

**Panama: Assessment of Financial Sector Supervision and Regulation, including  
Reports on the Observance of Standards and Codes on the following topics:  
Banking Supervision, Insurance Supervision, and Securities Regulation**

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## PANAMA

### ASSESSMENT OF FINANCIAL SECTOR SUPERVISION AND REGULATION

Prepared by the Monetary and Capital Markets Department

Approved by Jaime Caruana

September 12, 2006

This report is based primarily on work undertaken during two visits—a main mission from May 16 to June 1, 2005 and a second mission from November 15 to 22, 2005.

The assessment team comprised Michael Moore (Head), Francisco Figueroa, Ernesto Lopez, and Magally Bernal (assistant) (all MFD), Hellen Chirino-Roosberg (LEG), Alvir Hoffmann (banking supervision expert, the Central Bank of Brazil), Jose Antonio Monreal (banking supervision expert, consultant), Paloma Portela (Spanish Securities Commission—CNMV), Cristina Rohde (insurance supervision expert, consultant), and Nancy Worthington (legal expert, consultant). The main findings in the report are:

- The assessment of bank supervision showed a high degree of compliance with the Basel Core Principles (BCP) reflecting generally satisfactory implementation combined with an adequate legal and regulatory foundation. Areas of weakness were (i) legal protection for supervisors; and (ii) the need for harmonization of the regulation for nonbank deposit-taking institutions with that of banks.
- The supervisory and regulatory frameworks for capital markets and insurance sectors are underdeveloped. The securities law and regulations are generally effective; however, resources for securities markets oversight are insufficient, and independence is affected by unfilled positions, including a commissioner's post. For insurance, the legislation does not afford sufficient operational independence from government and industry, and resources for prudential supervision are strained.
- The authorities will need to be attentive to sustaining the favorable reputation of the international financial center by ensuring that any modification to supervisory and regulatory arrangements is not viewed as reducing operational independence from government and industry interference.
- Panama is largely compliant with the majority of FATF Recommendations for anti-money laundering and countering the financing of terrorism (AML/CFT), reflecting the efforts of the authorities and industry to put in place an effective AML system. Nevertheless, staff makes several recommendations regarding (i) modifications to the law to criminalize all money laundering predicate offenses; and (ii) resources for law enforcement authorities (investigators and judges) and the regulatory agencies overseeing AML/CFT compliance by nonfinancial businesses and professions.

Additional information on compliance with international standards is provided in the *Reports of the Observance of Standards and Codes (ROSCs)* for banking and insurance supervision, securities regulation, and anti-money laundering and countering the financing of terrorism (see Annex).

*The AFSSR is a summary report on the implementation of financial sector standards. It has been developed to help jurisdictions identify and remedy weaknesses in their financial sector supervision. The assessments do not cover risks that are specific to individual institutions such as asset quality, operational or legal risks, or fraud, or vulnerabilities to macroeconomic and cross-border shocks.*

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## ACRONYMS

AML	Anti-Money Laundering
AFSSR	Assessment of Financial Sector Supervision and Regulation
Bolsa	Bolsa de Valores de Panamá, S.A.
BCP	Basel Core Principles
BHN	Banco Hipotecario Nacional
CFATF	Caribbean Financial Action Task Force
CFT	Countering the financing of terrorism
CNV	National Securities Commission
CONAPRED	Commission for the Study of Prevention of Drug-Related Crimes
CPSS	Committee on Payment and Settlement Systems
CTR	Currency transaction report
DLMV	Decree law of securities markets (Decree law number 1, July 8, 1999)
DNFBP	Designated Nonfinancial Businesses and Professions
EGMONT	EGMONT Group of financial intelligence units
FATF	Financial Action Task Force
FIU	Financial intelligence unit
US-GAAP	United States generally accepted accounting principles
IAS	International accounting standards
IAIS	International Association of Insurance Supervisors
IOSCO	International Organization of Securities Commissions
IPACOOOP	Panamanian Autonomous Institute for Cooperatives
LEG	IMF's Legal Department
LatinClear	Central Latinoamericana de Valores, S.A.
MEF	Ministry of Economy and Finance
MFD	IMF's Monetary and Financial Systems Department <sup>1</sup>
MICI	Ministry of Commerce and Industry
MOU	Memoranda of understanding
ROSC	Report on Observance of Standards and Codes
SdB	Superintendency of Banks
SROs	Self regulatory organizations
SSRP	Superintendency of Insurance and Reinsurance
STR	Suspicious transaction report
UAF	Financial Analysis Unit
UN	United Nations
ZLC	Free-trade zone

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<sup>1</sup> In August 2006, the Monetary and Financial Systems Department (MFD) was renamed to the Monetary and Capital Markets Department (MCM).

## EXECUTIVE SUMMARY

1. **The Panamanian financial system is dominated by its banking system, which is the largest in the Central American region.** A revised banking law and the creation of the Superintendency of Banks (SdB) in 1998 helped to modernize the regulatory and supervisory framework for banking. This modernization was observed in the IMF's 2001 assessment and in this assessment, with both assessments showing a high level of observance with the Basel Core Principles for banking supervision.<sup>2</sup>
2. **In contrast to the banking sector, the regulatory frameworks for the capital markets and insurance sectors remain underdeveloped.** The securities law and regulations are generally effective; however, resources for securities markets oversight are insufficient, and a key commissioner position remains unfilled, which affects the overall independence of the National Securities Commission (CNV). The Superintendency of Insurance and Reinsurance (SSRP) does not have independence from the industry and the executive branch of government, and lacks resources for prudential supervision, which will require revision to the underlying legislative framework to address.
3. **Cross-border arrangements are in place to facilitate information sharing for financial sector regulation by the SdB and CNV,** and both agencies have good records of cross-border cooperation. For the CNV, however, there are legislative impediments that limit information sharing, including its ability to implement the IOSCO multilateral MOU (MMOU). For insurance, the legislative framework does not define the level of cooperation with the home-country supervisors of the foreign-owned insurance companies.
4. **Supervisory and regulatory arrangements are less developed for cooperatives and savings and credit institutions as compared to banks.** These two sectors are small; however, the different regulatory treatment creates an uneven playing field particularly as some of the cooperatives have achieved the asset size of smaller banks.
5. **Essential components for an effective system for *anti-money laundering and countering the financing of terrorism (AML/CFT)* are in place; although, resources (financial, human, information technology) are a concern for law enforcement authorities (investigators and judges) and nonfinancial businesses and professions.** Supervision of AML/CFT for banks, securities firms, and cooperative institutions is generally sound but weak for the insurance industry (which largely reflects a general lack of resources for supervision by the SSRP).
6. **Box 1 summarizes the key recommendations from the four assessments.** A number of other technical recommendations are discussed in the main body of this report and in the Annex.

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<sup>2</sup> See IMF staff assessment—Panama: Banking Sector Assessment, August 2001  
<http://www.imf.org/External/NP/ofca/2001/eng/pan/083101.PDF>.

### Box 1. Summary of Key Recommendations

- For all of the regulatory agencies, protection against legal action should be provided to staff members when performing official functions and acting in good faith.

#### Basel Core Principles

- The authorities should rationalize the supervisory and regulatory arrangements for nonbank deposit taking institutions (cooperatives and savings and credit institutions).
- The SdB should develop policies for market risk that consider the complexity in activities among larger financial institutions, including use of value-at-risk and/or building-block approaches for risk measurement. This effort should be in conjunction with Basel II preparations.
- The authorities should amend the banking law to provide the SdB with the same clarity for the consolidated supervision of financial activities by holding companies as is currently the case for the SdB's direct oversight of banks and their subsidiaries.
- SdB should develop clear processes for working with distressed entities, including use of remedial measures, and for insolvent banks, guidelines for winding up, and transferring assets and liabilities.

#### IOSCO Principles

- The authorities should strengthen CNV's operational independence, which is constrained by a lack of resources, technical capacity, and the unfilled post for CNV commissioner (vacant since 2004).
- The CNV should be given control over administrative decisions, including the hiring of staff.
- Legislation should address recent adverse judicial decisions that undermine the CNV authority.
- Securities legislation should be amended to allow sharing of information with foreign securities counterparts for market abuse investigation.
- A new framework for the governance of the accounting profession should be formulated. The Accounting Technical Board needs to be able to enforce its rules on the accounting industry.

#### IAIS Principles

- The Superintendency of Insurance and Reinsurance (SSRP) should have greater operational independence from industry and the executive branch. Independence is adversely affected by insufficient staffing and resources (including for technology). An actuary should be hired.
- Prudential capacity (including the development of regulations) needs strengthening: (i) the regulation on technical reserves should apply actuarial standards to calculation methods; (ii) timely presentation of audited financial statements should be enforced; (iii) asset-liability matching requirements should be introduced; (iv) reinsurance companies should be subject to solvency requirements; (v) on-site supervision should be widened beyond financial aspects; and (vi) processes for cooperation with foreign supervisors should be developed.
- Legislative impediments to a more competitive market for insurance should be removed. The legislation should provide the flexibility to permit insurance firms to employ directly their own brokers and agents, and there should be a requirement to disclose fees and commissions.

#### FATF 40+9 Recommendations

- Criminalization of Money Laundering—Amend Article 389 to criminalize all money laundering predicate offenses in accordance with the Vienna and Palermo Conventions. Expand the predicate list for the AML law to include financing of terrorism.
- For the law enforcement, prosecution, and other competent authorities (including the Financial Analysis Unit), undertake an urgent review of staffing and training requirements with a view to increasing capacity for investigations and prosecutions.
- Amend the AML law to impose monitoring obligations on insurance and savings and credit institutions. The SSRP and BHN should take measures to put in place and implement requirements for customer identification and record keeping in the insurance and savings and credit sectors.
- Amend the AML law and regulation to subject lawyers and accountants to AML/CFT requirements, including for obtaining and maintaining accurate information on beneficial owners of legal vehicles.
- Strengthen enforcement of preventive requirements for Free-Trade Zone (ZLC) merchants, especially in higher risk areas. Better auditing capabilities and training for the administrator in the ZLC are needed, as well as close cooperation with the UAF and with Customs.

## I. INTRODUCTION

7. This report contains the findings of an assessment of the regulation and supervision of the Panamanian financial sector that was conducted under the IMF's initiative for offshore financial centers. This assessment is a follow up to one undertaken in 2001.

8. In 2003, the IMF Executive Board reviewed the status of the OFC initiative and agreed that there should be periodic assessments (every 4–5 years) in order to monitor progress in the development of supervisory systems.<sup>3</sup> Under the initiative, all assessments are voluntary.

9. Included in this report are the findings from a reassessment of compliance with the Basel Core Principles (BCP) for effective banking supervision (included in the 2001 assessment) and new assessments of compliance with (i) the International Association of Insurance Supervisors (IAIS) insurance core principles (ICP); (ii) the International Organization of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulation (IOSCO Principles); and (iii) the Financial Action Task Force (FATF) 40+9 Recommendations for anti-money laundering and countering the financing of terrorism (AML/CFT).

10. Section II provides an overview of the financial system including a description of the financial system, discussion of financial soundness indicators for the banking system, and a summary of findings from earlier assessments. Section III provides a summary of the main findings from the sectoral assessments and a discussion regarding cross-border cooperation. The Annex to this report provides the four *reports on the observance of standards and codes* (ROSCs) for banking and insurance supervision, securities regulation, and anti-money laundering and countering the financing of terrorism.

## II. FINANCIAL SYSTEM OVERVIEW

### A. Economic Background

11. **Real GDP expanded by 6.4 percent in 2005 following growth of 7.6 percent in 2004**, while unemployment fell substantially to 9.8 percent of the labor force, and the external position improved. Inflation has remained low but rose to 3.4 percent due to the pass-through of increases in oil prices. As a result of the strong economy and new legislation to enhance revenues and curtail outlays, the fiscal deficit is estimated to have fallen somewhat below the target of 2.6 percent of GDP in 2005.<sup>4</sup>

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<sup>3</sup> See PIN No. 03/138, November 24, 2003, at <http://www.imf.org/external/np/sec/pn/2003/pn03138.htm> for a summary of the Executive Board discussion on the assessment program on offshore financial centers.

<sup>4</sup> Economic background indicators are revised since the release of the Public Information Notice (PIN) No. 06/29, March 14, 2006, at <http://www.imf.org/external/np/sec/pn/2006/pn0629.htm>.

12. **Financial services remain an important sector.** In 2005, financial intermediation contributed about \$1 billion or 7.2 percent of GDP. The staff estimates that financial intermediation will increase to 7.5 percent of GDP in 2006.

### **B. Financial System and Regulatory Arrangements**

13. **The banking system is the largest in the Central America region, with consolidated assets representing more than three times Panama's GDP.** The other financial services sectors are small by comparison. These include securities, insurance, cooperatives, and savings and credit institutions.

14. **There are several regulatory agencies involved in the oversight of the financial sector.** The regulatory agencies for banking, securities, and insurance sectors, respectively, are the Superintendency of Banks (SdB), the National Securities Commission (CNV), and the Superintendency of Insurance and Reinsurance (SSRP). In addition, the Panamanian Autonomous Institute for Cooperatives (IPACOOOP) is responsible for the oversight of cooperative institutions (including credit cooperatives) and the Banco Hipotecario Nacional (BHN) is responsible for the 4 savings and credit institutions.

15. **Closely associated with banking activities are the wealth management services provided to both domestic and foreign clients.** These services include the creation of trusts or companies to hold and administer assets, which typically involves the work of lawyers and accountants as well as banks and trust companies.<sup>5</sup> The procedure for the formation of all companies (corporations and others) is the same whether their activities are local or foreign. In statistics provided for the assessment, there are about 9,000 lawyers and company service providers and about 12,000 accountants.

16. **AML/CFT obligations are imposed on financial and nonfinancial businesses and professions under Law 42-2000.** The regulatory agencies mentioned above are responsible for the supervision of AML/CFT compliance by their respective sectors. In addition, the SdB is responsible for the supervision of trust companies. Lawyers and accountants are not covered by law 42-2000 or regulations, which is a weakness in the compliance with the FATF Recommendations.

#### **The bank and nonbank deposit taking institution sectors**

17. **Panama's banking system over several decades has achieved regional and global status as an important international financial center.** The well-developed banking system comprises established domestic and foreign-owned banks that offer integrated domestic and international financial services. **Banking system assets on a nonconsolidated basis were**

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<sup>5</sup> Only lawyers admitted to practice in Panama can provide the formal incorporation services.

**\$39.6 billion**, and on a consolidated basis (including local and foreign subsidiaries of Panamanian-headquartered banks) were \$45.8 billion at end-March 2006.

18. **At end-March 2006, there were 73 banks, including 2 state-owned banks, 37 general license private banks, and 34 international license banks** (Table 1). In addition, there were five representative offices of foreign banks. The substantial majority of banking activities are carried out through general license banks, representing about 83 percent of banking system assets and liabilities, with the remaining assets and liabilities in international license banks. General license banks are unrestricted in their ability to transact with residents and nonresidents while international license banks may only do business with nonresidents.

19. **Most of the general and international license banks are subsidiaries or branches of internationally or regionally active financial institutions.** Several of Central America's largest regional financial groups have elected to consolidate their banking activities in Panama. **About one half of banking system assets are invested outside of Panama** in the form of placements in foreign banks, foreign investments, and foreign loans. Similarly, about one half of banking system liabilities are from abroad in the form of deposits and other borrowings.

20. The **cooperatives and savings and credit** institutions constitute very distant second and third categories, respectively, of deposit-taking institutions by assets, deposits, and loans. Each of the two sectors has its own regulator. There were 276 deposit taking cooperatives at end-2004, with assets of \$860 million or about 2 percent of the banking system assets.<sup>6</sup> There were 4 savings and credit institutions at end-2004, with assets of \$70 million or less than 0.2 percent of banking system assets

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<sup>6</sup> Total number and assets excludes other forms of cooperatives.

Table 1. Deposit-Taking Institutions Structure  
(amounts in millions of US dollars)

	2001	2002	2003	2004	2005	Mar-06
<b>Deposit Taking Institutions</b>						
<i>Number</i>						
Banks	74	71	71	67	70	73
General License Banks	49	43	41	39	39	39
Private commercial	47	41	39	37	37	37
<i>of which:</i> locally-owned financial institutions	20	17	16	14	14	14
foreign-owned financial institutions	27	24	23	23	23	23
State-owned	2	2	2	2	2	2
International License Banks	25	28	30	28	31	34
Memo: Banks with representative license	7	6	6	6	5	5
No. of bank branches	373	369	359	379	425	
No. of bank branches per 100,000 inhabitants	12	12	12	13	14	
Other credit institutions						
Cooperative credit institutions 1/ Savings and credit associations		283		276		4
<i>Total assets</i> 2/						
General and International License Banks	38,053	33,149	32,304	34,610	38,615	39,556
Other credit institutions:						
Cooperative credit institutions 1/ Savings and credit associations		725		860		70
<b>Banking Institutions Only</b>						
<b>General License Banks</b>						
Total assets (non-consolidated)	31,049	26,839	26,289	29,077	32,114	32,862
Foreign assets (includes foreign loans)	13,365	11,101	10,694	12,324	13,045	13,320
Advances and Loans	18,962	15,312	15,096	16,989	19,554	19,896
Total deposits	20,935	19,379	19,117	20,481	22,348	23,092
<i>Of which: non-resident deposits</i>	7,109	6,042	5,808	6,544	6,642	7,075
Total foreign liabilities (includes non-res. deposits)	12,202	9,239	8,350	9,781	10,574	10,959
Advances and loans distribution	18,962	15,312	15,096	16,989	19,554	19,896
Distribution by sector						
Foreign loans	6,740	4,593	3,880	4,366	5,274	5,253
Personal loans	2,390	2,483	2,560	2,796	3,198	3,303
Trade credit	3,861	3,112	3,003	3,388	3,711	3,732
Construction	323	372	451	544	655	693
Mortgage credit	2,889	3,019	3,248	3,526	4,218	4,368
Other	2,759	2,503	2,533	2,848	2,903	2,957
<b>International License Banks</b>						
Total assets	7,004	6,310	6,015	5,532	6,501	6,694
Claims on banks	2,304	2,209	2,322	1,452	1,371	1,397
Advances and loans	3,085	2,585	2,483	2,911	3,351	3,486
Total deposits	5,663	4,710	4,504	4,051	4,748	4,803
Other liabilities	927	1,092	870	781	933	1,043

Source: Superintendency of Banks

1/ Includes only deposit taking cooperatives: (i) savings and credit cooperatives, and (ii) multiple services cooperatives.

2/ Unconsolidated.

## The securities markets sector

21. **Securities markets are small and illiquid.** Activity is concentrated mostly in the primary market for government debt and corporate bonds (see Table 2). The investment culture remains underdeveloped, with users of financial services generally preferring to use banks for the safekeeping of savings. Historically, investors have preferred investment options provided by foreign capital markets, usually the United States. These factors, combined with a limited amount of promotion of the securities markets, weigh on the size and volume of the Panamanian stock market. An additional factor is that the corporate structures are frequently heavily influenced by significant family ownership, which has affected the development of the local markets.

22. **For 2004, the total market capitalization was \$3.9 billion, which represents an increase of 28 percent over 2003.** The proportion of market capitalization represented by that of the three largest companies averaged 58 percent. There were 81 issuers of listed securities in the capital markets at end 2004, representing a decline of 15 during the year due to mergers, or withdrawals of issues because they were cancelled before maturity. In 2005, the number of issuers increased only slightly to 83.

23. **Primary issues are the largest component of the market activity by volume at about 68 percent,** while the secondary market represents about 25 percent and the repurchases about 6 percent. The total amount of securities issued in 2004 was \$518 million with an additional \$460 million issued through end-May 2005. For the first five months of 2005, the pace of issuance is substantially ahead of 2004. There are 17 mutual funds (domestic) and 3 international collective investment schemes with total assets of \$422 million and \$20 million, respectively.

24. **The CNV licenses both securities houses and investment advisors.** There are 33 securities houses registered with a total transaction volume of about \$7.3 billion in 2004. About 55 percent of transaction volume was concentrated in five securities houses. **Interest in Panama's capital markets is expanding.** The CNV licensed three securities houses in 2004. In 2005, five firms applied to obtain licenses to operate as securities houses, and one firm applied to obtain an investment advisor license. The interest in the securities industry has also increased consistently among individuals that have obtained CNV licenses in a personal capacity. At end-May 2005, there were 265 licensed stockbrokers. The CNV licensed 50 stockbrokers in 2003, 38 in 2004, and 42 up to end-May 2005.

Table 2. Stock Market and Insurance Industry Indicators

	2001	2002	2003	2004	2005
Stock Market					
Indices					
General index at year-end (in percent, 2002=100)	94.4	100.1	109.1	130.3	147.7
Issuers					
Number of listed issuers	125	107	96	81	83
Number of listed securities					
Shares	38	37	38	40	
Corporate bonds	253	211	165	155	
Government bonds	9	10	11	12	
Total market capitalization (millions of US dollars)	2,602	2,950	3,075	3,934	
Proportion of market capitalization represented by the three largest companies (in percent)	N/A	49.9	57.8	57.9	
Insurance Industry Indicators					
Number of companies by business type					
Life	5	4	4	4	4
Composite	13	13	13	13	13
Non-Life	2	2	1	1	1
Total	20	19	18	18	18
Net Premiums (millions of US dollars)					
Life	108	122	127	153	153
Non-life	253	246	261	269	277
Total	361	368	388	422	430

Sources: Bolsa de Valores de Panama (BVP)

Comision Nacional de Valores (CNV)

Superintendency of Insurance and Reinsurance (SSRP)

## The insurance sector

25. **Insurance penetration in the economy measured as premiums subscribed to GDP is around three percent** (see Table 2). The total premiums subscribed in 2005 were \$430 million, up a modest 1.9 percent from 2004. The dominant share of insurance underwriting is in the local market. Total assets for 2004 were \$765 million (around five percent of GDP), with investments representing 69 percent of total assets. Life insurance business represented 35 percent of the total market. Within the nonlife insurance business, automobile insurance and health insurance are the two largest categories, representing respectively 16 and 17 percent of total premium subscriptions. The insurance market is highly concentrated with the five largest companies accounting for around 74 percent of the market.

26. **There are 18 authorized insurance companies.** Of these, four specialize in the life business, one in surety business and 13 operate both life and nonlife insurance. Nine of the life/nonlife companies also have a license to operate reinsurance and a further five companies are authorized to operate exclusively in reinsurance. In 2003, premiums issued by reinsurers represented 11 percent of the premiums issued by insurers. Of the 18 insurance companies, five are subsidiaries of foreign firms and four are affiliates of local banks. The captive insurance sector is immaterial, and no data are available.

### C. Financial Soundness Indicators for the Banking System

27. **A key strength to the financial sector has been the stable banking system,** which has benefited from Panama's continuing favorable economic and business climate (see Table 3). The fully dollarized economy and completely open capital account have helped to keep inflation low and interest rates stable. Market discipline continues to be an important force for transparency and high operating standards, as there is no lender of last resort or deposit insurance.

28. **The favorable economic climate allowed the banking system to return to growth starting in 2004.** Bank balance sheets grew 7 percent in 2004, about 12 percent in 2005, and 10 percent (annualized) in the first quarter 2006. This contrasts with several years prior to 2004, where growth was either negative or low. The primary contributor to growth has been increased lending in the local market—primarily mortgages and consumer credit, which has been funded by increased deposits, retained earnings, and new capital.

29. **The banks continue to report satisfactory earnings** due to increasing fee income and lower operating costs that combined have outpaced a moderate decline in net interest income. Through the first quarter 2006, the banking system reported 2.4 percent return on assets (annualized), which is up from 2.1 percent for all of 2005. Return on equity for the first quarter was 20.2 percent, up from 15.7 percent for all of 2005. **System nonperforming loans are low and provision coverage is adequate.** At end March 2006, past due loans totaled \$373 million or 1.6 percent of system loans, which is unchanged from end 2005. Provisions for loan losses were 2 percent of the loans and provided a cover of 126 percent of past due loans.

30. **Liquidity remains stable, although loan growth has resulted in some decline in liquid assets.** Liquid assets to total deposits were 24 percent, and loans represent a conservative 59 percent of assets and 84 percent of deposits at end-March 2006. **The banks and banking system have remained well-capitalized.** At end-March 2006, system regulatory capital (Basel I rule) was a strong 17.2 percent. The private Panamanian owned banks report 14.7 percent regulatory capital, which remains well above the 8 percent regulatory minimum requirement. Equity to assets as a measure of capital adequacy for the system was a strong 12.9 percent.

Table 3. Financial Soundness Indicators for the Banking System  
(In percent)

	2003	2004	2005	Mar-06
Return on assets	2.0	2.3	2.1	2.4
Return on equity	17.1	17.9	15.7	20.2
Liquid assets to deposits	33.2	30.1	25.0	24.3
Loans to deposits	74.4	81.1	84.5	83.8
Loans to assets	54.4	57.5	59.3	59.1
Regulatory capital to risk-weighted assets	18.4	17.8	17.2	17.2
Equity to assets	12.4	13.4	13.0	12.9
Nonperforming loans to total loans	2.3	1.7	1.6	1.6
Loan-loss provisions to nonperforming loans	150.6	147.0	131.0	126.3

Source: Superintendency of Banks

#### D. Findings from Earlier Assessments

31. The IMF's 2001 assessment consisted of a review of compliance with the Basel Core Principles. **The two areas of material weakness that were identified, namely off-site monitoring (BCP 16) and investment activities (BCP 5), both showed that the SdB had important shortcomings in its analysis of financial factors of banks.** In the most recent assessment of the Basel Core Principles, the assessors commented that SdB processes had been strengthened, and that they viewed earlier concerns had been addressed.

32. **A mutual evaluation was conducted by the Caribbean Financial Action Task Force (CFATF) in July 2001.** The CFATF evaluation made several recommendations that have been partially acted on.

- The amplification of money laundering to include asset forfeiture was not effective. For the staff's AML/CFT assessment, the Public Prosecutor advised that the process is now in place, since the AML law refers specifically to and adopts the freezing, seizing, and forfeiture powers of the prosecutor in the Unified Text of Drug Laws.
- The UN Convention Against Transnational Organized Crime (Palermo) was ratified by Panama through law No. 23 of July 7, 2004. However, full implementation will require the inclusion of additional predicate offenses.
- It was recommended, and Panama acted accordingly, to adopt regulations on money remitters. However, implementation and supervision of these new requirements are not yet effectively implemented.

- The money laundering criminal law has not been changed to expand the list of predicate crimes to include those required by article 6(2)(b) of the Palermo Convention.
- Panama has complied with the CFATF recommendation to negotiate and sign Mutual Legal Assistance Treaties (MLATs) and has signed various other conventions and treaties which support the fight against money laundering and financing of terrorism.

### III. MAIN FINDINGS AND RECOMMENDATIONS

#### A. Sectoral and AML/CFT Assessments

33. **There is a high level of observance with regulatory standards for the systemically relevant banking sector.** Comparatively, however, the other two key financial sectors—securities markets and insurance—have a lower level of compliance with the respective regulatory standards. In addition, the supervisory and regulatory arrangements for cooperative credit institutions and savings and credit institutions are underdeveloped. For AML/CFT, the assessment showed Panama to be largely compliant with a majority of the FATF recommendations.

34. **Legal protection.** A common finding in the three assessments of the regulatory arrangements for banking, insurance, and securities is that legal protection for staff members when performing official functions and acting in good faith is not sufficient. The lack of protection potentially exposes staff members to lawsuits from industry.

35. **Operational independence at the CNV and SSRP is weak.** At the CNV, this weakness reflects that it does not have full control over its operating budget and staffing decisions, and a key position on the commission board remains unfilled. The SSRP similarly does not control its budget and its board includes representatives from the government ministry and from industry.

36. **The reputation of Panama as a well regulated financial center will depend on achieving operational independence** in its regulatory and supervisory functions. The authorities will need to ensure that any future modifications to the regulatory arrangements for the financial center would be viewed as providing operational independence from undue government or industry interference.

37. **The SdB for banks and banking groups and the CNV for publicly traded firms requires the use of internationally accepted financial reporting standards**—either international accounting standard (IAS) or United States Generally Accepted Accounting Principles (US GAAP). For insurance companies, however, the SSRP does not require the use international accounting standards for regulatory purposes, which should be modified.

38. **Other hurdles for the satisfactory implementation of high-quality financial reporting remain**, in particular, the oversight mechanism for accountants/auditors is

underdeveloped. Sustaining the progress to date will depend on the continued commitment of government, accounting professionals, and industry. Draft legislation is pending to reinforce the rules and powers of the accounting professional body, the Accounting Technical Board.

**39. Below is a summary of other key findings from the four individual assessments.**

The Reports on Observance of Standard and Codes (ROSCs) contained in the annex to this report provide more information on the individual assessments, including recommended actions to achieve a higher level of compliance with the standards.

## **Banking**

**40. There is a high level of compliance with the Basel Core Principles standard.** The body of banking laws and regulations is appropriate. The SdB's program for ongoing supervision includes the oversight of local and foreign activities of Panamanian banks. Under the SdB's program for on-site inspections, the local offices of foreign banks receive similar supervisory treatment as locally headquartered banks, which include banks that hold the international license. In addition to the already noted lack of legal protection, weakness in achieving a higher level of compliance with the Basel standard by the SdB results from underdeveloped processes for the measurement and monitoring of market risk—including incorporating market risk where significant into the current capital adequacy requirement.

**41. The SdB has substantial autonomy to enable it to accomplish its legal mandate.** Article 14 of the Banking Law states that neither the directors nor the superintendent can be removed except for reasons included in the banking law and according to a decision of the Supreme Court of Justice. Article 15 provides a closed list of six reasons for removing the superintendent and directors. Together, the two articles provide a legal foundation for independence that limits political pressure on supervisory tasks. The autonomy is reinforced because the SdB has independent resources that derive from fees charged to supervised entities.

**42. The special regime for cooperative credit institutions is set out under Law 17—1997.** Activities among cooperatives are concentrated in a few larger cooperatives that have grown to sizes comparable to smaller commercial banks. Though there is an apparent active program of on-site inspections and technical assistance by IPACOOOP, the supervision of larger cooperatives is not comparable to that provided for banks and creates an unlevel playing field. An additional weakness is that IPACOOOP does not have an active system for off-site monitoring of the cooperatives. It is recommended that the regulatory framework be modified to establish a size threshold (or other objective criteria), beyond which the cooperative would receive oversight by the SdB as its primary regulator. Mechanisms to permit off-site monitoring also need strengthening.

**43. The Banco Hipotecario Nacional (BHN) oversees four small savings and credit institutions.** Given the sector's small size, the policy issue is whether there is sense in retaining a separate regulatory framework. Some consideration for greater harmonization is

needed, including exploration of whether some or all of these activities could be brought in under SdB supervision.

## Securities

44. **The National Securities Commission (CNV) is responsible for the supervision and regulation of the securities markets.** In general terms, the legislative and regulatory regime is modeled after developed countries, containing many modern features. The decree law of securities markets (DLMV) provides for independence of the commissioners, such as the procedures for appointment by the president, a five-year term in office and removal criteria that requires a decision of the Supreme Court.

45. **The assessment identified significant operational issues related to financial and staffing resources that caused weak compliance with the IOSCO standard.** While on balance the legislative framework is effective and the staff of the CNV qualified, the key weaknesses identified by the assessment were (i) there is insufficient funding for the development and retention of a qualified professional staff; (ii) the selection and appointment of technical and administrative personnel requires the approval of the Ministry of Economy and Finance (MEF); (iii) one of the three commissioner positions has remained vacant since end-2004; (iv) the CNV staff and commissioners do not possess sufficient legal protection when acting in the bona fide performance of their functions and powers; and (v) judicial actions appear to have called into question the certainty of the CNV's decisions.

46. **There is a demonstration of cooperation by CNV staff with market regulators in other jurisdictions, but legislative impediments limit information sharing.** These impediments also limit the ability of the CNV to implement the IOSCO multilateral MOU (MMOU) (see discussion under section on cross-border cooperation and information exchange). Nevertheless, the CNV has provided substantial assistance to foreign regulatory authorities within the limits of Panama legislation. Discussions with other regulators confirm this assistance.

## Insurance

47. **Compliance with the IAIS core principles is weak due to the outmoded legal regime and underdeveloped supervisory and regulatory framework.** The legislation for the SSRP and the insurance sector dates from 1996 and includes Law 59 for traditional insurance, Law 63 for reinsurance, and Law 60 for captive insurance operations.

48. **The assessment found that the SSRP lacks independence from the industry and the executive branch of government—**participation on the Board of the SSRP by industry representatives and by MICI should be discontinued. To strengthen capacity of the SSRP to carry out supervision—both on-site and off-site—more staff and resources will be needed. The industry pays a fee for regulation; however, it is not substantially available to the SSRP for regulation purposes.

49. **The SSRP has not issued rules regarding corporate governance, internal controls, or responsibilities of board members and senior managers.** Disclosure to policyholders is weak. Commissions paid to brokers are not disclosed, and companies are prevented from employing their own agents.

#### **Anti-money laundering and Countering the Financing of Terrorism (AML/CFT)**

50. **Panama is largely compliant with a majority of the Financial Action Task Force (FATF) Recommendations.** Money laundering and the financing of terrorism are crimes under the law—there have been 10 prosecutions to date—and most types of financial institutions are subject to comprehensive preventive and reporting obligations and supervision. Less developed are preventive regimes for several designated nonfinancial businesses and professions (DNFBPs). Active cooperation with international counterparts occurs at the supervisory, prosecutorial level, and with other financial intelligence units (FIUs). Cooperation within government for AML/CFT appears generally adequate (see additional discussion under section on cross border arrangements and information exchange).

51. **The legislative and institutional frameworks are generally effective.** Law 41, 2000 criminalizes the laundering of proceeds, and Law 42-2000 imposes AML/CFT obligations on financial and nonfinancial businesses and professions. Under Law 42, cash transactions and suspicious transaction reports must be made to the Financial Analysis Unit (UAF). The UAF receives and analyzes these reports to provide appropriate referrals to the prosecutors for criminal investigation. To carry out its functions more effectively, the UAF requires additional personnel, and budgetary resources.

52. **Areas where strengthening is needed include resources and expertise for law enforcement and the judiciary, implementation of preventive measures in sectors outside of the banking and securities sectors, more active reporting of suspicious transactions, and training and coordination of the regulatory bodies.** The preventive regimes for the DNFBP sectors remain underdeveloped. In the DNFBP area of corporate service providers, regulation is needed to clarify the obligation that owner information should be retained by the resident agent for Panamanian corporations. Lawyers in general are not subject to customer identification, record keeping, or reporting obligations as required by the FATF standard.

#### **B. Cross-Border Cooperation and Information Exchange**

53. **Cross-border arrangements are in place to facilitate information sharing for financial sector regulation, except in the area of insurance.** The SdB has entered into numerous memoranda of understanding (MOUs) with countries where Panamanian financial institutions have affiliates or where Panama is host to foreign-controlled financial institutions. For the securities regulator, MOUs are also in place with counterparts in Latin America and Spain. Agreements are in place that permit expedited registration in Panama of securities also registered in El Salvador and Costa Rica. There is a good record of cross-border cooperation by the SdB and by the CNV.

54. **The CNV is a party to the IOSCO Multilateral MOU (Annex B only) that promotes cross-border cooperation and information exchange to deter securities market abuse.** However, legislative impediments limit the ability of the CNV to fully meet the requirements of the multilateral MOU as follows: (i) the CNV is unable to share nonpublic information held in its files with its overseas counterparts; (ii) the bank secrecy law prevents the CNV from sharing with foreign authorities information and records that it obtains pertaining to bank accounts; and; (iii) the CNV cannot initiate an investigation or inspection solely on behalf of a foreign authority but only for the purposes of its own investigations.

55. **A framework for cooperation among the three key financial sector regulators was formalized in May 2005 for coordinating the oversight of financial groups that carry out banking, insurance, and securities activities.** Differences in terms of resources and supervisory approaches, however, create inconsistent levels of supervision across the dominant banking groups. The SdB already considers the risks on a consolidated basis for many insurance and securities firms that are included within larger banking groups.

56. **In the area of AML/CFT, the government has a very good level of international cooperation** through adoption of international conventions and numerous mutual legal assistance treaties. In addition, for extraditions, formal and informal cooperation exists involving the UAF, the police, and their counterparts in other countries. Panama should ensure that it can enforce other countries' forfeiture orders. Panama is a member of the Caribbean Financial Action Task Force (CFATF) and the Egmont Group. The UAF is able to share information with other Egmont member countries through the Egmont Secure Web. A team from CFATF members conducted a mutual evaluation of Panama's compliance with the FATF and CFATF anti-money laundering recommendations in July 2001.<sup>7</sup>

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<sup>7</sup> The CFATF is a regional anti-money laundering group modeled after the FATF to carry out mutual evaluations of members. The Egmont Group is an association of *financial intelligence units*, created to facilitate information sharing.

## **Annex. Reports on the Observance of Standards and Codes—Summary Assessments**

This annex contains summary assessments of the observance of international standards and codes relevant for the financial sector. The assessments help identify the extent to which the regulatory and supervisory framework is adequate to address the potential risks in the financial system. They also identify priority areas for ongoing legislative changes and recommendations to improve financial regulation and supervision.

The overall evaluation of the financial sector was led by Michael Moore of the IMF's Monetary and Financial Systems Department. The following individual assessments of financial sector standards were undertaken:

- The Basel Core Principles for effective banking supervision (BCP), by Mr. Alvir Hoffmann (consultant to the Fund from the Central Bank of Brazil) and Mr. Jose Antonio Monreal (private consultant to the Fund and formerly with the Central Bank of Spain), using the 1998 BCP methodology;
- The IOSCO objectives and principles of securities regulation, by Ms. Paloma Portela, Deputy Director, Spanish Securities Commission (CNMV), using the 2003 methodology;
- IAIS Insurance Core Principles, by Ms. Cristina Rohde (Consultant to the Fund and formerly of the Mexican Insurance Commission), using the Insurance Core Principles methodology adopted in October 2003;
- The Financial Action Task Force Recommendations, by a team led by Mr. Francisco R. Figueroa (MFD) that included Mr. Ernesto Lopez (MFD), Ms. Hellen Chirino-Roosberg (LEG), and Ms. Nancy Worthington (LEG Consultant), using the 2004 FATF methodology.

The assessments were carried out during a main mission from May 16 to June 1, 2005 and a second mission from November 15 to 22, 2005. Additional information was added during the review process.

The assessments were based on the following sources:

- Self-assessments by the supervisory authorities;
- Reviews of relevant legislation, decrees, regulations, policy statements, and other documentation; and
- Detailed interviews with the supervisory authorities.

## A. Summary Assessment of Observance of the Basel Core Principles

### General

57. **This assessment of observance of the Basel Core Principles (BCPs) for Effective Banking Supervision has been completed as part of an evaluation of Panama’s observance of regulatory standards for the financial sector.**<sup>8</sup> The assessment is a follow up to the 2001 BCP assessment that reviewed the regulation and supervision by the Superintendency of Banks (SdB). The assessment required a review of the legal framework, both generally and as specifically related to the financial sector, and a detailed examination of the policies and practices of the institutions responsible for banking supervision. The assessment team received the full cooperation of its counterparts and received all information required.

58. **Panama is largely compliant with the BCP standard.** The body of banking laws and regulations is appropriate. The SdB’s program for ongoing supervision includes the monitoring of the foreign activities of Panamanian banks and the conduct of on-site inspections of the subsidiaries of banks, both domestic and foreign. Under the SdB’s program for on-site inspections, the local offices of foreign banks receive similar supervisory treatment as locally headquartered banks, which include banks that hold the international license. Weakness in achieving a higher level of compliance with the Basel standard resulted from (i) insufficient legal protection for SdB supervisors acting in their official capacity; and (ii) underdeveloped processes for the measurement and monitoring of market risk—including incorporating market risk where significant into the current capital adequacy requirement.

59. **The SdB has substantial autonomy to enable it to accomplish its legal mandate.** Article 14 of the Banking Law states that neither the directors nor the superintendent can be removed except for reasons included in the banking law and according to a decision of the Supreme Court of Justice. Article 15 provides a closed list of six reasons for removing the superintendent and directors. Together, the two articles provide a legal foundation for independence that limits political pressure on supervisory tasks. The autonomy is reinforced because the SdB has independent resources that derive from fees charged to supervised entities. Quantitatively the charging for on-site inspection is the most relevant service to collect funds.

60. **Two other categories of deposit-taking institutions are very small by comparison with the banking sector.** The credit cooperatives are supervised by the Panamanian Autonomous Institute for Cooperatives (IPACOO), and the saving and credit institutions are supervised by the National Mortgage Bank (BHN).

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<sup>8</sup> The assessment was conducted by Mr. Alvir Alberto Hoffmann (consultant to the Fund from the Central Bank of Brazil) and Mr. Jose Antonio Monreal (private consultant to the Fund and formerly with the Central Bank of Spain).

61. **The differences in regulatory treatment for banks, cooperatives, and savings and credit institutions lead to regulatory arbitrage.** Examples include the large cooperatives, which compete with banks for deposits and loans, but do not need to meet the same level of requirements as banks. In addition, a savings and credit institution was established after the owners had been sanctioned by the SdB for nonauthorized banking activities. Some consideration of greater harmonization is needed, including exploration of whether some of these activities could be brought under SdB supervision.

### **Institutional Setting and Market Structure**

62. **There are three types of banking licenses.** The differences among the license types and the number of banks within each type are as follows: (i) there are 39 general license banks (including two government-owned banks) that are able to conduct the full range of domestic and international banking activities; (ii) there are 29 international license banks that are able to carry out banking activities only with nonresidents; and (iii) there are 5 representative offices of foreign banks, whose activities in Panama are limited to liaison function with the head office, research, and marketing.

63. **By comparison, there are about 276 credit cooperatives (assets \$860 million) and four small savings and credit institutions (assets \$70 million).** These two sectors are small in total assets, and the level of supervision is substantially less than that provided by the SdB.

64. **Financial reporting by banks and banking groups must conform to international accounting standard (IAS) or U.S. Generally Accepted Accounting Principles (US GAAP).** The reporting conforms with international best practice, which promotes high transparency in the financial sector. The requirement for the use of high-quality financial reporting is further complemented by the 2005 fiscal reform law, which established IAS as the only accounting standard for commercial firms.

65. **The extent of a traditional safety net is limited as there is no depositor protection scheme or a central bank to serve as the lender of last resort.** To compensate, banks are subject to strict liquidity requirements and close liquidity monitoring by the SdB. Limited deposit protection is provided in the event of a bank failure as depositors have priority in liquidation on the bank's assets for up to \$5,000 per depositor.

66. **To deal with a bank in crisis, three broad processes exist for intervention** (i) the appointment of an advisor; (ii) substitution of managers and intervention of the bank in difficulty; and (iii) liquidation of the entity. The experience with the use of the power to appoint an advisor has been generally effective. Since the creation of the SdB, there have been five instances when an advisor has been appointed and only in one of these instances did the bank subsequently fail. Currently, three banks are in the process of being liquidated.

## Main Findings

### *Objectives, autonomy, powers, and resources (CPI)*

67. **The SdB has established clear objectives for the supervision of banks and fiduciary institutions.** The SdB was created by the Decree-Law No. 9 as an autonomous body to: (i) promote public trust and integrity of the banking sector; (ii) prevent unauthorized people from running banks; (iii) ensure the soundness and efficiency of banks; (iv) contribute to the development of the international financial center; (v) control the adequacy of capital and liquidity banking ratios; (vi) develop procedures to facilitate national and international coordination with other supervisory bodies; and (vii) sanction banking activities carried out in contravention of legal provisions.

68. **Objectives and powers for regulation of cooperatives and savings and credit institutions are set out in the legislation; however, the supervision is not comparable to that for banks.** The difference in supervision reflects, in part, resources available to IPACOOOP and the National Mortgage Bank. The assessment team's views that for some of the larger cooperatives that compete with comparably sized banks, there should be comparable regulation and oversight. For the savings and credit institutions, there is little justification for continued separation of the sector from the banking system, and the four institutions could be brought into the banking system, including the regulation.

69. **The SdB manages its own budget, and its funding comes primarily from supervised entities.** The SdB has two ruling bodies—the Superintendent and the Board of Directors. The superintendent has a five-year mandate renewable just on one occasion. The five directors have an eight-year mandate, also renewable. The superintendent is responsible for technical bank supervisory tasks and day-to-day administration of the Superintendency. The Board has two basic functions: developing a sound regulatory framework and counseling the superintendent. The SdB has 236 employees. About 200 employees have completed university studies in law or finance. They actively participate in seminars and educational events.

70. **The banking law does not provide for legal protection for SdB personnel acting in their official capacity.**

### *Licensing and structure (CPs 2–5)*

71. **The banking law provides the SdB with broad powers** to issue or deny a banking license; to have full access to the supervised entities for inspections; to sanction managers, directors, banking employees, and others who were involved in violations of its regulations. The use of the word “bank” is clearly defined by Article 24 of the Banking Law (Decree-Law 9/1998). Also, permissible activities are specified in the same Law.

### *Prudential regulations and requirements (CPs 6–15)*

72. **The banking law requires that general and international license banks have capital adequacy consistent with Basel capital rules.** The requirement considers the Tier 1 and Tier 2 capital items. Paid-in capital, retained net income and certain reserves are included in Tier 1 computations. The banking system is well capitalized; however, certain elements of the capital calculation are not consistent with the Basel capital accord, including no additional consideration of market risk, and nonconforming risk weighting for some types of assets (e.g., risk weight for commercial mortgages is 50 percent instead of 100 percent).

73. **Bank policies and procedures are evaluated on an ongoing basis for loans and investment activities through the SdB on-site supervision.** Bank policies and procedures, internal control rules, and methodology for measuring risk in portfolios are among the requirements that the SdB imposes on the banks. The SdB has produced clear guidance for loan evaluation and loan-loss provisioning. The level of provisioning must equal the higher of a minimum level as prescribed by the provisioning guideline or 1 percent of the portfolio. SdB imposes a limit on bank exposures to related parties and to single borrowers of 25 percent of capital.

74. **The SdB requires that supervised entities establish policies for country risk (e.g., transfer risk, political risk and sovereign risk) and market risk.** However, the SdB has not developed its own risk parameters. The regulation for country and market risks fall short given the increasing cross-border activities and complexity of activities by some banks. Corporate governance and internal control procedures are set out in SdB regulations and are consistent with Basel guidance.

75. **The general framework for AML/CFT is set out under law 42 of 2000 (AML/CFT Law), which establishes prevention measures for customer identification, transaction reporting, and record retention.** The SdB is charged with reviewing the compliance of reporting institutions. Further, the SdB regulations obligate that reporting institutions appoint a compliance officer. A formal inspections program to ensure compliance with legal and regulatory requirements is in place. Following the assessment mission, the SdB issued a new regulation (Accord 12-2005) that takes account of the 2003 revision to the FATF recommendations. The new regulation was issued to address gaps that had existed in earlier regulation when measured against the 2003 revision of the FATF recommendations.

*Methods of ongoing supervision (CPs 16–20)*

76. **All banks are examined by the on-site team about every 18 months, with large banks examined annually.** Financial information and credit portfolio details are collected monthly for overall financial analysis. For liquidity monitoring, the information is gathered on a weekly basis. The consolidated information of financial groups is collected quarterly. Off-site analyses are carried out monthly and concerns raised are submitted to the on-site team for review. The SdB meets with relevant banks' management on a yearly basis, in order to discuss each bank's trends and strategies.

*Information requirements (CP 21)*

77. **The SdB requires all banks to file audited financial statements** within the time period established by law (three months) and verifies that such information is consistent with the regulatory information received. The banking law establishes that banks may choose to elaborate their financial statements either under IAS or U.S. GAAP regimes. Permission to use U.S. GAAP reflects that several of the banks are from the United States or issue securities that trade in the United States. The accounting standards are comparable to those applied in high-income countries. Most of the audit firms are those associated with internationally known firms.

*Formal powers of supervisors (CP 22)*

78. **Article 17 of the banking law provides the SdB with the regulatory power for intervention**, reorganization, or liquidation of a bank, including for the removal of directors or executive personnel. Articles 38 and 76, respectively, provide the superintendent with the power to cancel a banking license and appoint an advisor to the bank's board to implement corrective measures. Article 95 establishes the reasons for the SdB to take control of a bank, including (i) lack of compliance with capital requirements; (ii) endangering the interests of the depositors; and (iii) lack of compliance with liquidity requirements. Article 137 establishes the SdB's sanctioning authority, which allows the superintendent to impose penalties for violations of the banking law that range from an oral reprimand (private or public) to civil penalties up to \$50,000. Additional sanctions may be imposed for certain specific violations.

79. **The SdB possesses adequate enforcement powers** and there is a history of their use. Notwithstanding, guidance for working with distressed entities and the processes for resolution of an insolvent bank are not sufficient. To ensure prompt, consistent application of remedial measures, the SdB should develop guidelines for use of remedial and contingency plans when there are violations of legal and regulatory requirements. In addition, there may be a need for some legislative revision.

*Cross-Border Banking (CPs 23–25)*

80. **The SdB is empowered to supervise economic groups and their bank and nonbank affiliates on a consolidated basis.** Its powers include the right to require audited financial statements and other reporting information as appropriate from the bank and nonbank affiliates of economic groups. The SdB requires that offices of foreign banks be subject to consolidated supervision by their home country supervisor. The SdB has signed agreements with foreign supervisors to facilitate cross-border information flows with most countries in the Western Hemisphere, and several agreements are pending with European jurisdictions.

81. **Several regional banking groups have established their holding companies in Panama**, and the SdB has become the home supervisor of these groups for consolidated supervision purposes. In March 2005, Resolution 1-2005 established practical and legal criteria for the definition of home and host supervisor under the Panamanian holding companies. Modifications to legislation should be considered to limit reliance on interpretive regulation, which would help clarify the SdB's consolidated supervisory powers for Panamanian financial holding companies that have a Panama bank subsidiary.

### **Recommendations**

82. Table 1 below identifies recommended actions to better achieve compliance with the BCP. Additional considerations for strengthening of the structure of the SdB would include the following:

- **Strengthen regulatory reporting information for cooperatives and savings and credit institutions.** The SdB has implemented an effective reporting and monitoring system to support the off-site supervision process and provide efficient mechanisms for improved disclosure of financial condition information to market participants. A clear weakness for cooperatives and savings and credit institutions is that there is not a process for off-site monitoring. Consideration could be given to outsourcing this activity on a full cost recovery basis to the SdB, which would take on the development of systems and subsequent processing of regulatory reporting information.
- **Require confidential treatment of SdB reports.** The supervision reports prepared by the inspection teams are issued to the bank without stipulation of the confidentiality of the reports. An apparent pattern is that banks are sharing the SdB reports with rating agencies and correspondent banks to show the standing that they have with the SdB. This practice is problematic as there will be a continued expectation of access to SdB reports when perhaps a bank's condition is not favorable.
- **Strengthen the regulatory department given that it is currently underdeveloped for its functions.** High-level and expert contributions are needed in the frequently difficult areas of regulatory capital, market and country risk, and investments activities by banks. In light of the looming implementation of Basel II capital rules, consideration to strengthen the Regulatory Department is warranted. From a hierarchical point of view the department demands an important position within the SdB's organizational structure.
- **Build capacity and retain experienced staff.** The SdB staff has invested considerable resources towards building its capabilities as a bank supervisor. Further development should be considered towards developing specific career streams for professional staff and strengthening retention of experienced staff. In addition, some thought could be given to putting in place a requirement in employment contracts that

would provide for reimbursement of the SdB for some educational costs in the event that the employee is hired by the private sector.

Table 1. Recommended Action Plan in Relation to the Basel Core Principles

<b>Basel Principle</b>	<b>Recommended Action</b>
Objectives and powers (CP 1.1)	Harmonize the supervisory and regulatory arrangements for nonbank deposit taking institutions (cooperatives and savings and credit institutions).
Independence (CP 1.2)	Develop a career plan to reduce the risk of losing senior SdB officials.
Legal protection (CP 1.5)	Implement an insurance policy to provide legal protection for SdB staff acting in their official capacity.
Licensing and supervision over foreign banks (CPs 3 and 25)	Closer coordination with other country supervisors is warranted in the establishment of parallel banks as recommended by Basel Committee.
Capital adequacy (CP 6)	Adapt capital charges according to Basel Accord.
Country risk (CP 11)	Develop and revise as appropriate current supervisory policy for country risk, which is becoming increasingly significant.
Market risk (CP 12)	Develop policies for market risk that consider the evolution in the complexity in activities among larger financial institutions, including the adoption of VaR and/or building-block approaches.
Remedial measures (CP 22)	Develop clear guidelines for working with distressed entities, including use of remedial measures, and for insolvent banks, guidelines for winding up, and transferring assets and liabilities.
Global consolidated supervision (CP 23)	Amend the banking law to provide the same level of clarity for the consolidated supervision of financial activities by holding companies as is currently the case for SdB direct oversight of banks and their subsidiaries.

### **Authorities' Response**

January 23, 2006, Response by the Superintendency of Banks of the Republic of Panama.

The Superintendency of Banks of Panama (SdB) wishes to express its appreciation to the IMF Mission on the Assessment of compliance with the Basel Core Principles for an Effective Banking Supervision. The assessment recognizes that the banking supervisory regime is largely compliant with the Basel Core Principles for Effective Banking Supervision.

The discussion and consultations during the course of the Assessment permitted the SdB to update some of its regulations and procedures to meet with the IMF recommendations. Regulations and Procedures updated after the Mission Visit in May 2005 are as follows:

- In July 2005, the SdB introduced a disclaimer rule expressing that the reports of inspections are for the exclusive use of the bank and the SdB.
- The structure of the Regulation Department (Departamento de Normas) will be analyzed and measures taken to strengthen its capacity.

- In August 2005, General Resolution No.2-2005 was issued and implemented a classification system for banks and economic groups based on the structure of the CAMELS.
- In December 2005, Accord 12-2005, Accord 12-2005 E and Resolution of the Board of Directors No. 32-2005 were approved. These regulations upgrade the Know-Your-Customer rules and compliance with AML/CFT regulations for banks and trust companies administrators. At the same time, they regulate correspondent banks and establish the Know your Employee Policy.

#### Response to Recommended Actions:

CP 1.1. The SdB is not responsible for the supervision of cooperatives and savings and credit institutions.

CP 1.2. The SdB will develop a program for financial stability of professionals in order to reduce the risk of losing senior officials.

CP 1.5. The SdB will evaluate the administrative and legal instruments that need amendment to provide legal protection for SdB staff acting in their official capacity.

CPs 3 and 25. The SdB has already established a procedure of consultation with home country supervisors to prevent parallel banks.

CP 6. The SdB will complete the necessary technical studies to update the regulations concerning capital adequacy on certain aspects recommended by the IMF. Other recommendations will require evaluations about the impact on the banking and monetary system.

CP 11. The SdB will conduct an integral review concerning the regulation about asset quality to include, among others, an adequate measure regarding country risk.

CP-12. The SdB is hiring a technical advisor that will support the implementation of new regulations and practices including VaR and/or building-block approaches to market risk.

CP 22. The Regulation Department (Departamento de Normas) is developing a guideline for working with distressed entities.

CP 23. Our Legal Department will analyze the corresponding regulations in order to clarify the SdB's power to execute globally consolidated supervision.

## **B. Summary Assessment of Observance of the IOSCO Principles**

### **General**

**83. This assessment of the observance of the IOSCO Objectives and Principles of Securities Regulation (the IOSCO Principles) was conducted as part of the evaluation of**

**observance of regulatory standards for the financial sector.**<sup>9</sup> The IOSCO assessment considered the securities regulatory framework, the powers, capabilities, and responsibilities of the authorities as well as issues related to the securities markets, market intermediaries, issuers of securities, and the management of collective investment schemes and private pension funds.

84. **The National Securities Commission (CNV) is responsible for the supervision and regulation of the securities markets.** In general terms, the legislative and regulatory regime is modeled after developed countries containing many modern features. The decree law of securities markets (DLMV) provides for independence of the commissioners, such as the procedures for appointment by the president, a five-year term in office and the removal criteria requiring a decision of the Supreme Court.

85. **While the legislative framework on balance is effective and the staff of the CNV is qualified, the assessment of IOSCO principles identified significant operational issues related to financial and staffing resources that have resulted in weak compliance with the IOSCO Principles.** Key concerns raised by the assessment were (i) there are insufficient resources for the development and continued retention of qualified staff; (ii) the selection and appointment of technical and administrative personnel requires the approval of the Ministry of Economy and Finance (MEF); (iii) one of the three commissioner positions has remained vacant since end-2004; (iv) the CNV staff and commissioners do not possess sufficient legal protection when acting in the bona fide performance of their functions and powers; and (v) Judicial actions have called into question the certainty of the CNV's decisions.

86. **The assessment used the 2003 version of the IOSCO objectives and principles of securities regulation,** the IOSCO assessment methodology, and other relevant IOSCO documentation. Reference also is made to the IOSCO and Committee on Payment and Settlement Systems (CPSS) Recommendations on Securities Settlement Systems. The assessment considered the DLMV law and associated regulations, the CNV's policies and procedures, including those relating to the enforcement process, and the self-assessment report prepared by the CNV.

87. **The assessment included discussions with CNV commissioners and former commissioners,** directors, and senior staff responsible for each of the functional areas as well as senior officials of the Bolsa de Valores de Panama (the Bolsa) and Central Latinoamericana de Valores, S.A. (LatinClear). The assessor also met with selected brokerage firms, corporate issuers, securitization companies, and mutual fund managers, auditors, and other organizations representing different financial services activities.

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<sup>9</sup> The assessment was conducted by Ms. Paloma Portela, Deputy Director, Spanish Securities Commission (CNMV).

## **Institutional Setting and Market Structure**

88. **The CNV licenses both securities houses (casas de valores) and investment advisors.** There are 33 securities houses registered with a total transaction volume of about \$7.3 billion in 2004. About 55 percent of the transaction volume was concentrated in five securities houses.

89. **Interest in Panama's capital markets is expanding.** The CNV licensed three securities houses in 2004. In 2005, five firms applied to obtain licenses to operate as securities houses, and one firm applied to obtain an investment advisor license. The interest in the securities industry has increased consistently among individuals. At end-May 2005, there were 265 licensed stockbrokers. The CNV licensed 50 stockbrokers in 2003, 38 in 2004, and 42 until end-May 2005.

90. **Securities markets are small and illiquid.** Activity is concentrated mostly in the primary market for government debt and corporate bonds. The investment culture remains underdeveloped, with users of financial services generally preferring to use banks for the safekeeping of savings. Historically, investors have preferred investment options provided by foreign capital markets, usually the United States. These factors, combined with a limited amount of promotion of the securities markets, weigh on the size and volume of the Panamanian stock market. An additional factor is that the corporate structures are frequently heavily influenced by significant family ownership, which has affected the development of the local markets.

91. **The CNV licenses credit rating agencies.** Presently, there are four credit rating agencies registered with the CNV. The CNV also licenses private pension fund managers and investment managers, stockbrokers, principal executives, and market analysts.

### *Description of regulatory structures and practices*

92. **Passage of the DLMV in 1999 reconstituted the CNV as an autonomous government agency to regulate the securities markets.** The DLMV removed the CNV from the Ministry of Commerce and Industry (MICI) with the aim of modernizing the securities market regulatory framework. The CNV became operational in early 2000, and through mid-2005 has produced 66 regulations (Accords) and established administrative positions through the issuance of 70 opinion letters. In 2003 and 2005, the CNV reached agreement with its counterparts in El Salvador and Costa Rica, respectively, for expedited registration in Panama of securities also registered in those countries.

93. **The CNV supervises the Bolsa de Valores and LatinClear; both are self-regulatory organizations (SROs).** The Bolsa is a demutualized corporation organized under Panama Law. Its shareholders include the main local banks, commercial firms, insurance companies, and stockbrokers. The Bolsa has authorized capital of \$1 million, divided into 180,000 shares. No individual shareholder owns more than 2.5 percent of the capital.

LatinClear began operations in 1997 as the central securities depository for performing custody, clearing, and settlement operations for equity instruments, government bonds, corporate bonds, commercial paper, and treasury certificates. All of the securities held at the depository are immobilized. At end-2004, LatinClear held 43 percent of the total capitalization of securities in Panama.

94. **The pension funds law number 10 of April 1993 regulates pension funds.** The DLMV gave the CNV specific authority to supervise and inspect the private pension plans. The pensions system falls into two types, one administered by the public sector (of an obligatory nature) and the other administered by the private sector (of a voluntary nature). By end-2004, there were two fund and pension administrators with 17,000 members and combined assets under management of \$55 million. The CNV has a technical department working on developing a regulatory framework, updating the 1993 law, a new pensions law, and some manuals and guidelines on supervision and inspection for internal use.

95. **The CNV has issued several regulations (Accords) based on the anti-money laundering law (Law 42-2000).** The regulations require reporting entities to establish adequate internal control systems and procedures for: (i) identifying customers; (ii) reporting currency and suspicious transactions; (iii) providing training to personnel; and (iv) retaining customer information and transaction records.

96. **Accord 2-2000 requires that issuers and intermediaries provide periodic financial information in accordance with either International Accounting Standard (IAS) or the Generally Accepted Accounting Principles of the United States (US GAAP).** Accord 7-2002 set a mandatory declaration on the part of the president, treasurer, and/or CFO of the company, regarding the reasonableness of the financial statements filed with the CNV. Though the requirements are sound, there are some doubts as to the capacity of the accounting profession to fully implement requirements. Moreover, the framework for regulating the accounting profession is limited.

## **Main Findings**

### ***Power, resources, independence, enforcement (Principles 1–5 and 8–10)***

97. **The securities market legislative framework is basically sound.** The DLMV authorizes the CNV to regulate the market by establishing procedures and issuing regulations, accords, and opinions. The CNV staff are committed to their assigned duties of enforcing their oversight responsibilities, improving efficiency, putting in place policies that promote the market and investor education, including implementation of IOSCO principles, and cooperating at a local level.

98. **The CNV employs a combination of investigatory and administrative powers to enforce DLMV requirements.** The CNV has authorized 16 formal investigations from 2001

to mid-2005. Some of these cases began after a preliminary investigation had been carried out by the CNV to determine whether there was sufficient merit to authorize a formal investigation. When a formal investigation uncovers evidence that makes it appear to the CNV that a person is violating or about to violate any provision of DLMV or its regulations, appropriate legal sanctions are imposed. For instance, during 2001, the CNV imposed several sanctions against individuals and corporations for providing false or misleading information to investors. In one particular case, the issuer and its CEO and CFO were fined \$300,000 each.

99. **The CNV also imposed administrative penalties for the violation of the rules concerning periodical disclosure of information.** The CNV imposed 153 penalties in 2000, 119 in 2001, 67 in 2002, 25 in 2003, 21 in 2004, and 18 in 2005. However, some weaknesses relating to legal provisions and the CNV's independence have been identified, and these need to be addressed. The assessment detected some gaps in legal provisions, which do not provide the regulator with powers to fully perform its duties. The decisions taken by the CNV are subject to both administrative and judicial review. If an affected person does not agree with some decision, he/she is entitled to file a complaint at the *Sala de lo Contencioso Administrativo* of the Supreme Court of Justice. This judicial body has the final word concerning the legal validity of the proceedings or decisions taken by the CNV. So far, the *Sala de lo Contencioso Administrativo* has decided on only 5 of the 19 complaints since 2001; although, some of these cases refer to crucial issues.

100. **The CNV is building the capacity of its staff (albeit with limited resources) and formulating policies to promote the development of broader capital markets and improve investor education.** The CNV also needs to improve its technical competence and abilities. This can be achieved through a medium-term training program in areas such as supervision procedures for intermediaries, investment firms, collective investment schemes, and SROs. They should also improve their techniques on risk management, internal control, and capital-adequacy methods.

*Self-regulatory organizations (SROs) and secondary market (Principles 6–7, and 25–30)*

101. **The CNV oversees the SROs to ensure that they implement the CNV's regulations and rules;** however, clarification of responsibilities and coordination between the respective roles of the CNV and the Bolsa in enforcement operations is needed in order to reduce duplication or inconsistency in the exercise of supervisory powers by the various authorities.

102. **The scarcity of resources at the CNV is also a factor that has an impact on the ongoing oversight program of the SROs,** including the ability of the CNV to exercise prudential supervision over the operations of LatinClear which provides the clearance and settlements system.

### *Cooperation (Principles 11–13)*

103. **The CNV may share information that is publicly available in its files or other public records with local and foreign authorities.** However, information obtained during the course of inspections or investigations is deemed confidential and may only be shared with the judicial powers in class action cases or with the attorney general's office in cases where there are reasonable grounds to believe that a criminal violation of law has occurred.

104. **Article 22 of the DLMV provides that the CNV may enter into arrangements with local or foreign, public or private entities to fulfill its oversight functions.** At the domestic level, there are in force some agreements with other authorities. At the international level, the CNV has signed memoranda of understanding with regulators in Latin America, including El Salvador, Dominican Republic, Honduras, Chile, Mexico, Argentina, and Costa Rica, and in Europe (Spain).

105. **The CNV is a party to the IOSCO Multilateral MOU (Annex B only) that promotes cross-border cooperation and information exchange to prevent securities market crime.** However, the CNV is not able to comply with all the provisions of the IOSCO multilateral MOU. For example, the CNV is not permitted to share nonpublic information held on its files with its overseas counterparts (as noted above regarding bank account information). The CNV cannot initiate an investigation or inspection solely on behalf of a foreign authority but only for the purposes of its own investigations. Nonetheless, the CNV has assisted foreign regulatory authorities within these restrictions of Panamanian law. Discussions with other regulators confirm this assistance.

### *Issuers (Principles 14–16)*

106. CNV regulations as noted earlier require registrants to use either IAS or US GAAP accounting standards and the president, treasurer, and/or CFO must declare that the financial statements filed are correct. Although this requirement represents a high standard, the capacity and skill of the accountancy profession and its representative body are underdeveloped. **The Accounting Technical Board, as the key representative body of the accounting profession, needs to reinforce its rules and powers to permit it to enforce its code of professional ethics and to establish an effective oversight system.** A draft law was introduced to the National Assembly in April 2005 to modify the existing statutes that regulate the accounting profession and the *Accounting Technical Board*.

### *Collective investment schemes (Principles 17–20)*

107. **The DLMV requires that the CNV regulate investment companies, both Panamanian and foreign.** The law further establishes categories of investment funds according to whether they are open- or close-ended and according to the redemption offer. The law grants the CNV authority to establish procedures and to issue detailed regulations.

108. **The new regulatory framework sets out authority and responsibility for regulation of collective investment schemes**, including clear power to establish and enforce entry criteria for open-ended funds. Because the law is recent, the CNV has not yet introduced a program for the ongoing monitoring of the conduct of collective investment schemes or their administrators, including enforcement of compliance with eligibility, licensing, registration, or authorization requirements.

*Market intermediaries (Principles 21–24)*

109. **The CNV exercises supervision and oversight of compliance over market intermediaries through Article 263 and 264 of the DLMV.** Securities houses are licensed intermediaries, both in the primary and secondary markets, with most owned by banking groups. Banking entities are allowed to deal in securities under Article 23 of DLMV, once they obtain a securities house license from the CNV. The CNV has a full range of supervision and enforcement manuals and technical resources; however, reporting and inspection programs are not in place to ensure that prudential and risk-management requirements are observed. Consequently, monitoring of compliance with prudential requirements and internal control and risk-management standards are weak. With an increase in current enforcement staff, it should be able to improve its supervision efforts. Further improvement will come when regulations raising standards for internal control systems, capital adequacy requirements, and asset valuation are passed. The CNV is able to compel financial intermediaries to reconstruct any securities transaction and during the course of an ordinary inspection is duly authorized to request and obtain records from intermediaries in accordance with Article 264 of the DLMV.

**Recommendations**

110. Table 2 below identifies recommended actions to better achieve compliance with the IOSCO Principles.

Table 2. Recommended Action Plan in Relation to the IOSCO Principles

<b>IOSCO Principle</b>	<b>Recommended Action</b>
Principles Relating to the Regulator (P 1–5)	<p>Operational independence is severely constrained by resources and by the failure to appoint a third commissioner. The commissioner’s position has remained vacant since the term of the prior commissioner ended in December 2004. This has required that the work of the CNV be directed by the two named commissioners, with the third seat temporarily filled through the rotation of directors who serve in an acting capacity. A new commissioner should be appointed as provided for under the current law.</p> <p>The CNV should be able to direct administrative matters, including the right to hire and fire its staff. Additional resources should be granted to the CNV on an urgent basis, particularly for the recruitment of skilled staff.</p> <p>The authority of the CNV should be strengthened with regard to corporate governance, liability of auditors, and code of conduct. Training programs should be put in place in a variety of areas, including risk management and prudential supervision, supervision of collective investment schemes, and intermediaries and supervision of SROs.</p> <p>Legislation should be put in place to address recent adverse judicial decisions. Legislative protection should be extended to staff against liability for good faith acts carried out in the course of duty.</p>
Principles of Self-Regulation (P 6–7)	<p>The CNV’s monitoring of the Bolsa needs to be strengthened. Accordingly, the CNV should work with the Bolsa to develop a comprehensive oversight program for market intermediaries and to put in place SRO staff examination, inspection, and enforcement programs. These programs should be augmented with additional training and assistance.</p> <p>CNV staff needs to have technical training specifically on trading systems, monitoring risks, detection of deceptive conduct, and market abuses. We also suggest setting up a special training program on clearing and settlements systems.</p>
Principles for the Enforcement of Securities Regulation (P 8–10)	<p>Although the CNV has strengthened its enforcement powers in the last few years, it does not have the necessary human and technological resources to provide effective prudential oversight for inspections, investigations, and sanctions other than when a breach of relevant securities laws has been identified.</p> <p>Improvements in the implementation of an effective system of inspections should be put in place whereby the CNV would carry out inspections, not just based upon complaints, but on a routine periodic basis or based upon a risk assessment.</p> <p>Technology tools have to be improved to allow a more efficient use of information gathered in the National Securities Registry.</p>
Principles for Cooperation in Regulation (P 11–13)	<p>The law limits the sharing of information with foreign securities counterparts when investigating market abuse. This limitation significantly constrains Panama’s ability to cooperate internationally.</p> <p>CNV has signed a Memorandum with Superintendency of Banks and Superintendency of Insurance. Practical rules and procedures are needed to implement those formal accords. The importance of receiving feedback in the collaboration with the UAF must also be stressed.</p> <p>Accordingly, legislative changes and modifications to procedures to improve</p>

<b>IOSCO Principle</b>	<b>Recommended Action</b>
	information exchange at the domestic and international levels are needed. In particular, legislative changes should be undertaken in order that Panama meet commitments to the IOSCO multilateral MOU before 2010.
Principles for Issuers (P 14–16)	<p>A new framework for the governance of the accounting profession should be formulated. The Accounting Technical Board needs to be in a position to enforce its rules including compliance with the code of professional ethics and for establishing an effective oversight system.</p> <p>The authorities are encouraged to implement the recommendations of the <i>report on the observance of standards and codes</i> (ROSC) on Corporate Governance prepared by the World Bank and published in 2004.</p>
Principles for Collective Investment Schemes (P 17–20)	<p>Ongoing monitoring of the administrators of Collective Investment Schemes should be strengthened without delay.</p> <p>The regulatory framework has in place appropriate rules regarding the valuation of assets of collective investment schemes and mutual fund (Accord 5-2004, arts. 36–39). However, because of the scarcity of resources, the CNV has not yet applied the tool; nor has the CNV provided its staff with the corresponding technical skills training that would enable the CNV to ensure compliance with the relevant rules. It is important that action be taken without delay to address this problem of lack of expertise and resources.</p> <p>In addition, introducing minimum conduct standards for administrators of collective investment schemes and better reporting mechanisms would enhance the ability of trustees and private supervisors to monitor their activity.</p>
Principles for Market Intermediaries (P 21–24)	<p>Staffing resources should be reviewed with a view to improving the quality and breadth of the supervisory work being undertaken. In the same way, several draft regulations should be prepared without delay to raise standards in (i) internal control systems; (ii) capital adequacy requirements; and (iii) asset valuation.</p> <p>The CNV should pass as soon as possible the agreement on ongoing capital, based on a capital adequacy test that addresses the risks to intermediaries. An early warning system or other mechanism should be developed to give the CNV notice of a potential default. Risk-based inspection programs could also be developed.</p> <p>It is necessary to put in place criteria that are related to the integral systems of internal control of the organizations supervised by the CNV. The current frequency of reporting and monitoring may not be sufficient to ensure that an institution experiencing difficulties with these transactions would be identified prior to experiencing more serious financial exposures.</p>
Principles for the Secondary Market (P 25–30)	<p>The Bolsa should be required and empowered to assume direct regulatory oversight and surveillance responsibility for all participants who use its trading platforms. It has to develop more robust and effective and self-regulatory organizational capabilities, including broker-dealer examination and risk management capabilities.</p> <p>The CNV should also reinforce its resources to provide it with the capability of determining the operational or other competence of the operator of an exchange or trading system as a secondary market. Also, it has to put in place mechanisms to identify and address disorderly trading conditions.</p> <p>The CNV must put in place arrangements for the continuous collection and analysis of information concerning trading activities. They currently have no mechanism that provides the results of such analysis to inspection officials in a position to take</p>

<b>IOSCO Principle</b>	<b>Recommended Action</b>
	<p>remedial action if necessary. There are currently no other systems monitoring the conduct of market intermediaries participating in the market.</p> <p>An industry-wide guarantee fund could be considered to facilitate an orderly settlement of transactions and limit the ripple effects of a failure.</p> <p>The exposure to systemic risk for intermediaries should be consistent with the risk analysis included under those principles and with any completed assessment of the CPSS/IOSCO Recommendations for Securities Settlement Systems.</p> <p>Although Principle 30 was not assessed, it is noted that resource constraints at the CNV limit its capacity in this highly specialized technical area. Corrective action is recommended to rectify this limitation.</p>

### **Authorities' Response**

The CNV gratefully appreciates the effort made by the members of the IMF Mission and, in particular, by Ms. Paloma Portela, during the assessment of the observance of the IOSCO Objectives and Principles of Securities Regulation (the IOSCO Principles) by the Panamanian securities sector, which includes the regulator, market participants, and public investors.

The CNV considers that this assessment accurately reflects the current situation of the securities market regulation and oversight in Panama.

### ***Key developments since the on-site evaluation***

To update key elements since the on-site work of the assessment team through December 2005, the number of regulated entities has increased. There now are 34 securities houses (including 3 that are undergoing voluntary liquidation), 294 brokers, 5 investment advisors/corporations, 2 natural persons, 13 investment administrators, 2 self-regulated organizations, and 4 risk rating agencies.

The increase in the number of regulated entities and participants is positive as it shows the growing interest in Panama's capital markets. However, this growth brings further challenges for the CNV (the enforcement) because of ongoing limitations regarding its autonomy, human resources, and training. The situation has been further aggravated in the last quarter of 2005, in which four staff members in the National Directorate of Markets and Enforcement have resigned, with most taking up positions in the private sector. In addition, with relation to Principle 9, the CNV notes that the only auditor that had been in place at the time of the assessment has now resigned to take up a position in the private sector.

The lack of adequate independent authority and budgetary resources removes the self-determination of the commissioners over the formal functions of the CNV. The lack of resources and autonomy results in a consignment of the CNV's oversight to appointees of the Presidency of the Republic.

The commissioner's position has remained vacant since the term of the prior commissioner ended in December 2004. This has required that the work of the CNV be directed by the two named commissioners, with the third seat temporarily filled through the rotation of directors who serve in an acting capacity.

At the end of 2005, seven judicial cases were solved, compared to four in 2004. Most important among these judgments, which was decided on November 11, 2005, was the clarification that the CNV has the expressed power to prescribe the form and content of the financial statements of entities regulated by the CNV.

In a second set of cases pending since June 2001, there has been mixed results. A \$300,000 fine imposed against the chairman and manager of an economic group due to the false presentation of financial and account information is still pending before the courts. However, on April 26, 2006, the courts confirmed the CNV's \$100,000 fine against an internal accountant involving the same group for the same failure.

On July 31, 2005 the international consultancy with Novaster Grupo Empresarial, S.L. came to an end, consequent on the approval of Accord 11-2005 (August 5, 2005) (published in Official Gazette No. 25,370, on August 24, 2005) that developed the regulation for Law 10 of April 16, 1993, on pension funds, retirement funds, and other benefits and the activities of the investment administrators. In addition, the consultancy helped to elaborate the manuals for the authorization, control, and supervision of the administrators of pension plans and retirement funds.

On December 15, 2005, GC de Panama, S.A. (Infosgroup) concluded their consultancy work for the development and implementation of the supervision system and control for retirement and pensions funds regulated by Law 10 of 1993.

### **C. Summary Assessment of Observance of the Insurance Core Principles**

#### **General**

111. **The assessment of insurance supervision was carried out by analyzing compliance with the Insurance Core Principles of the International Association of Insurance Supervisors (IAIS).**<sup>10</sup> For this purpose, the existing laws on insurance, reinsurance, and captive insurance operations as well as specific regulation and a new draft insurance law were analyzed. In addition, several interviews were held with officials at the supervisory authority and with other market participants.

112. **The Superintendency of Insurance and Reinsurance (SSRP) supervises the insurance and reinsurance sectors.** Compliance with the IAIS core principles is weak due to the outmoded legal regime, and underdeveloped supervisory and regulatory framework.

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<sup>10</sup> This assessment was carried out by Ms. Cristina Rohde (Consultant to the Fund and formerly of the Mexican Insurance Commission).

The SSRP lacks independence from the industry and the executive branch of government. To strengthen the capacity of the SSRP to carry out supervision—both on-site and off-site—more staff and resources will be needed and compensation will need to be sufficient to attract and retain skilled staff, including filling the actuary’s position. The industry pays a fee for regulation; however, it is not substantially available to the SSRP for regulation purposes.

113. **Insurance is regulated by Law No. 59, reinsurance by Law No. 63, and captive insurance operations by Law No. 60,**<sup>11</sup> all issued in 1996. A draft law is under preparation to address some of the weaknesses identified in the evaluation; however, shortcomings remain in the draft law, including (i) the SSRP would remain dependent on MICI; (ii) market conduct requirements would continue to favor the industry and brokers; and (iii) accounting and disclosure practices for insurance firms do not meet international standards. The draft law seeks to incorporate reinsurance and captive insurance operations.

### **Institutional Setting and Market Structure**

114. **The insurance sector in Panama is small compared with the banking sector.**<sup>12</sup> There are 18 authorized insurance companies.<sup>13</sup> Of these, four specialize in the life business, one in surety business and 13 operate both life and nonlife insurance. Of these 13, nine have in addition a license to operate reinsurance. Of the 18 insurance companies, five are subsidiaries of foreign firms and four are subsidiaries of local banks.

115. **There are five companies authorized to operate exclusively in reinsurance.** In 2003, premiums issued by reinsurers represented 11 percent of the premiums issued by insurers, but since there is no information available for 2004, the analysis that follows considers only the insurance sector. The captive insurance sector is insignificant, and no data are available.<sup>14</sup>

116. **Insurance penetration in the economy measured as premiums subscribed to GDP is around three percent.** The total premiums subscribed in 2005 were \$430 million, up 1.9 percent from 2004. Total assets for 2004 were \$765 million, which is about six percent of GDP, with investments representing 69 percent of total assets. Life insurance business represented 35 percent of the total market. Within the nonlife insurance business,

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<sup>11</sup> Captive insurers are defined in Law No. 60 as those corporations “exclusively devoted to insure or reinsure, from an office located in Panama, private risks located abroad or those that may be specifically authorized by means of a license granted by the Superintendency....”

<sup>12</sup> Data on insurance was provided through 2005. However, figures were not available for reinsurance or for captives.

<sup>13</sup> The SSRP does not supervise the government-owned Instituto del Seguro Agrícola, which provides crop and livestock insurance. It is not supervised by the SSRP.

<sup>14</sup> There are two captive insurers.

automobile insurance and health insurance are the two largest categories, representing respectively 16 and 17 percent of total premium subscriptions. The Panamanian insurance market is highly concentrated with the five largest companies accounting for around 74 percent of total business.

117. **A legal system that incorporates transparency and disclosure requirements is necessary** to have a strong and growing insurance market that is efficient and integrated in the financial sector. Human resources and other resources used to carry out effective supervision are required. Moreover, strong governance mechanisms and a more competitive environment should be enforced to develop confidence in the industry, which will translate into better conditions for the policyholder.

### **Main Findings**

118. **The insurance sector is small compared with the banking sector. The legislative framework for insurance supervision is weak.** The industry pays a fee and taxes levied on net premiums from local risks are paid to the central government; however, the tax is not substantially available for the SSRP. The tax is two percent of net premiums issued for risks located in the country, and 5 percent for fire insurance.

119. **The stated objective of insurance supervision is to enhance and strengthen the insurance industry,** and therefore, the SSRP has the responsibility to ensure that insurers comply with the technical reserves and solvency requirements stated in the law. The overall budget of the SSRP is strained and dependent on MICI, therefore it is difficult to implement changes in the structure of the SSRP that would allow for higher wages to hire and retain skilled staff and develop infrastructure needed for supervision.

120. **Although accounting rules are in place for insurers, the SSRP does not require companies to use International Accounting Standards (IAS) for regulatory purposes.** However, IAS, for publicly traded companies and for fiscal purposes, is required by the securities law. The use of two different approaches for accounting could create confusion.

121. **The SSRP has not issued rules regarding corporate governance, internal controls, or the responsibilities of board members and senior managers.** Disclosure to policyholders is weak. Commissions paid to brokers are not disclosed, and companies are prevented from employing their own agents.

### ***Organization of an Insurance Supervisor***

122. **The SSRP has little or no autonomy from the industry or MICI.** The SSRP is part of the MICI and does not have a separate budget.<sup>15</sup> The Technical Council is composed of

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<sup>15</sup> Part of the SSRP's budget comes from a fixed rate charged to supervised companies and brokers, and part of it comes from MICI.

nine board members, and is responsible for setting the SSRP's policies, issuing licenses for new insurance companies, and solving controversies arising from decisions taken by the superintendent. The members of the Technical Council include the superintendent, the Minister of MICI, its legal director, the actuary of the SSRP, a director of the National Securities Commission, and four representatives from the insurance sector (two from insurance companies and two from the brokers).<sup>16</sup>

123. **Staff salaries at the SSRP are significantly below industry levels and below the salaries of other financial supervisory agencies (e.g., Superintendency of Banks),** which affects the ability of the SSRP to retain qualified staff.<sup>17</sup> There is no legal protection for actions taken against them while discharging their duties.

124. **Other resources at the SSRP are limited as well,** making it hard to gather and analyze financial reporting information or to effectively address issues such as reinsurance activities, valuation of assets and technical provisions, risk management and risk assessment and consolidated supervision of insurers belonging to financial groups.

125. **The draft insurance law (dated April 2005) strengthens some areas.** The SSRP financial autonomy from MICI would be strengthened, though a representative of MICI would remain on the board. The draft law set out qualifications for the superintendent, the period he/she will stay in office (seven years), and the explicit procedure for his/her dismissal. This project also eliminates the Technical Council of Insurance and National Reinsurance Commission and instead proposes a board of directors composed of the minister of MICI, the insurance superintendent and three independent members of the society with experience in the insurance sector, but no other links to the government or to any insurance, reinsurance, captive insurance company or broker. There is a fixed term for the independent board members so that they are staggered. Alternative considerations to the makeup of the board could include a representative from the Superintendency of Banks given the substantial participation of bank owned insurance firms in the sector.

### *Licensing and Changes in Control*

126. **A license is required to carry out any insurance business in Panama.** Foreign investment is allowed in the insurance industry, so long as the investment is through a local subsidiary as opposed to a branch. Licenses to sell life, nonlife, and surety products are issued separately in the sense that a company needs authorization to operate each line of

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<sup>16</sup> There is a similar body for the reinsurance market. The National Reinsurance Commission is a five member board composed of the superintendent, the minister of MICI, the minister of MEF and two representatives from the reinsurance sector.

<sup>17</sup> There are currently no actuaries working for the SSRP, although one was contracted to train two staff members.

business to which it plans to subscribe, but not in the sense that companies need to specialize in only one type of products, i.e., there are composite licenses to operate every line of business (including reinsurance).<sup>18</sup>

127. **To receive an insurance license, applicants must provide information on shareholders and members of the board of directors** along with documentation describing the products to be sold, reinsurance programs, and feasibility of business plan in the medium and long term. Once the required information is complete, the Technical Council or National Reinsurance Commission has 90 days to grant the license.

128. **The law states that a license for insurance should not be granted if a shareholder, director, or senior manager has been convicted for crimes** related to drug dealing, fraud, or other related crimes during the previous ten years. This requirement applies to both insurance and reinsurance companies.

129. **The SSRP undertakes a limited fit-and-proper review of shareholders, board members, management, auditors, and actuaries.** The law only requires that company board members submit their curriculum vitae and “recommendation letters” along with the other documents for getting a license, and requires information on who the shareholders are. The SSRP checks the information on shareholders and board members with the Financial Analysis Unit (UAF) prior to granting any license.

130. **The term “control” over an insurer is not defined in legislation, and changes in shareholders or board members** must be reported to the SSRP within 30 days after these changes take place, i.e., the law does not require a previous authorization for changes in control over an insurer. Insurers by law are required to receive prior approval of the Technical Council or National Reinsurance Commission before they transfer all or any part of their business, and the requirements to another insurer.

131. **The draft law includes in its definition of “control” over an insurer a description of persons who may not be shareholders, directors or senior managers,** and requires that any transfer that implies more than 10 percent of the total outstanding shares, must be reported to the SSRP in advance of taking place.

### *Corporate Governance and Internal Controls*

132. **The insurance law does not impose any measurable requirements for corporate governance** and, therefore, the SSRP does not verify compliance with corporate governance principles. The law does not set out responsibilities for the board of directors or for senior

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<sup>18</sup> Licenses are granted by the Technical Council of Insurance or National Reinsurance Commission. Prior analysis is made by the SSRP.

management. The internal organization of companies is an area where the supervisor does not play a role.

133. **An external financial audit is required once a year, and an actuary is required to certify the proper constitution of mathematical reserves in the life insurance business.**

The SSRP has no power to oversee or verify internal controls within companies and, therefore, does not require that companies have them in place. Some firms (at least the big ones that belong to financial or economic groups) have in place internal controls and corporate governance rules.

134. **The draft insurance law could be modified to require that insurance and reinsurance firms have in place a framework for corporate governance and internal controls.** The law should include provision that the SSRP have sanctioning authority if there is noncompliance.

### *Prudential Rules*

135. **The SSRP verifies that the design of insurance products relies on a technical basis for their feasibility.** However, the SSRP neither requires nor verifies that insurers have in place comprehensive risk-management systems able to control, monitor, and report risks. Regarding reinsurance contracts and policies, there are no provisions on minimum ratings for reinsurers or for exposing limits towards single reinsurers.

136. **Actuarial standards are not issued by the SSRP, but general international standards are applied.** Technical reserves for nonlife business are calculated as a proportion of net retained premiums, and for life business, according to the actuarial value of expected losses according to accepted actuarial principles. Mathematical reserves must be calculated and presented to the SSRP by an independent and certified actuary,<sup>19</sup> and these calculations must be certified by another independent actuary once a year.

137. **The law specifies that 75 percent of all investments that cover technical reserves must be within the country, and it lists the type of instruments allowed.**<sup>20</sup> The other 25 percent is allowed to be invested abroad but in the same type of instruments listed and with a rating of at least “investment grade.” There are no diversification or liquidity requirements and no asset valuation rules. Although there is currently no regulated market for derivatives, restrictions on the use of these instruments should be addressed and discussed in the context of the insurance industry.

138. **There is a solvency regime specified in the law and detailed through specific regulation.** Capital requirement must be calculated according to procedures dictated by the SSRP and it is verified by the supervisor and published every trimester. Solvency control

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<sup>19</sup> A certified actuary refers to someone with an actuarial degree.

levels are established, and publicly disclosed actions are taken by the authority in case companies fail to comply with these.

139. **The draft law does not change the way in which technical reserves are calculated**, but it introduces some comment on the liquidity of assets aiming to improve matching of assets and liabilities which is appropriate.

### *Market Conduct*

140. **The supervisory authority requires insurance brokers to be licensed; to have adequate knowledge; and to have passed a licensing examination.** The insurance law lists the requisites, obligations, and prohibitions for insurance brokers and gives the SSRP the power to cancel the broker's license when appropriate.

141. **The law sets minimum requirements for insurance policy models such that these are easy for consumers to read and understand and have all the necessary information** (benefits, limitations, exclusions, etc.). Policy models need authorization from the SSRP prior to their use. In addition, the SSRP has a legal department that receives claim-related complaints from consumers. The draft law could usefully provide the requirement that a regulation be issued for the disclosure of fees/commissions paid to brokers or agents.

142. **With respect to financial disclosure, insurers are required to publish audited statements annually and in accordance with regulatory accounting principles**, and the SSRP publishes the solvency margins quarterly. Statistical information is gathered by the SSRP and available for consultation by interested parties.

### *Monitoring, Inspection, and Sanctions*

143. **Market analysis performed by the authority includes monitoring the amount of premiums, number of policies issued, and claims on a monthly basis.** It does not include a qualitative analysis or off-site monitoring of trends in prudential indicators. Insurance companies are required by law to submit audited financial statements during the first four months of every year. In addition, statistical information must be submitted to the SSRP on a monthly basis, and information on the solvency margin must be submitted quarterly. There is no requirement to report outsourced functions. The supervisory authority has the power to carry out on-site inspections to examine companies' compliance with legislation and supervisory requirements. However, there are currently four auditors working for the SSRP, making it hard to cover all insurance companies, and the inspections focus only on financial aspects rather than on wider managerial factors.

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<sup>20</sup> At least 50 percent of the capital exceeding the minimum required capital has to be invested in the country as well.

144. **Reinsurance companies have one year to submit their audited financial statements and are not subject to the solvency regime.** Although the SSRP has authority to conduct on-site inspections of reinsurance companies, staffing resources do not allow this to be done on a consistent basis.

145. **The supervisory authority takes preventive and corrective measures in order to achieve its objectives.** As specified in the law, these measures are mainly triggered when insurance companies fail to achieve the minimum solvency margin, and they range from a plan proposed to reorganize the company, including an increase in capital levels, to intervention or revoking the license to operate. The law also establishes the reasons and amounts of the fines that can be imposed by the SSRP against different market participants.

146. **The legal framework defines a range of options for the exit of insurers and reinsurers from the marketplace, giving priority to the protection of policyholders.**

147. **The draft insurance law introduces a new regularization process that allows the SSRP to impose conditions** on insurance firms when it determines that any of the following specific weaknesses poses a risk for policyholders: (i) when there are problems in the constitution and/or coverage of technical reserves; (ii) when the solvency margin or minimum required capital is not maintained; (iii) when the financial auditors or the independent actuary refrain from giving an opinion; and, (iv) when liquidity conditions are not met. In the event of a weakness being identified, the regularization plan must be submitted by the board of directors of the company. This measure not only outlines the responsibility for board members but will improve prospective supervision.

#### *Cross-Border Operations, Supervisory Coordination and Cooperation, and Confidentiality*

148. **Cross-border insurance operations are prohibited.** According to insurance law, in those cases where the insurance product needed is not offered in the local market, the interested party may obtain an authorization from the SSRP to get the product abroad. These authorizations need to be registered at the SSRP.

149. **The SSRP does not have any powers of supervise any financial entity other than the regulated insurance company that forms part of a group.** The responsibilities of each supervisory authority are well defined. The SSRP recently signed a memorandum of understanding with the Superintendency of Banks and the National Securities Commission to share information and coordinate supervision efforts of financial groups.

150. **The insurance law does not allow for supervision by a home supervisor.** On confidentiality, the law specifies a sanction for public officials who improperly provide information on companies or brokers under the SSRP's supervision.

#### **Recommendations**

Table 3 below identifies recommended actions to better achieve compliance with the IAIS Insurance Core Principles.

Table 3. Recommended Action Plan in Relation to the IAIS Insurance Core Principles

<b>IAIS Principle</b>	<b>Recommended Action</b>
Organization of an Insurance Supervisor	<p>Strengthen independence of the SSRP from the industry and from the executive— participation on the Board of the SSRP by industry representatives should be discontinued; also the Board should be independent from the MICI.</p> <p>More staff and resources should be provided to the SSRP. Compensation needs to be sufficient to attract and retain skilled staff.</p> <p>An actuary should be hired, and protection against legal action for staff members should be provided.</p> <p>Publish the SSRP’s audited financial statements.</p> <p>The manual of internal procedures should be revised in order to incorporate other relevant supervision processes that take place.</p> <p>Where applicable, reinsurance and insurance laws should be equivalent.</p>
Licensing and Changes in Control	<p>Prior to issuing a license, prospective companies should be required to have in place internal control, information technology, and risk management systems.</p> <p>Shareholders, senior managers, board members, actuaries, and auditors should be required to meet fit-and-proper tests.</p> <p>The process for changes in control over an insurer or reinsurer should be disclosed and clearly stated in the law or regulation.</p>
Corporate Governance and Internal Controls	<p>A regulatory framework for corporate governance structure and internal controls should be developed. The law should incorporate corporate governance rules and minimum internal controls that should be in place and reviewed. Board members responsibilities should be clearly stated.</p> <p>Consideration should be given to the specifying the composition of the board such as requiring the inclusion of independent members, appointing a compliance officer, or creation of committees.</p>
Prudential Rules	<p>The regulation of the constitution of technical reserves could be revised in order to implement actuarial standards for calculation methods.</p> <p>Audited financial statements should be turned in promptly.</p> <p>Asset-liability matching requirements should be introduced.</p> <p>Reinsurance companies should be included in the solvency regime.</p>

<b>IAIS Principle</b>	<b>Recommended Action</b>
Market Conduct	<p>Insurance brokers or agents should be able to be employed by a specific company.</p> <p>Brokers' fees and commissions should be disclosed.</p> <p>Institutions should be required to disclose information on their financial performance.</p>
Monitoring, Inspection, and Sanctions	<p>Objectives of on-site supervision should be widened and not focus only on financial aspects.</p> <p>Information technology systems should be improved in the SSRP so as to be able to receive and analyze information.</p>
Cross-Border Operations, Supervisory Coordination and Cooperation, and Confidentiality	<p>Supervisory coordination should be enforced, and the legislative framework should define if there is to be cooperation and information sharing with home supervisors of foreign firms operating in Panama, and if so, the terms or conditions under which this could be done.</p>

### **Authorities' Response**

Our Institution (the SSRP) is grateful for the interest that International Monetary Funds has shown in order to guide us throughout the assessment performed to our financial sector more specifically the Superintendence of Insurance and Reinsurance of Panama.

The recommendations are being reviewed and many of them have been amended and we are still making progress in others, mainly based on the Observance of the IAIS Insurance Core Principles.

The Superintendence of Insurance and Reinsurance is making considerable efforts working in the appropriate regulation for the insurance service sector. Thanks to your support and advice, we have been working real hard to enforce the new insurance law that we hope would be accepted by the Executive in order to be independent from the Ministry as you recommended it. But in this process we need support within the financial and political scope which is taking us time but we are confident that our effort will bring amazing results which is to pass the new insurance law.

We will appreciate that the IMF would be willing to cooperate in the case we need some assessor opinion to review the financial framework of the new law.

## D. Summary of Assessment of Observance of the FATF Recommendations

### General

151. **Panama is largely compliant with a majority of the Financial Action Task Force (FATF) Recommendations.** Money laundering and the financing of terrorism are crimes under the law—there have been 10 prosecutions to date—and most types of financial institution are subject to comprehensive preventive and reporting obligations and supervision. Less developed are preventative regimes for several designated nonfinancial businesses and professions (DNFBPs). Active cooperation with international counterparts occurs at the supervisory, prosecutorial level, and with other financial intelligence units (FIUs).

152. **Areas where strengthening is needed include resources and expertise for law enforcement and the judiciary, implementation of preventative measures in sectors outside of the banking and securities sectors, more active reporting of suspicious transactions, and training and coordination of the regulatory bodies.** The preventive regimes for the DNFBP sectors remain underdeveloped. In the DNFBP area of corporate service providers, regulation is needed to clarify the obligations that owner information should be retained by the resident agent for Panamanian corporations.

153. **This report provides a summary of the level of observance with the FATF 40+9 Recommendations** and provides recommendations on how aspects of the system could be strengthened (see Table 4). This assessment was conducted as part of an evaluation of the financial system within the framework of the Offshore Financial Center (OFC) Program of the IMF.<sup>21</sup> The assessment was carried out using the 2004 FATF Methodology, and it reflects the views of the assessment team and not necessarily the views of the government or the IMF's Board. The assessment is based on the information available at the time of two on-site visits by the assessor team and IMF staff in May and in November 2005. In preparing the assessment, the Fund assessors reviewed the relevant institutional framework, laws, regulations, guidelines, and other supervisory and regulatory arrangements in place to deter money laundering and the financing of terrorism.

### Institutional Setting and Market Structure

154. **The financial system is composed of domestic and internationally active banks, insurance companies, trust companies, and securities brokerage companies.** To a much lesser degree, other financial services include finance companies, leasing companies, cooperatives, and savings and credit institutions. Banking activities represent the most significant component accounting for more than 90 percent of the financial services sector.

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<sup>21</sup> The AML/CFT mission team was led by Mr. Francisco R. Figueroa (MFD) and included Mr. Ernesto Lopez (MFD), Ms. Hellen Chirino-Roosberg (LEG), and Ms. Nancy Worthington (LEG Consultant). Mr. Michael K. Moore carried out a second mission in November 2005 to review specific AML/CFT preventive measures in the banking sector.

155. **Law 42-2000 obliges banks, trust companies, remittance companies, finance companies, cooperatives, securities firms, and investment administrators to meet requirements for anti-money laundering and countering the financing of terrorism (AML/CFT).** AML/CFT requirements include (i) customer identification—obligation to identify the true beneficial owner or beneficiary; (ii) monitoring for unusual transactions;<sup>22</sup> (iii) sending to the Financial Analysis Unit (UAF) reports of suspicious transactions—regardless of the transaction amount—and reporting currency and cash-like transactions in excess of \$10,000;<sup>23</sup> (iv) avoiding “tipping off” customers when a suspicious transaction report<sup>24</sup> (STR) has been forwarded to the UAF; (v) establishing internal control systems and communication mechanisms to prevent money laundering; (vi) training personnel; and (vii) maintaining customer records for at least five years.

156. **Law 42-2000 applies to other businesses but only with respect to the filing of reports for operations above \$10,000 in cash.** These businesses are: insurance and re-insurance companies and brokers; casinos, the national lottery; and other gaming businesses; companies located in the Colon Free Trade Zone (ZLC) or in any export-processing zone; real estate intermediaries and developers; and most recently, pawnshops. The authorities responsible for overseeing these businesses have issued regulations that impose additional obligations such as the reporting of suspicious transactions and the appointment of compliance officers. However, the enforceability of those regulations is weak as they exceed both Law 42-2000 and the general regulatory powers of each authority. Not surprisingly, these businesses and their corresponding supervisors have focused excessively on cash-threshold reporting, while overlooking the need to strengthen internal controls to detect unusual transactions. Similarly, insufficient attention has been paid to the development and implementation of procedures addressing risks specific to each industry.

157. **The Financial Analysis Unit (UAF), which was established in 1995,** is a member of the Egmont Group and actively exchanges information with foreign FIUs. It has the typical characteristics of an administrative FIU without enforcement or investigative police powers and is functionally independent. The Director of the UAF reports directly to the President although the budget of the UAF depends on distributions from the Public Security and National Defense Council, which is the highest level advisory body created to advise the President on matters of public security.

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<sup>22</sup> Unusual transactions are those of which the size, characteristics, and pattern do not fit the economic activity of the client or which are beyond the normal parameters in the market or which do not have a clear legal basis.

<sup>23</sup> Currency and cash-like transactions are first received by the respective supervisory authorities and immediately forwarded to the UAF.

<sup>24</sup> Suspicious transactions: transactions which, based upon the information the financial institution has of the client and in accordance with the “Know-Your-Customer” standards, it is assumed that they are linked to illegal activity.

## **Main Findings**

158. **As already noted, Panama is largely compliant with a majority of the FATF recommendations.** Law enforcement authorities have adequate legal authority to carry out their responsibilities, although resource constraints are apparent in the operating budget and staffing. Money laundering investigations are being conducted by the Judicial Technical Police under the direction of prosecutors. The assessment team notes the high level of international cooperation in AML/CFT.

159. **Lawyers, accountants, and corporate service providers are not covered by law 42-2000 or regulations.** By law, only lawyers can incorporate companies and private interest foundations. Accounting firms do not incorporate companies (except through their in-house attorneys) but can provide services which fall under FATF Recommendation 12, such as management of client companies, assets, and bank accounts. All companies must be registered in the public registry (regardless of the type of company or its local or foreign ownership), and they must have a lawyer as resident agent. The registry does not maintain sufficient information to determine the ownership structure of all companies.

160. **Although lawyers and accountants are not required to belong to a professional association, and the codes of ethics of the associations provide guidance to members.** The law establishes ethical rules for lawyers; violators are subject to investigation and sanction by the Supreme Court, although there have been very few sanctions.

161. **Coordination of AML/CFT issues among government authorities should be further enhanced** to establish policies and priorities and to adequately address the capacity constraints of those agencies responsible for overseeing new reporting institutions, such as the Ministry of Commerce and Industry (MICI). It is expected that the not-yet-operational High Level Presidential Commission on AML/CFT issues, if accompanied by task-specific working groups, will facilitate much needed policy oversight and recommendations.

162. **Outside the banking and securities sectors, the focus on formalistic controls may negatively impact prevention and detection of suspicious transactions;** greater focus of preventive efforts on higher risk areas in a cost-effective manner is warranted. The experience has been that a large number of fines have been imposed on reporting institutions for the failure to report monthly to the UAF that there were “no CTRs to be filed” while at the same time there has been a low number and generally weaker quality of STR reporting.

### ***General Situation of Money Laundering and Financing of Terrorism***

163. **Information from various criminal investigations shows that the reporting and other preventive requirements in the money laundering law have had a dissuasive effect** on money laundering activity in financial institutions. The UAF reported that money laundering has moved towards other parts of the economy in order for launderers to avoid the developed capacity of banks to detect the introduction of illicit capital.

164. **To date, the 10 money laundering cases that have been prosecuted were based on narcotics-related predicate crimes.** The cases have resulted from internal efforts in the Public Ministry (*Ministerio Público*) as well as from international cooperation. Other financial crimes cases have resulted mainly from foreign investigations of corruption where funds were later deposited in Panamanian financial institutions. The Colon Free Trade Zone is also recognized as an area of vulnerability for money laundering.

***Overview of the Financial Sector and DNFBP***

165. **AML/CFT supervision is under the responsibility of the following authorities:** the Superintendency of Banks (SdB); the Superintendency of Insurance and Reinsurance (SSRP); the National Securities Commission (CNV); the Ministry of Commerce and Industry (MICI);<sup>25</sup> the Autonomous Panamanian Cooperatives Institute (IPACOOB); the Administration of the Colon Free Trade Zone; and the Gaming Control Board.

166. **Lawyers exclusively are able to incorporate companies, personal interest foundations and legal persons in general.** About 29,000 companies and private interest foundations were registered in the public registry in 2004. No information is available from the registry to determine the percentage that bearer share companies represent of this total. Leasing and factoring companies, insurance brokers/agents, and savings and credit institutions are not covered by Law 42-2000.

167. **The DNFBPs subject to AML/CFT obligations are casinos, trust service providers, and real estate agents.** Other nonfinancial businesses that are regulated for AML/CFT purposes are pawn shops and businesses located in free trade zones. Not covered by AML/CFT regulations are lawyers, accountants, and corporate service providers. Dealers in precious metals and stones are partly covered if they are also merchants located in the ZLC, which makes them subject to the free zone's CTR requirements.

***Legal Systems and Related Institutional Measures***

168. **ML is criminalized by both the older Unified Text on Drug Crimes and the newer AML law found in Law 41-2000.** The AML law lists the specific predicate crimes for money laundering but does not include all the offenses required by the Palermo Convention. **Terrorism and the financing thereof are incorporated in the Criminal Code as autonomous offenses consistent with international standards.** However, financing of terrorism is not on the list of predicate offenses for money laundering. In addition, to date there have been no prosecutions of financing of terrorism cases. Apart from the need to expand the list of offenses to be included as predicates for money laundering, the legislative requirements generally comply with both the Vienna and Palermo Conventions.

169. **The legal process available to freeze, seize, and confiscate assets related to money laundering offenses is largely compliant with international standards.** The Unified Text

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<sup>25</sup> The MICI is responsible for supervision of finance companies, money remitters and exchanges, export-processing free-zone companies, real estate developers and intermediaries, and pawnshops.

of the Drug law provides complete authority for both direct and indirect proceeds of crime. The Penal Code as amended by Law 41 applies the sanctions of prison from 5 to 12 years and 100 to 200 days of imprisonment or the assigned value of a fine to money laundering cases. Forfeited assets for general money laundering cases go by law into the Special Fund for the Retired and Pensioned while the forfeited assets in drug cases go into a fund held by CONAPRED (National Commission for the Study and Prevention of Drug-Related Crimes). Since at this point most cases involving forfeiture are drug-related, most of the funds are at CONAPRED's disposal.

170. **The legal functions and powers of the UAF are generally adequate.** Presently, nearly all STRs received by UAF are passed to prosecutors, with a very low number of prosecutions and convictions for money laundering and financing of terrorism and an even lower number of cases arising from those STRs. **Additional resources (financial, human, and technological) are needed to strengthen the capacity of the UAF.** The Panamanian system's high reliance on threshold reporting also requires technological and analytical capacity that is not currently available to the UAF. A review is necessary to determine the need for an independent budgetary process, and the UAF needs to promote interagency coordination, training, and public outreach/awareness activities.

171. **Legal powers for law enforcement with regard to AML/CFT matters are generally adequate but resources are lacking.** There is a general need for financial resources, specialized training, and additional personnel, the lack of which inhibits full implementation of the law and results in a small number of prosecutions for money laundering offenses. This is the case, for example, with respect to the specialized financial intelligence unit (UIF) investigates financial crimes within the Technical Judicial Police. Also, the budget for the prosecution should be reviewed to ensure sufficient resources are available to investigate and prosecute money laundering and related offenses. **Some capacity building and institutionalized training is needed on AML/CFT freezing, seizing, and forfeiture issues.** Further, the authorities should ensure that they are able to enforce other countries' forfeiture orders as they relate to assets in Panama.

172. **The courts should also have an appropriate case database** for improved transparency on financial crime cases as well as to permit the coordination of case data with other relevant government agencies (e.g., UAF, Technical Judicial Police, prosecutors). Further, the judiciary should have access to forensic accounting experts to support judges in complicated financial crime cases. This would ensure that cases are handled fairly and without delay.

### *Preventive Measures—Financial Institutions*

173. **The law requires financial institutions to report suspicious transactions to the UAF** regardless of the amount and to file (through their respective supervisory authority) reports for any currency and cash-like instruments transaction in excess of \$10,000. It also establishes the requirements for customer identification and due diligence, internal control systems to be in place within the reporting institutions, record retention requirements, administrative sanctions, and penalties for noncompliance. Under Executive Decree No. 1,

2001, all supervision and control authorities have ample powers to enforce and ensure compliance with the requirements of Law 42-2000.

174. **The SdB and the CNV have developed and implemented sound and effective mechanisms to ensure that their institutions comply with the requirements of the law and regulations.** The Autonomous Panamanian Cooperatives Institute (IPACOOOP) is developing similar AML/CFT supervisory programs with the assistance of the SdB. However, deficiencies were identified in the Superintendency of Insurance and Re-Insurance (SSRP), the MICI, and the Banco Hipotecario Nacional (BHN—the supervisor of savings and credit institutions). These deficiencies included lack of AML/CFT supervision, weak internal controls and compliance systems, and minimal AML/CFT training for authorities and institutions alike.

*Preventive Measures—Designated Nonfinancial Businesses and Professions*

175. **The DNFBPs subject to AML/CFT obligations are trust service providers, casinos, and real estate intermediaries that are legal persons.** Trust service providers are supervised by the SdB and are subject to the same AML/CFT requirements and supervision as financial institutions; however, the fact that some trust service providers are subsidiaries of law firms presents practical problems for the effective reporting of suspicious transactions. Gaming and real estate businesses have specific regulatory requirements which include the identification of customers and reporting of suspicious transactions, but the enforceability of anything other than filing CTRs is unclear.

176. **Other businesses subject to filing cash-transaction reports are pawnshops and companies in the Free Trade Zones.** Dealers in precious metals and stones are not subject to any AML/CFT regulations as such, but many of the larger transactions are completed by wholesale jewelers located in the Free Trade Zone, which makes them subject by default to the free zone's CTR requirements.

177. **Government oversight of DNFBPs is not conducive to effective compliance.** Detection and reporting of suspicious transactions by DNFBPs have been minimal or nonexistent, while hundreds of reports are sent simply to comply with the formalistic obligation to inform that no cash transaction has occurred during the reporting period. Little guidance exists to address the special nature of risks relevant to the different sectors. Especially in the case of the MICI, the personnel available for inspections are scarce and require better training and prioritization based on the level of risk posed by each industry and each institution.<sup>26</sup>

178. **The Gaming Control Board has ample legal powers to regulate and supervise casinos, but its independence and expertise are negatively affected** by a drain of personnel recruited by the regulated institutions and by the high turnover of

<sup>26</sup> The MICI is responsible for regulating and supervising AML/CFT compliance for a very large number of DNFBPs in different industries including real estate, pawnshops, and processing free zones in addition to financial services such as finance companies, leasing, factoring, and money remittance.

auditors/inspectors every time there is a change in government. The background check of applicants for a casino license is weak in practice as it is based almost exclusively on information provided by the UAF. The regulations prohibit owners and managers from gambling in their own facilities as a mechanism to avoid abuse within the industry; but there is little evidence of effective supervision and sanctioning for noncompliance with this and the other AML/CFT regulations enacted by the Gaming Board. Yet to be addressed are the risks derived from money services, such as the exchange of currency, wire-transfer of money, and payment of winnings by check.

179. **The authorities have initiated attempts to deal with the special risks present at the Free Trade Zone,** such as the opportunity that it presents for cash smuggling and trade-based money laundering schemes. The law requires all merchants of the ZLC to report transactions above \$10,000 in cash, and other regulations require them to report suspicious transactions.<sup>27</sup> However, most companies are not aware of what makes a transaction in their particular business suspicious, and many ZLC exporters do not appear to pay attention to potential illicit sources of payments. The Administration ZLC must strengthen its audit procedures, increase the number of inspections and cooperate closely with the UAF and Customs in order to determine risk indicators to target its oversight activities. It also needs to acquire adequate technology, as even the basic issuance of importation and re-exportation documents is still done without computerized tools.

180. **Lawyers are not covered by STR, customer due diligence, or record-keeping obligations.** They provide a wide range of offshore corporate structuring services in which bearer-share corporations and personal interest foundations are used. Common features are pre-established dormant shelf corporations, nominee directors, mail forwarding services, and resident agent services, among others. All companies must have a resident agent who is a lawyer. This agent is obliged to disclose the identity of his customers only upon requests from judicial authorities in the course of narcotics-related investigations.

181. **Some banks report that they have difficulties in adequately identifying the beneficial owner of accounts where law firms represent or introduce foreign clients.** Some lawyers in turn consider that it is not their responsibility to identify their ultimate customer when they deal with counterparts such as foreign law firms acting on behalf of a client abroad. The current provisions make banks directly responsible for carrying out their identification obligations, regardless of whether the customer has been introduced by a third party. However, the special difficulties that banks have in identifying foreign clients represented by local law firms have yet to be specifically addressed.

182. **In order to comply with the FATF Recommendations, lawyers, accountants, and company service providers in general should be subject to AML/CFT regulation and compliance oversight.** Customer due diligence, record-keeping and reporting of suspicious transactions should be required of all professionals who provide services covered by the FATF Recommendations such as buying and selling real estate; organization of contributions

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<sup>27</sup> The additional obligations imposed by regulation have not been enforced and seem to be, in fact, not enforceable for the same reasons explained with respect to DNFBPs (lack of legal basis).

for the creation, operation or management of companies; creation, operation or management of legal persons or arrangements, and buying and selling of business entities.

### *Legal Persons and Arrangements and Nonprofit Organizations*

183. **Trust service providers (fiduciary companies) are subject to the same AML/CFT requirements established for financial institutions, and they are under the supervision of the SdB.** However, 7 of the 57 licensed fiduciary companies are subsidiaries of law firms that are not subject to the same obligations. Given that legal and fiduciary services are part of a package offered to customers, it is difficult for these fiduciary companies to report any suspicious transaction involving a customer to whom their affiliated law firm owes a duty of confidentiality. It is also unclear to what extent the SdB can have access to all the necessary records of a fiduciary customer when relevant information is derived from the legal services provided by the affiliated law firm.

184. **All companies, including bearer share corporations, are subject to the same incorporation requirements.** Such requirements include the obligation to have a resident agent and to be registered in the Public Registry. This registry keeps public records of the articles of incorporation, the identity and address of directors and officers as of the time of incorporation (update is not mandatory), and current details of the registered agent. However, the registry does not include ownership information of all companies, especially of bearer share corporations.

185. **Nonprofit organizations (NPOs) including private interest foundations which provide a common vehicle for the creation of offshore legal structures are** subject to incorporation requirements similar to those of corporations, including registration in the Public Registry. NPOs must obtain an additional authorization from the Ministry of Government and Justice, which does not supervise this sector. The ministry has begun to create a database of NPOs in order to know their number, purpose and activities; assess their potential for misuse; update the regulatory framework; and create the oversight mechanism which is currently lacking.

### *National and International Cooperation*

186. **There is cooperation both formal and informal between the various agencies of the government** involved in the fight against money laundering and financing of terrorism, though in some cases, communication could be strengthened, made more uniform and on a regular basis. Only CONAPRED has regular meetings on illegal drug issues with public and private sector representatives. The recently established High Level Presidential Commission is intended to provide national policy guidance on AML/CFT matters.

187. **The government has a very good level of international cooperation** through adoption of international conventions, numerous mutual legal assistance treaties, and a good record regarding extraditions, as well as between the UAF, the police, and their counterparts in other countries through formal and informal means. However, the formal level of international cooperation could be enhanced by establishing asset-sharing agreements with international counterparts through which Panama could both receive and retain funds/assets

for the use of law enforcement and judicial agencies. As noted previously, Panama should ensure that it can enforce other countries' forfeiture orders.

## Recommendations

Table 4. Recommended Action Plan in Relation to the FATF Recommendations

<b>FATF 40+9</b>	<b>Recommended Action</b>
<b>1. Legal System and Related Institutional Measures</b>	
Criminalization of Money Laundering (R.1 & 2)	<ul style="list-style-type: none"> <li>• Amend Article 389 to criminalize all money laundering predicate offenses as required by the Vienna and Palermo Conventions.</li> <li>• Address the differing treatment for the conspiracy offense that depends on whether or not the offense is drug-related (treatment should be consistent).</li> <li>• Implement the UN Convention against Corruption following the National Assembly's approval May 10, 2005.</li> </ul>
Criminalization of Terrorist Financing (SR.II)	<ul style="list-style-type: none"> <li>• Expand predicate list to include financing of terrorism for the AML Law.</li> </ul>
Confiscation, freezing and seizing of proceeds of crime (R.3)	<ul style="list-style-type: none"> <li>• Amend legislation to permit the investigating authority to freeze and seize in all criminal cases to conform to Palermo Convention.</li> <li>• Amend legislation to permit forfeiture of assets of criminals without necessarily showing nexus to a particular crime.</li> <li>• Establish/improve systems to hold and maintain seized assets pending forfeiture orders to reduce the potential for improper use or the appearance regarding maintenance of assets which have not been determined to belong to the government.</li> </ul>
Freezing of funds used for terrorist financing (SR.III)	<ul style="list-style-type: none"> <li>• Expand predicate list to include financing of terrorism for the AML Law in order that prosecutors gain freeze and seize authority under the Unified Text on Drug Laws to this offense.</li> </ul>
The Financial Intelligence Unit and its functions (R.26, 30 & 32)	<ul style="list-style-type: none"> <li>• Review funding arrangements for UAF.</li> <li>• Strengthen protection of the information reported to UAF to maximize the secured electronic receipt and dissemination.</li> <li>• UAF undertake more outreach and awareness-raising to government agencies, UAF reporting entities, and the public.</li> </ul>
Law enforcement, prosecution and other competent authorities (R.27, 28, 30 & 32)	<ul style="list-style-type: none"> <li>• Review staffing levels and training requirements with a view to increasing capacity for investigations and prosecutions. Consider whether special courts should be created for financial crimes. Review the dependence on a general budget allotment to ensure proper distribution of funds for enforcement purposes.</li> <li>• Develop training for judicial authorities, prosecutors, financial police, and UAF staff to undertake the investigation of financial crime (e.g., fraud, corruption), protection of informants, investigative skills, and use of typologies.</li> <li>• Develop a process for the courts to independently obtain expert forensic and accounting assistance on complicated financial matters related to financial crimes and money laundering.</li> <li>• Develop secure data base systems for investigative agencies and the courts.</li> <li>• Develop process of coordination of government statistics so that AML/CFT data can be interpreted across agencies.</li> <li>• Carry out more frequent coordination meetings among relevant government enforcement agencies to exchange ideas and report policy recommendations to the High Level Commission.</li> </ul>
Cash couriers (SR IX)	<ul style="list-style-type: none"> <li>• Require the declaration in all circumstances for currency that is mailed,</li> </ul>

<b>FATF 40+9</b>	<b>Recommended Action</b>
	<p>transported or shipped by any means of transportation.</p> <ul style="list-style-type: none"> <li>• Consider a more systematic approach for spot checking containers for smuggled currency.</li> <li>• Make better use of the current investigative powers of Customs, in cooperation with the UAF.</li> </ul>
<b>2. Preventive Measures–Financial Institutions</b>	
Customer due diligence, including enhanced or reduced measures (R.5 to 8)	<ul style="list-style-type: none"> <li>• SSRP and BHN should take measures to put in place and implement requirements for customer identification and due diligence in the insurance and savings and credit institution sectors.</li> </ul>
Third parties and introduced business (R.9)	<ul style="list-style-type: none"> <li>• Supervisory authorities should issue guidance that considers customer due diligence measures performed by third parties or introducers in line with the essential elements of R.9.</li> </ul>
Record keeping and wire transfer rules (R.10 & SR.VII)	<ul style="list-style-type: none"> <li>• Extend full record-keeping requirements to the insurance sector (including for insurance brokers and agents) and to the savings and credit institution sector.</li> </ul>
Monitoring of transactions and relationships (R.11 & 21)	<ul style="list-style-type: none"> <li>• Amend the AML law to impose monitoring obligation on insurance and savings and credit institutions.</li> </ul>
Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV)	<ul style="list-style-type: none"> <li>• Amend the law to extend coverage to reporting transactions related or linked to terrorism and require reporting by the insurance sector, and savings and credit institutions.</li> <li>• Supervisory/competent authorities should provide more feedback to reporting institutions by conducting forums, periodic meetings.</li> <li>• Supervisory/competent authorities should provide training to ensure greater awareness of obligations including when transactions do not take place.</li> </ul>
Internal controls, compliance, audit and foreign branches (R.15 & 22)	<p>The SSRP and the BHN should extend internal control requirements to insurance sector and savings and credit institutions including obligations for: (i) policies, procedures and practices to deter money laundering and financing of terrorism; (ii) customer identification and due diligence; (iii) appointment of a compliance officer; (iv) Independent audit and compliance program; (v) training programs; and (vi) codes of ethics and policies for recruitment.</p>
The supervisory and oversight system - competent authorities. Role, functions, duties and powers (including sanctions) (R. 17, 23, 25, 29, 30, & 32).	<ul style="list-style-type: none"> <li>• Amend Law 42-2000 to extend AML/CFT obligations and sanctions authority to the BHN.</li> <li>• SSRP and BHN should develop supervisory capabilities to better evaluate internal controls, risk management, board oversight and involvement, and compliance with laws and regulations.</li> <li>• SSRP, BHN, and MICI should develop inspection programs to ensure that higher risk institutions and activities receive timely and effective supervision.</li> <li>• Ensure that the SSRP and BHN introduce formal licensing requirements and procedures, including fit and proper tests of owners and senior managers.</li> <li>• Supervisory/competent authorities should issue guidance on AML/CFT obligations for regulated entities and ensure that there are mechanisms for providing feedback on effectiveness consistent with Recommendation 25.</li> <li>• Ensure SSRP, BHN, MICI are adequately resourced (including human, financial, and technical skills) to effectively supervise consistent with Recommendation 30 all of the entities that they are responsible for.</li> <li>• Competent authorities need to create processes for collecting and sharing statistical information on the effectiveness and efficiency of the AML/CFT regime consistent with Recommendation 32.</li> </ul>
Money value transfer	<ul style="list-style-type: none"> <li>• Ensure that MICI is adequately resourced to supervise remittance and exchange</li> </ul>

<b>FATF 40+9</b>	<b>Recommended Action</b>
services (SR.VI)	houses. <ul style="list-style-type: none"> <li>Consider adjusting the threshold amount for filing currency transaction reports to provide the UAF with useful information for the detection of structured transactions in the remittance area.</li> </ul>
<b>3. Preventive Measures–Nonfinancial Businesses and Professions</b>	
Customer due diligence and record-keeping (R.12)	<ul style="list-style-type: none"> <li>Extend customer due diligence and recordkeeping obligation to lawyers, accountants, and dealers in precious metals and stones.</li> <li>Provide guidance to DNFBPs for customer due diligence that considers the specific risks from money laundering.</li> <li>Review the legal framework for DNFBPs to ensure regulations are supported by clear legal powers.</li> </ul>
Monitoring of transactions and relationships (R.12 & 16)	<ul style="list-style-type: none"> <li>Extend monitoring obligation to real estate agents and promoters for customers meeting FATF thresholds, and for both casinos and real estate agents, to monitor customer activity and to report any suspicious transaction to the UAF.</li> <li>Authorities should identify the risks that DNFBPs face according to their special nature and issue relevant guidance based on the risk presented. Different degrees of control may be warranted in different industries.</li> </ul>
Suspicious transaction reporting (R.16)	<ul style="list-style-type: none"> <li>Provide training to authorities and issue guidance to DNFBPs on the typologies of money laundering in their respective sectors. The AML/CFT regulations for real estate businesses merit review to make them sector specific, having regard to the different risks of real estate as opposed to that of financial institutions.</li> <li>Extend legal protection to DNFBPs from civil or criminal liability for reports made in good faith.</li> </ul>
Internal controls, compliance & audit (R.16)	<ul style="list-style-type: none"> <li>Clarify the obligation of when to file cash-threshold reports or suspicious transaction reports by regulated institutions.</li> <li>DNFBPs should be required to implement adequate internal controls (i.e., AML Programs) according to their specific activities.</li> </ul>
Regulation, supervision and monitoring (R.17, 24-25)	<ul style="list-style-type: none"> <li>MICI should implement an AML/CFT oversight program that allocates resources based on money laundering risks within each sector. The program should include criteria for monitoring (off-site surveillance) and inspections.</li> <li>The auditors of MICI should receive training on AML/CFT issues targeting in order to be able to identify areas of priority.</li> <li>Ensure greater stability and independence of personnel of the Gaming Board, and update the regulations and inspection procedures to prevent the misuse of casinos by their own owners or operators.</li> </ul>
Other designated nonfinancial businesses and professions (R.20)	<ul style="list-style-type: none"> <li>Strengthen enforcement of preventive requirements for Free-Trade Zone merchants, especially in higher risk areas. Better auditing capabilities and training for the administrator in the ZLC are needed, as well as close cooperation with the UAF and with Customs.</li> <li>Free Trade Zone merchants need training and awareness of the modalities by which their businesses could be misused for money laundering, in order to foster compliance with the obligation to report suspicious transactions.</li> <li>MICI should ensure that the Directorate of Finance Companies (Empresas Financieras) has adequate resources and training.</li> </ul> <p>Regulation and oversight of pawn shops needs to be targeted according to its identified risks to better prioritize the scarce resources available to the MICI.</p>
<b>4. Legal Persons and Arrangements &amp; Nonprofit Organizations</b>	
Legal Persons–Access to beneficial ownership and control information (R.33)	<ul style="list-style-type: none"> <li>To the extent that lawyers are involved in the financial activities or nonfinancial activities described under the FATF recommendations, these activities should be regulated and supervised.</li> </ul>
Legal Arrangements–	<ul style="list-style-type: none"> <li>Company incorporation and related services should be subject to AML/CFT</li> </ul>

<b>FATF 40+9</b>	<b>Recommended Action</b>
Access to beneficial ownership and control information (R.34)	reporting obligations, to avoid the negative incentive that trust companies owned by law firms do not have to report suspicious transactions.
Nonprofit organizations (SR.VIII)	<ul style="list-style-type: none"> <li>• The Ministry of Government and Justice should create a registry (inventory) for NPOs, and undertake a risk assessment of the NPO sector. Depending on the result, an updating of the regulatory framework to include AML regulations and other oversight may be appropriate.</li> </ul>
<b>5. National and International Cooperation</b>	
National cooperation and coordination (R.31)	<ul style="list-style-type: none"> <li>• Ensure that the High Level Presidential Commission against money laundering and financing of terrorism is fully appointed and functioning.</li> <li>• Develop a coordinating government committee on AML/CFT matters, which assigns working groups to address specific issues, including sensitive internal matters.</li> <li>• Review overlaps between the authorities of the AML/CFT Commission and CONAPRED as to drug and nondrug-related money laundering.</li> <li>• Develop a working group within the coordinating committee for the review of the supervision or need for supervision of DNFbps.</li> <li>• Review the CONAPRED's use of the drug asset forfeiture fund to determine whether current monies could be more promptly and effectively spent.</li> <li>• Determine whether CONAPRED could benefit from lower level task forces to improve coordination of law enforcement efforts in drug-related money laundering cases.</li> </ul>
The Conventions and UN Special Resolutions (R.35 & SR.I)	<ul style="list-style-type: none"> <li>• Review newly-ratified financing of terrorism convention to determine which of its provisions need national enabling legislation for effective implementation.</li> <li>• Amend Penal Code to add additional predicate act offenses, including financing of terrorism.</li> </ul>
Mutual Legal Assistance (R.32, 36-38, SR.V)	<ul style="list-style-type: none"> <li>• Review dual criminality principle to determine whether Panama might render mutual legal assistance in cases where Panama would normally reject the request for mutual legal assistance due to the lack of dual-criminality. Consider eliminating the requirement of dual criminality.</li> <li>• Review the policy that noncriminal forfeiture orders will not be recognized or enforced.</li> </ul>
Extradition (R.32, 37 & 39, & SR.V)	<ul style="list-style-type: none"> <li>• Review the statutory authority regarding the requirement of dual criminality to determine whether Panama might render mutual legal assistance.</li> </ul>
Other Forms of Cooperation (R.32 & 40, & SR.V)	<ul style="list-style-type: none"> <li>• Ensure that all of the statistics required by R.32 are collected and maintained.</li> </ul>

### **Authorities' Response**

For the Government of Panama, under the leadership of His Excellency, President Martin Torrijos Espino, to be at the forefront in efforts to prevent money laundering and terrorist financing in our region is a priority.

As such, the evaluation of Panama's AML/CFT regime was dealt with as a State matter and developed on the basis of an inter-institutional effort that involved the management and staff of the following institutions: the National Securities Commission (CNV); the Customs Department (DGA); the Autonomous Panamanian Cooperatives Institute (IPACOO); the Gaming and Control Board (JCJ); the National Lottery (LNB); the Ministry of Industry and Commerce (MICI); the Ministry of Government and Justice; the Ministry of Foreign Affairs;

the Judicial Branch; the Panamanian National Police (PNP); the Attorney General; the Superintendency of Banks (SdB); the Superintendency of Insurance and Re-insurance of Panama (SSRP); the Financial Analysis Unit (UAF); and the Administration of the Colón Free Trade Zone.

The work and unquestionable commitment of these institutions facilitated the organization of their tasks and the work of the assessors. These tasks were undertaken in harmonious collaboration since all the involved sectors agreed that only a thorough and independent assessment of our regime could produce the necessary recommendations to further protect our economy from the serious threats that money laundering and the financing of terrorism are posing for the financial systems in the world.

Panama has been known for being a model country with respect to regulation and implementation of measures designed to prevent money laundering and terrorist financing risks, and this is a responsibility that we take very seriously. We have achieved continuous and consistent progress, although we still have a long way to go. Nevertheless, we appreciate the fact that we are not alone in this effort. The support that we receive from neighboring countries, international organizations, and cooperating nations is an important incentive to continue our fight against these crimes.

It is important to mention that since the assessment visit, several actions have been taken with the objective of implementing the recommendations provided in the assessment report, even before the report is approved by the Caribbean Financial Action Task Force. Among the corrective actions taken, we would like to highlight the following:

- The Financial Analysis Unit and the Superintendency of Banks will provide training and will collaborate in the development of supervisory programs for the savings and credit institutions.
- The National Securities Commission, the Superintendency of Banks, and the Superintendency of Insurance and Re-insurance signed an inter-institutional cooperation agreement.
- A Tripartite Coordination Commission (the Financial Analysis Unit, the Public Ministry, and the Judicial Branch) was created to address the systemic division of responsibilities among these institutions.
- Training seminars by and feedback from the Financial Analysis Unit have been delivered to supervision and control agencies such as the Administration of the Colón Free Trade Zone and the National Securities Commission. Many others are currently scheduled to take place in the near to medium-term.
- The risk analysis unit within the Customs Department will become operational on or around December 2006.
- A specialized AML/CFT department was established within the Administration of the Colón Free Trade Zone. This department has been adequately staffed and is currently

conducting AML/CFT on-site inspections, including imposing sanctions and collecting fines for noncompliance.

- The legislation governing pawnshops was approved in May 2005. The Directorate of the Ministry of Industries and Commerce has received a total of 83 applications for pawnshop licenses. At the same time, and in partnership with the Financial Analysis Unit, a currency transaction report was developed. We anticipate delivering AML/CFT training to these new reporting entities during the month of November 2006.
- Modifications to the regulation that governs the accounting profession are currently undergoing their first debate at the National Assembly.
- We have taken the necessary measures as a result of the assessment to revise and update the different reports and templates currently used by the reporting entities and the Financial Analysis Unit.

Based on the aforementioned observations, we agree with the assessors' conclusions and we think the assessment report fairly reflects the actual situation of Panama's AML/CFT regime.