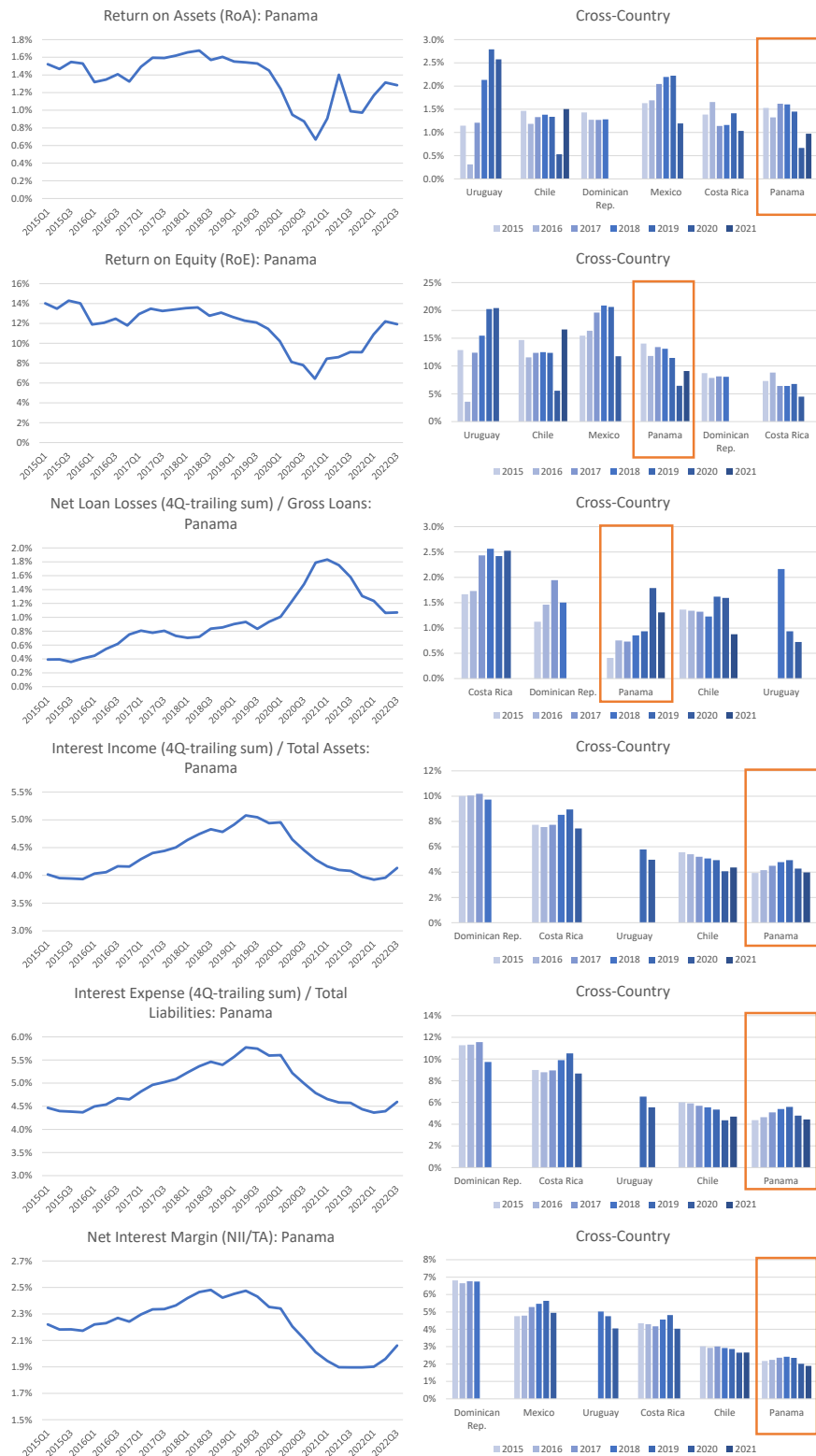
Appendix II. Financial Soundness Indicators

Figure 6. Panama: Solvency and Asset Quality Metrics



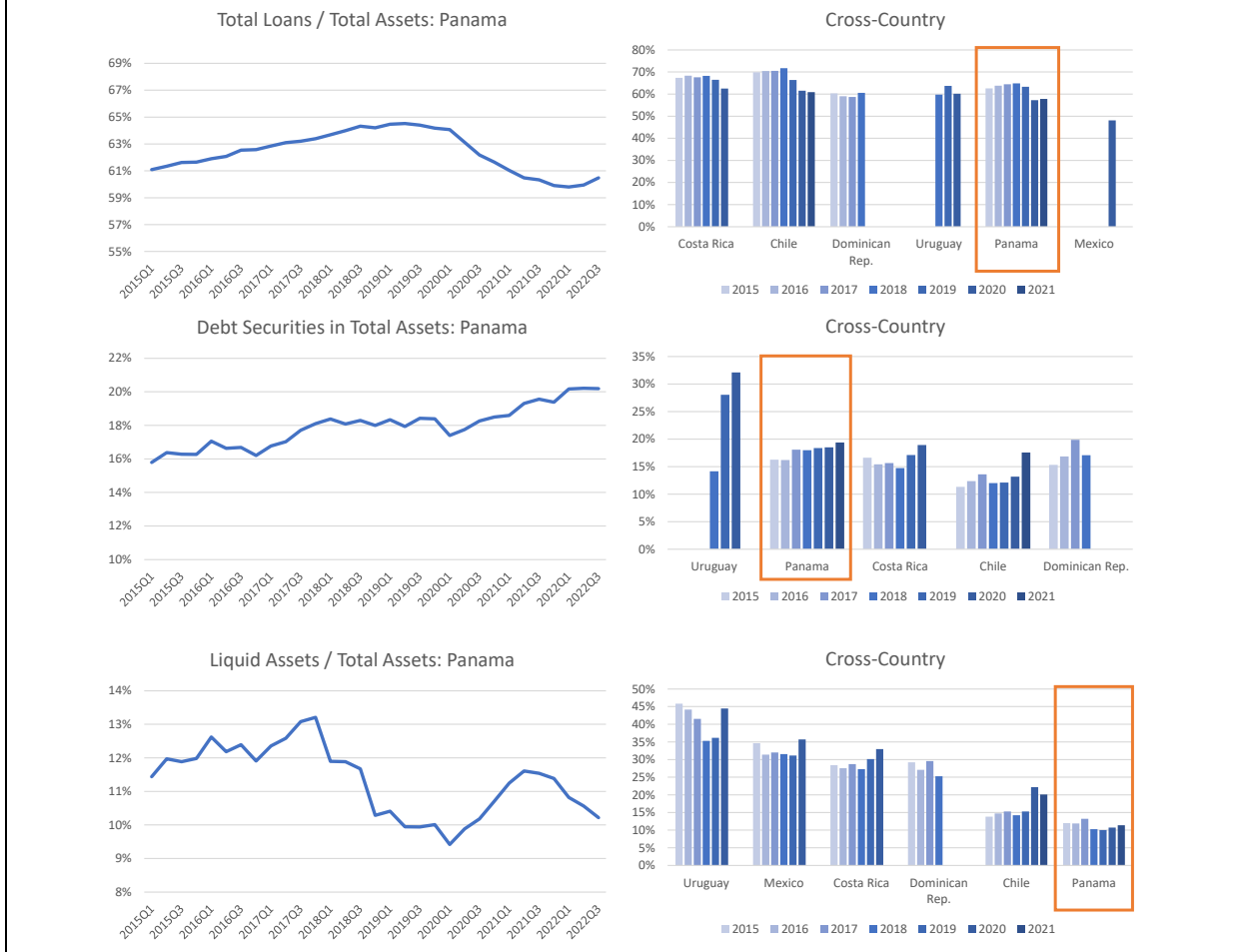
Source: IMF Financial Soundness Indicators and IMF staff calculations.

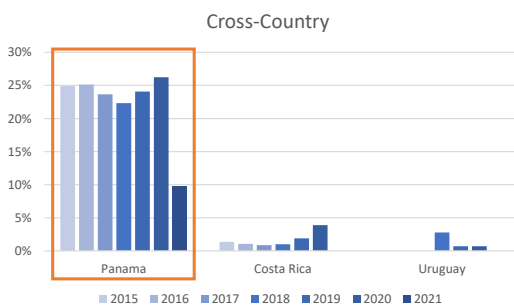
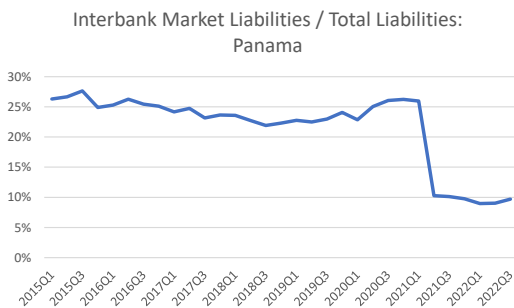
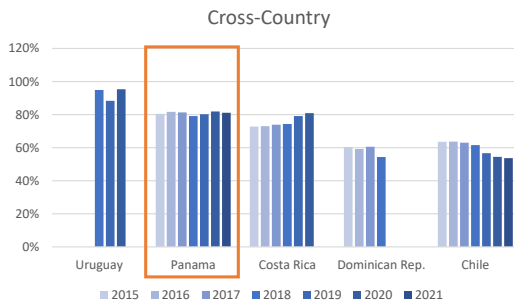
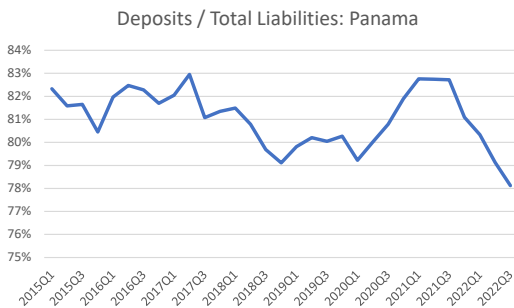
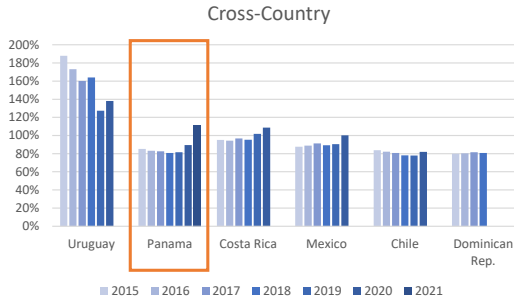
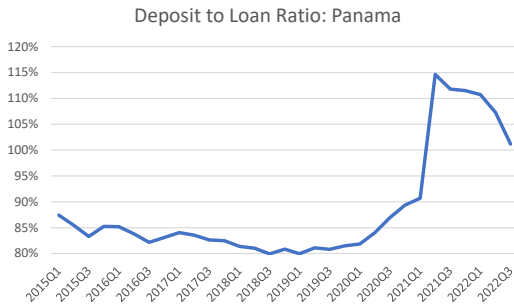
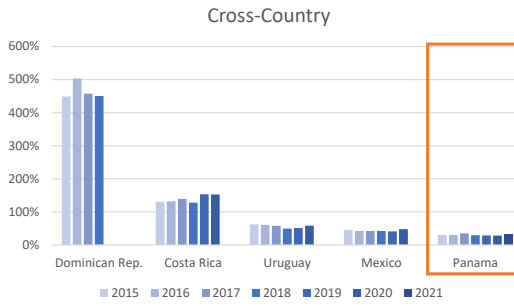
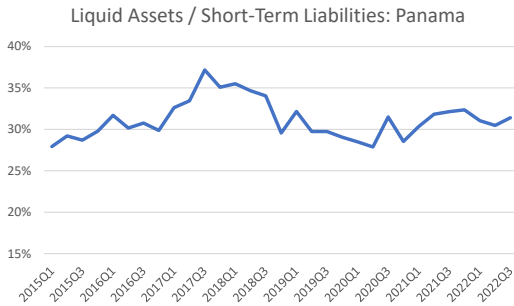
Figure 7. Panama: Bank P&L and Profitability Metrics



Source: IMF Financial Soundness Indicators and IMF staff calculations.

Figure 8. Panama: Bank Balance Sheet Structure





Source: IMF Financial Soundness Indicators and IMF staff calculations.

Appendix III. Implementation Status of Previous FSAP Recommendations

Table 4. Panama: Implementation of 2012 FSAP Recommendations	
Recommendation	Status/Expected Completion Date
Banking Oversight	
Finalize and implement regulations on operational and interest rate risks.	Implemented. The SBP issued regulations on operational risk (No. 11-2018) and market risk (Decision No. 3-2018).
Enhance systemic risk monitoring and the capacity to implement macroprudential policies.	In progress. Panama has strengthened its institutional framework for the conduct of macroprudential policy. The SBP has established an internal database that contains granular data of all loans from all banks in Panama, including the loan-to-value ratio at origination, the repayment performance for each loan, and the total debt service payments for each borrower. The SBP's systemic risk dashboard has been further developed. The SBP has developed a sensitivity analysis framework that covers banks' credit risk, and it is currently further developing its solvency stress test model with the support of IMF TA. The Financial Coordination Council (established in 2012) continues to strengthen its capacity to coordinate across agencies, joint onsite inspections, and to address regulatory gaps and conduct macroprudential policies.
Develop capital adequacy and regulatory reporting standards for financial holding companies.	In progress. Regulation establishing a minimum capital requirement for bank holdings was issued in February 2015, while also aligning capital requirements for banks with Basel III rules, with the exception of the capital conservation buffer and surcharges for capital requirements of systemically important institutions, which are still under consideration.
Develop concentration limits and risk management requirements for interbank deposits.	In progress. Article 14 of SBP Regulation 7-14 sets out concentration limits for banking groups on two exposure levels:

	<p>1. Of the banking group with a party not related to the banking group, including persons or legal entities that also constitute an economic group.</p> <p>2. Of the banking group with parties related to it. The calculation of the consolidated exposure concentration limits of the banking group shall be made according to the consolidated information thereof.</p> <p>There are no specific risk management requirements for interbank deposits.</p>
<p>Enhance offsite supervision to develop a view on macroprudential and systemic risk trends.</p>	<p>Partially implemented.</p> <ul style="list-style-type: none"> • Off-site supervision was improved in 2012 through a requirement for banks to report monthly performance and early warning indicators to the SBP based on supervisory data. On-site and off-site monitoring is integrated within supervisory departments, and multiple bank-specific and macro-economic analyses are taken into consideration in scoping and conducting examinations. • The SBP has identified 10 D-SIBs and developed methodologies to measure interconnectedness between banks. • The SBP publishes a Financial Stability Report twice per year.
<p>Regulate and effectively supervise cooperatives that provide credit and savings products.</p>	<p>In progress. The legislation on cooperatives has not changed since the last FSAP. However, IPACCOOP is in the process of consulting with the cooperative sector on: i) draft Law 24-1980 that would transform IPACCOP into a National Cooperative Authority; and ii) the modification of Law 17-1997, that aims to strengthen the regulation and supervision of the sector.</p>
<p>Insurance Sector Oversight</p>	
<p>Approve draft Insurance Law with strengthened prudential requirements.</p>	<p>Implemented. The law creating the Superintendency of Insurance was adopted in 2012 (Ley 12-2012). In addition to the supervision requirements established in Law No. 12 of 2012, the SSRP has issued complementary regulations on AML/CFT and prudential supervision. Law No. 3 of November 2022 was an update of Law No. 3 of July 2015. Regarding prudential supervision, Resolution No. DG-SSRP-007 of May 2022 was issued, regarding the inspection process carried out by the SSRP. This resolution</p>

	defines, for example, the required documents for inspections. SSRP is also developing the application of IFRS 17 for the insurance sector.
Strengthen disclosure of performance indicators and brokers' commissions.	Implemented. SSRP regularly publishes on its website statistics on policies issued, premiums collected, and claims paid, as well as reports on commissions or fees paid to brokers by insurers. The information is broken down by industry sector (general, life and bonds). The statistics and reports allow the SSRP to analyze economic and financial trends.
Securities Market Oversight	
Strengthen the budgetary position, and the supervisory and enforcement capabilities of the supervisor (National Securities Commission).	Implemented. Law 67 of September 2011 upgraded the Commission to a Superintendency (SMV), strengthening its supervisory and enforcement capacity as well as its budgetary position. Through Law 66 of December 2016, registration and supervision fees were adjusted to strengthen the SMV's budgetary position and allowing SMV's Board of Directors to adjust the fees in response to changes in operating costs of the SMV. Executive Decree No. 126 of May 2017 was adopted which regulated Chapter II of the Sanctioning Procedure of Decree Law 1 of July 1999 and Law 23 of 2015 regarding the obligating subjects of the securities market sector. The Intermediaries Supervision and Prevention and Control of Illicit Operations Departments have been strengthened with supervision methodologies and tools.
Payments and Securities Systems Oversight	
Create a comprehensive payments system law guaranteeing payment finality.	In progress. SBP worked with IDB on a draft bill in 2019-2020, which was shared for consultation.
Adopt an RTGS or Hybrid Payments System.	Partially implemented. BNP implemented an RTGS system in 2019, but it is not utilized to its full potential.
Financial Safety Nets	
Conclude studies and introduce a bank liquidity facility.	In progress. In July 2020 a temporary facility, operated by BNP, was put in place to address potential liquidity stress at banks resulting from the pandemic.

Establish a deposit insurance scheme.	In progress. There have been no initiatives in this direction.
Capital Market Development	
Build a single yield curve across domestic and global bonds by dual listing and extending market making to global bonds.	In progress. Since 2011, the Ministry of Economy and Finance has published information about the yields of Panamanian government bonds of different maturities. The authorities have been making efforts to extend market making to global bonds. The SMV registers the issuance of corporate (private) bonds. SMV and Latinex are working jointly on the development of the bond market. Data for yield curves pertaining to global and domestic bonds are compiled by the Ministry of Economy and Finance.
Review and restructure or close public development banks and guarantee funds.	Implemented. Banco Hipotecario Nacional (BHN) and Banco de Desarrollo Agropecuario (BDA) were reformed and reorganized through Law 123 of 2013 and Law 17 of 2015, respectively.