

**BANCO GENERAL, S. A.
AND SUBSIDIARIES**
(Panama, Republic of Panama)

Consolidated Financial Statements

December 31, 2017

(With Independent Auditors' Report)

"This document has been prepared with the
knowledge that its contents shall be made
available to the investing and general public"

(FREE ENGLISH LANGUAGE TRANSLATION
FROM THE SPANISH VERSION)

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Table of Contents

Independent Auditors' Report

Consolidated Statement of Financial Position
Consolidated Statement of Income
Consolidated Statement of Comprehensive Income
Consolidated Statement of Changes in Equity
Consolidated Statement of Cash Flows
Notes to Consolidated Financial Statements



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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders
Banco General, S. A.

Opinion

We have audited the consolidated financial statements of Banco General, S. A. and subsidiaries ("the Bank"), which comprise the consolidated statement of financial position as of December 31, 2017, the consolidated statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Bank as of December 31, 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are described further in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in the Republic of Panama. We have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Allowance for Loan Losses

See Notes 3(h), 7 and 30 to the consolidated financial statements

Key audit matter

How the key matter was addressed in our audit

The allowance for loan losses is considered as one of the most significant matters because it requires management to make judgments and subjective assumptions. The loan portfolio's gross balance represents 65% of the Bank's total assets. The allowance for loan losses is comprised of allowances for individually assessed loans and collectively assessed loans.

The individual impairment allowance is determined by assessing exposures on a case-by-case basis, considering judgments and estimates made by management when an impairment event has occurred and when the present value of expected future cash flows is uncertain. This constitutes a challenge from an audit perspective with respect to loans, because calculation of forecasted or expected future cash flows include estimates of time and cash flows that derive from the future sale of assets pledged as collateral on loans.

The collective impairment allowance is determined by grouping together loans with similar credit risk characteristics. Estimates of probability of default and loss given default are applied on these homogeneous groups of loans to establish the collective allowance. This is a challenge from an audit perspective due to the use of complex models and the judgments made by management for this calculation.

Our audit procedures included:

- Testing the operating effectiveness of the controls relating to the calculation of delinquency on payments, internal credit risk rating of clients, risk assessment of loans, and methodologies and models used.
- Testing a sample of corporate and commercial loans with individual allowance, loans included in watch-list, and those that present a change in credit risk rating with respect to the previous year, which consisted of examining clients' loan files and reviewing the assessment of the estimated allowance made by risk officers.
- For the individual impairment allowance model, assessed the reasonableness of the cash flows, including the value of collateral determined by experts and clients' contractual payments.
- Testing the credit risk grade for corporate loans and the delinquency profile for the different consumer loan types.
- Assessment by our specialists of the collective impairment allowance models and re-performed calculations of this allowance. In addition, we tested the country risk allowance model and assessed related inputs.
- Assessment of management's judgments and related assumptions made on current economic conditions and credit conditions that, based on our experience and industry knowledge, could possibly change the level of actual historic inherent loss.

Valuation of Investments

See Notes 3(b), 6 and 30 to the consolidated financial statements

Key audit matter

How the key matter was addressed in our audit

As of December 31, 2017, securities at fair value through profit or loss and available-for-sale represent 25% of total assets. The Bank uses external service organizations that provide pricing for most of these investments, and uses internal valuation methodologies for those securities for which pricing is not provided by external service organizations.

The internal valuation models for these investments involve judgments made by management and the use of some inputs that are not readily available in active markets. Furthermore, the valuation of investments, for which prices are provided by an external service organization, require additional effort from auditors to assert the reasonableness of their valuation.

Judgments made over estimates of fair value of an investment, when it includes some unobservable inputs (i.e. investments categorized as Level 3 in the fair value hierarchy), are significant. As of December 31, 2017, the investments categorized as level 3 represent 26% of total investments measured at fair value and 6% of total assets.

Our audit procedures included:

- Testing the operating effectiveness of the key controls within the processes of identification, measurement, and valuation risk management; and assessment of methodologies, inputs, and assumptions made by the Bank over the fair values.
- Testing the valuation of instruments categorized as level 1, by comparing the fair values established by the Bank against public and observable market inputs.
- Assessment of fair value models and inputs used in the valuation of Level 2 instruments; by comparing observable market inputs against independent sources and readily available external market data.
- Testing a sample of investments with significant unobservable valuation inputs (Level 3), which consisted of assessing the internal valuation models approved by the Bank's Corporate Governance and re-performing calculations of prices used for valuation of these investments.
- Obtaining Type 2 reports (ISAE 3402), which contain an independent opinion on the internal controls implemented by the service organization that provide prices used for the valuation of the investment portfolio. We also, assessed the complementary user controls applied by the Bank, indicated in these reports.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient and appropriate evidence related to the financial information of the entities and business activities within the Bank to express an opinion about the consolidated financial statements. We are responsible for the direction, supervision and execution of the group audit. We are solely responsible for the auditors' report.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provided to those charged with corporate governance a declaration of compliance with the relevant ethical requirements regarding independence and we communicated all relations and other matters that we consider could reasonably affect our independence and, when applicable, the appropriate safeguards.

Among the matters that have been communicated to those charged with corporate governance, we determined the ones that have been the most significant throughout the audit of the consolidated financial statements during the current period and are, consequently, the key audit matters. We have described these matters in the auditor's report except if legal dispositions or requirements prohibit the public disclosure of the matter, or in extreme rare circumstances, we determine the matter should not be communicated in our report because we could reasonably expect the adverse consequences of doing so outweigh the benefits of public interest of such communication.

The partner in charge of the audit who has prepared this independent auditor's report is Ricardo A. Carvajal V.

KPMG (SIGNED)

Panama, Republic of Panama
January 30, 2018

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Consolidated Statement of Financial Position

December 31, 2017

(Expressed in Balboas)

<u>Assets</u>	<u>Note</u>	<u>2017</u>	<u>2016</u>
Cash and cash items		283,199,967	255,676,459
Deposits with banks:			
Local demand deposits		89,035,277	87,314,190
Foreign demand deposits		166,467,290	193,343,637
Local time deposits		212,659,475	200,405,275
Foreign time deposits		94,026,167	81,963,479
Total deposits with banks		562,188,209	563,026,581
Total cash, cash items and deposits with banks		845,388,176	818,703,040
Securities and other financial assets at fair value through profit or loss	6	1,160,244,285	1,039,742,841
Securities and other financial assets available for sale	6	3,204,556,748	2,964,842,191
Securities held to maturity, net	6	49,982,822	59,368,381
Total investment securities and other financial assets, net		4,414,783,855	4,063,953,413
Loans	7	11,506,060,752	10,769,010,278
Less:			
Allowance for loan losses		144,832,305	128,917,367
Unearned commissions		38,254,754	35,511,085
Loans, net		11,322,973,693	10,604,581,826
Investments in associates	8	22,075,753	18,590,561
Property, furniture, equipment and improvements, net of accumulated depreciation and amortization	9	223,200,152	195,541,895
Customer liabilities under acceptances		38,619,957	45,567,270
Securities and other financial assets sold pending settlement	10	350,981,692	365,660,394
Accrued interest receivable		67,637,536	58,571,608
Deferred tax assets	24	33,756,441	30,280,858
Goodwill and other intangible assets, net	11	61,725,358	64,342,750
Foreclosed assets, net	12	5,667,571	3,872,569
Other assets		185,111,764	146,157,317
Total assets		17,571,921,948	16,415,823,501

The consolidated statement of financial position should be read along with the accompanying notes which are an integral part of the consolidated financial statements.

<u>Liabilities and Equity</u>	<u>Note</u>	<u>2017</u>	<u>2016</u>
Liabilities:			
Deposits:			
Local:			
Demand		2,414,866,377	2,550,027,002
Savings		3,271,077,384	3,142,495,967
Time:			
Customers		5,267,297,518	4,878,846,812
Banks		91,071,301	97,362,194
Foreign:			
Demand		79,518,651	89,583,184
Savings		127,477,535	137,532,031
Time:			
Customers		207,118,320	176,838,514
Total deposits		<u>11,458,427,086</u>	<u>11,072,685,704</u>
Securities sold under repurchase agreements	13	45,814,600	273,299,978
Borrowings and debt securities issued	15	2,661,365,208	1,950,624,340
Perpetual bonds	16	217,680,000	217,680,000
Acceptances outstanding		38,619,957	45,567,270
Securities and other financial assets purchased pending settlement	10	405,771,013	490,615,466
Accrued interest payable		108,732,837	89,718,134
Liabilities from insurance operations	17	16,999,292	14,956,842
Deferred tax liabilities	24	3,539,569	3,594,249
Other liabilities	14	569,129,576	424,895,676
Total liabilities		<u>15,526,079,138</u>	<u>14,583,637,659</u>
Equity:	20		
Common shares		500,000,000	500,000,000
Legal reserve		179,461,247	177,719,221
Capital reserves		36,796,615	33,286,812
Retained earnings		1,329,584,948	1,121,179,809
Total equity		<u>2,045,842,810</u>	<u>1,832,185,842</u>
Commitments and contingencies	25		
Total liabilities and equity		<u>17,571,921,948</u>	<u>16,415,823,501</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Consolidated Statement of Income

For the year ended December 31, 2017

(Expressed in Balboas)

	<u>Note</u>	<u>2017</u>	<u>2016</u>
Interest and commission income:			
Interest:			
Loans		708,926,086	634,590,295
Deposits with banks		6,215,318	5,141,335
Securities and other financial assets		133,428,336	124,546,599
Commissions on loans		43,080,817	44,118,606
Total interest and commission income		<u>891,650,557</u>	<u>808,396,835</u>
Interest expenses:			
Deposits		208,227,386	189,332,041
Borrowings and debt securities issued		85,033,238	64,494,051
Total interest expenses		<u>293,260,624</u>	<u>253,826,092</u>
Net interest and commission income		<u>598,389,933</u>	<u>554,570,743</u>
Provision for loan losses, net	7	44,484,763	45,532,128
Provision for impairment of securities	6	940	36,293
Provision for foreclosed assets, net	12	539,001	752,600
Net interest and commission income, after provisions		<u>553,365,229</u>	<u>508,249,722</u>
Other income (expenses):			
Fees and other commissions	27	199,461,792	179,744,482
Insurance premiums, net		26,884,905	22,498,050
Gain on financial instruments, net	21	16,477,377	4,638,647
Other income, net	22	39,085,609	18,079,609
Commission expenses and other expenses	11	(77,757,769)	(72,253,123)
Total other income, net		<u>204,151,914</u>	<u>152,707,665</u>
General and administrative expenses:			
Salaries and other employee expenses		165,674,924	157,090,553
Depreciation and amortization	9	22,214,444	18,961,057
Premises and equipment expenses		23,925,449	18,743,571
Other expenses		68,584,418	60,100,437
Total general and administrative expenses		<u>280,399,235</u>	<u>254,895,618</u>
Operational net income		<u>477,117,908</u>	<u>406,061,769</u>
Equity participation in associates	8	8,569,626	8,040,022
Net income before income tax		<u>485,687,534</u>	<u>414,101,791</u>
Income tax, net	24	55,941,007	48,713,736
Net income		<u><u>429,746,527</u></u>	<u><u>365,388,055</u></u>

The consolidated statement of income should be read along with the accompanying notes which are an integral part of the consolidated financial statements.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Consolidated Statement of Comprehensive Income

For the year ended December 31, 2017

(Expressed in Balboas)

	<u>Note</u>	<u>2017</u>	<u>2016</u>
Net income		<u>429,746,527</u>	<u>365,388,055</u>
Other comprehensive income (expense)			
Items that are or may be reclassified to profit or loss:			
Valuation of securities and other financial assets:			
Change in fair value of securities available for sale		3,344,161	56,521,380
Transfer to profit or loss for sales of securities available for sale		842,722	787,858
Change in fair value of hedging instruments	28	<u>(677,080)</u>	<u>682,173</u>
Other comprehensive income, net		<u>3,509,803</u>	<u>57,991,411</u>
Total comprehensive income		<u><u>433,256,330</u></u>	<u><u>423,379,466</u></u>

The consolidated statement of comprehensive income should be read along with the accompanying notes which are an integral part of the consolidated financial statements.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Consolidated Statement of Changes in Equity

For the year ended December 31, 2017

(Expressed in Balboas)

	Common shares	Legal reserve	Capital reserves			Total capital reserves	Retained earnings	Total equity
			Insurance reserve	Valuation of securities and other financial assets	Valuation of hedging instruments			
Balance as of December 31, 2015	500,000,000	157,231,585	1,000,000	(25,699,506)	(5,093)	(24,704,599)	988,541,512	1,621,068,498
Net income	0	0	0	0	0	0	365,388,055	365,388,055
Other comprehensive income								
Items that are or may be reclassified to profit or loss:								
Valuation of securities and other financial assets:								
Changes in fair value of securities available for sale	0	0	0	56,521,380	0	56,521,380	0	56,521,380
Transfer to profit or loss for sales of securities available for sale	0	0	0	787,858	0	787,858	0	787,858
Changes in fair value of hedging instruments	0	0	0	0	682,173	682,173	0	682,173
Total other comprehensive income, net	0	0	0	57,309,238	682,173	57,991,411	0	57,991,411
Total comprehensive income	0	0	0	57,309,238	682,173	57,991,411	365,388,055	423,379,466
Transactions with owner:								
Dividends paid on common shares	0	0	0	0	0	0	(210,963,500)	(210,963,500)
Complementary tax	0	0	0	0	0	0	(1,298,622)	(1,298,622)
Transfer from retained earnings	0	20,487,636	0	0	0	0	(20,487,636)	0
Total transactions with owner	0	20,487,636	0	0	0	0	(232,749,758)	(212,262,122)
Balance as of December 31, 2016	500,000,000	177,719,221	1,000,000	31,609,732	677,080	33,286,812	1,121,179,809	1,832,185,842
Net income	0	0	0	0	0	0	429,746,527	429,746,527
Other comprehensive income (expense)								
Items that are or may be reclassified to profit or loss:								
Valuation of securities and other financial assets:								
Changes in fair value of securities available for sale	0	0	0	3,344,161	0	3,344,161	0	3,344,161
Transfer to profit or loss for sales of securities available for sale	0	0	0	842,722	0	842,722	0	842,722
Changes in fair value of hedging instruments	0	0	0	0	(677,080)	(677,080)	0	(677,080)
Total other comprehensive (expense) income, net	0	0	0	4,186,883	(677,080)	3,509,803	0	3,509,803
Total comprehensive income	0	0	0	4,186,883	(677,080)	3,509,803	429,746,527	433,256,330
Transactions with owner:								
Dividends paid on common shares	0	0	0	0	0	0	(220,000,074)	(220,000,074)
Complementary tax	0	0	0	0	0	0	400,712	400,712
Transfer from retained earnings	0	1,742,026	0	0	0	0	(1,742,026)	0
Total transactions with owner	0	1,742,026	0	0	0	0	(221,341,388)	(219,599,362)
Balance as of December 31, 2017	500,000,000	179,461,247	1,000,000	35,796,615	0	36,796,615	1,329,584,948	2,045,842,810

The consolidated statement of changes in equity should be read along with the accompanying notes which are an integral part of the consolidated financial statements.

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Consolidated Statement of Cash Flows

For the year ended December 31, 2017

(Expressed in Balboas)

	<u>Note</u>	<u>2017</u>	<u>2016</u>
Operating activities:			
Net income		429,746,527	365,388,055
Adjustments to reconcile net income to net cash provided from operation activities:			
Provision for loan losses, net	7	44,484,763	45,532,128
Provision for impairment of securities	6	940	36,293
Provision for impairment of foreclosed assets, net	12	539,001	752,600
(Gain) loss unrealized on securities and other financial assets	21	(22,024,053)	2,034,700
Loss (gain) unrealized on derivative instruments	21	4,700,900	(63,870)
Gain on sale of securities and other financial assets fair value	21	(4,102,716)	(2,080,699)
Loss on sale of securities and other financial assets available for sale	21	1,029,905	3,120,056
Loss (gain) realized on derivative instruments	21	3,918,587	(7,648,834)
Foreign exchange fluctuations, net	22	5,791,607	(3,358,032)
Gain on sale of fixed assets, net	22	(18,374,575)	(113,387)
Deferred income tax	24	(3,530,263)	(4,747,269)
Depreciation and amortization	9	22,214,444	18,961,057
Amortization of intangible assets	11	2,617,392	2,617,387
Equity participation in associates	8	(8,569,626)	(8,040,022)
Interest income		(848,569,740)	(764,278,229)
Interest expense		293,260,624	253,826,092
Changes in operating assets and liabilities:			
Time deposits with banks		(10,288,606)	(10,907,981)
Securities and other financial assets at fair value through profit or loss		(101,412,361)	(110,601,530)
Loans		(765,620,299)	(1,045,675,633)
Unearned commissions		2,743,669	3,419,717
Tax credit from preferential interest loans	7	(36,228,726)	(33,760,531)
Other assets		11,824,343	(74,341,236)
Demand deposits		(145,225,158)	187,903,870
Savings accounts		118,526,921	165,143,925
Time deposits		412,439,619	399,114,299
Liabilities under insurance operations		2,042,450	988,604
Other liabilities		53,569,415	241,818,689
Cash provided by operating activities:			
Interest received		839,503,812	760,271,794
Interest paid		(274,245,921)	(242,238,318)
Dividends received	22	2,424,611	1,937,451
Total		<u>(416,559,041)</u>	<u>(220,376,909)</u>
Cash flows from operating activities		<u>13,187,486</u>	<u>145,011,146</u>
Investing activities:			
Purchases of securities and other financial assets available for sale		(9,075,052,687)	(3,881,437,360)
Sale and redemptions of securities and other financial assets available for sale		8,845,061,043	3,678,566,760
Redemptions of securities held to maturity		9,384,619	10,971,030
Investments in associates		5,084,434	6,843,376
Sale of property, furniture, equipment and improvements		25,124,375	117,706
Purchases of property, furniture, equipment and improvements	9	(56,622,501)	(60,631,194)
Cash flows used in investing activities		<u>(247,020,717)</u>	<u>(245,569,682)</u>
Financing activities:			
Proceeds from borrowings and debt securities issued		1,538,668,863	892,134,724
Repayment and redemptions of bonds and other obligations		(835,924,967)	(534,462,608)
Securities sold under agreements to repurchase		(227,485,378)	35,293,629
Dividends paid on common shares		(220,000,074)	(210,963,500)
Complementary tax		(5,028,683)	(6,057,475)
Cash flows from financing activities		<u>250,229,761</u>	<u>175,944,770</u>
Net increase in cash and cash equivalents		16,396,530	75,386,234
Cash and cash equivalents at beginning of year		656,337,603	580,951,369
Cash and cash equivalents at end of year	5	<u>672,734,133</u>	<u>656,337,603</u>

The consolidated statement of cash flows should be read along with the accompanying notes which are an integral part of the consolidated financial statements.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

December 31, 2017

(Expressed in Balboas)

Index of Notes to the Consolidated Financial Statements:

- | | |
|---|---|
| 1. General Information | 17. Liabilities from Insurance Operations |
| 2. Basis of Preparation | 18. Concentration of Financial Assets and Liabilities |
| 3. Summary of Significant Accounting Policies | 19. Segment Information |
| 4. Balances and Transactions with Related Parties | 20. Equity |
| 5. Cash and Cash Equivalents | 21. Gain on Financial Instruments, Net |
| 6. Investment Securities and Other Financial Assets | 22. Other Income, Net |
| 7. Loans | 23. Personnel Benefits |
| 8. Investments in Associates | 24. Income Tax |
| 9. Property, Furniture, Equipment, and Improvements | 25. Commitments and Contingencies |
| 10. Securities and Other Financial Assets Sold and Purchased Pending Settlement | 26. Investment Entities and Separate Vehicles |
| 11. Goodwill and Intangible Assets, Net | 27. Structured Entities |
| 12. Foreclosed Assets, Net | 28. Derivative Financial Instruments |
| 13. Securities Sold Under Repurchase Agreements | 29. Fair Value of Financial Instruments |
| 14. Other Financial Liabilities at Fair Value | 30. Financial Instruments Risk Management |
| 15. Borrowings and debt securities issued | 31. Critical Accounting Estimates and Judgments in Applying Accounting Policies |
| 16. Perpetual Bonds | 32. Main Applicable Laws and Regulations |

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

December 31, 2017

(Expressed in Balboas)

(1) General Information

Banco General, S. A. was incorporated under the laws of the Republic of Panama in 1954 and started operations in 1955. The Bank operates under a general license granted by the Superintendence of Banks of Panama which allows it, to engage in the banking business both in Panama and abroad. Banco General, S. A. and its subsidiaries will be referred to collectively as “the Bank”.

The Bank provides a wide variety of financial services, mainly, corporate, mortgage and consumer banking, management of investments and pensions, retirement and severance funds.

The Bank has representation offices in Colombia, Mexico, El Salvador, Guatemala and Peru.

Grupo Financiero BG, S. A., a 60.12% (2016: 60.17%) owned subsidiary of Empresa General de Inversiones, S. A., owns 100% of the common shares issued and outstanding of Banco General, S. A.

Banco General, S. A. owns 100% of the following subsidiaries which form part of its consolidation:

- Finanzas Generales, S. A. and subsidiaries: finance leases, loans and factoring operations in Panama. Finanzas Generales, S. A. owns the following subsidiaries:
 - BG Trust, Inc.: trust management in Panama.
 - Vale General, S. A.: administration and marketing of pretax food and health related contributions in Panama.
- BG Investment Co., Inc.: securities brokerage, assets management and brokerage company in Panama.
- General de Seguros, S. A.: insurance and reinsurance in Panama.
- Overseas Capital Markets, Inc. and subsidiaries: holding company in the Cayman Islands. Overseas Capital Markets, Inc. owns the following subsidiaries:
 - Banco General (Overseas), Inc.: international banking business in the Cayman Islands.
 - Commercial Re. Overseas, Ltd.: international reinsurance in the British Virgin Islands.
- BG Valores, S. A.: securities brokerage, asset management and brokerage company in Panama.
- Banco General (Costa Rica), S. A.: Banking business in Costa Rica.
- ProFuturo Administradora de Fondos de Pensiones y Cesantía, S. A.: management of pension and retirement, severance and investment funds in Panama.

The Bank’s main office is located at Banco General Tower, Urbanization Marbella, Aquilino de la Guardia Avenue, Panama City, Republic of Panama.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

(2) Basis of Preparation

(a) Statement of Compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standard Board (IASB).

These consolidated financial statements were reviewed by the Audit Committee and authorized for issue by the Board of Directors on January 30, 2018.

(b) Basis of Measurement

The consolidated financial statements have been prepared on a historical cost basis except for the assets and liabilities at fair value, available-for-sale securities and derivative financial instruments, which are measured at fair value; and foreclosed assets, which are measured at the lower of their carrying value or fair value less costs to sell.

The Bank initially recognizes loans, account receivables and deposits on the date on which they originated. All other financial instruments (including assets designated at fair value through profit or loss) are recognized on the trade date, which is the date on which the Bank becomes a party to the contractual provisions of the instrument.

(c) Functional and Presentation Currency

The consolidated financial statements are expressed in balboas (B/.), the monetary unit of the Republic of Panama, which is at par and freely exchangeable with the United States dollar (US\$). The Republic of Panama does not issue its own paper currency and, in lieu, the dollar (\$) of the United States of America is used as legal tender and functional currency.

(3) Summary of Significant Accounting Policies

The Bank has consistently applied the accounting policies as set out below to all periods presented in these consolidated financial statements:

(a) Basis of Consolidation

- Subsidiaries

The Bank controls a subsidiary when it is exposed to, or has rights to, variable returns from its involvement with the subsidiary and has the ability to affect those returns through its control over the entity. The financial statements of subsidiaries mentioned in Note 1 are included in the consolidated financial statements from the date on which control commences until the date when control ceases.

- Investment Entities and Separate Vehicles

An investment entity and a separate vehicle is used when the Bank manages and administers assets held in trust and other investment vehicles as collateral on behalf of investors. The financial statements of these entities are not consolidated, except for when the Bank has control over the entity.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

- *Structured Entities*

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, for example, when any voting rights are related solely to administrative tasks, and key activities are directed by contractual agreement. In assessing whether the Bank has control over such entities in which it has an interest, the Bank considers factors such as the purpose and design of the entity; its practical ability to direct the relevant activities of the entity; the nature of its relationship with the entity; and the size of its exposure to the variability of returns of the entity. The financials statements of these entities are not consolidated, except when the Bank has control over the entity.

- *Investments in Associates*

An associate is an entity over which it has significant influence, but has no control or joint control, over its financial or operating policies. It is presumed that it has significant influence when it owns between 20% and 50% of the voting power within the entity.

Investments in associates are accounted for using the equity method. Under this method, such investments are initially recognized at cost, including transaction costs.

The consolidated financial statements include the Bank's share of the profit or loss and other comprehensive income of equity-accounted investees, after any adjustment to conform to the Bank's accounting policies, from the date it has significant influence until the date on which significant influence ceases.

The investor's share of losses of an equity-accounted investee is recognized only until the carrying amount of the Bank's equity interest in the investee is reduced to zero. After the investor's interest is reduced to zero, a liability is recognized only to the extent that the Bank has an obligation to fund the investee's operations or has made payments on behalf of the investee.

- *Balances and Transactions Eliminated in Consolidation*

The consolidated financial statements include the assets, liabilities, equity, income and expenses of Banco General, S. A. and subsidiaries detailed in note 1. Significant intercompany balances and transactions are eliminated.

- (b) *Fair Value Measurement*

Fair value is the price that would be received for selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price).

The evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (entry price).

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The fair value of an instrument is measured using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. If there is no quoted price in an active market, then the Bank uses valuation techniques that maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing the transaction.

The fair value of financial instruments is determined using quoted prices in active markets, several electronic information systems, custodians, market makers, prices from a third party pricing vendors, investment management companies and banks. In addition, in certain instances the fair value measurement is determined using valuation techniques, mainly discounted cash flows at the appropriate discount rate for that instrument. Equity securities whose fair value cannot be measure reliably are carried at cost.

(c) *Cash and Cash Equivalents*

For the purpose of the consolidated statement of cash flows, cash equivalents include demand deposits and time deposits with banks that have an original maturity of three months or less.

(d) *Securities Purchased Under Resale Agreements*

Securities purchased under resale agreements are short-term transactions guaranteed with securities, in which the Bank acquires the securities at a discounted market price and agrees to resell them at a future date at a specified price. The difference between the purchase price and the value of the future sale is recognized as income under the effective interest rate method.

Securities received as collateral are not recognized in the consolidated financial statements, except in case of default by the counterparty, which gives the Bank the right to keep the securities.

The market price of these securities is monitored on a daily basis and additional collateral is obtained, if necessary, to protect the Bank from credit risk exposure.

(e) *Investment Securities and Other Financial Assets*

Investment securities and other financial assets are classified at their trade date, and are initially measured at fair value plus, in the case of investment securities not recorded at fair value through profit or loss, direct transaction costs attributable to their acquisition. Subsequently they are recognized based on management's ability and intent to sell or to hold them until their maturity date. The categories used are detailed as follows:

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

- *Securities and Other Financial Assets at Fair Value through Profit or Loss:*
 - *Held for Trading Securities and Other Financial Assets*

This category includes those securities and other financial assets acquired for the purpose of generating a profit from short term fluctuations in the market value of the instrument. These securities and other financial assets are reported at their fair value and changes in fair value are recognized in the consolidated statement of income.
 - *Other Securities and Financial Assets at Fair Value*

This category includes those securities and other financial assets acquired with the intention of holding them for an undetermined period of time and for which a quoted price in an active market is available. These securities and other financial assets are measured at their fair value and changes in valuation are recognized in the consolidated statement of income.
- *Securities and Other Financial Assets Available for Sale*

This category includes the securities and other financial assets acquired with the intention of holding them for an undetermined period of time. These securities and other financial assets are measured at their fair value and changes in valuation are recognized in equity accounts.
- *Securities Held to Maturity*

Securities held to maturity are financial assets that the Bank has the intention and ability to hold until maturity. These securities consist mainly of debt instruments and are carried at their amortized cost.

Impairment of Investment Securities and Other Financial Assets

- *Securities Available for Sale*

Periodically, the Bank assesses whether there is objective evidence that its investment securities or other financial assets are impaired based on whether there has been a significant or prolonged decline in their fair value below their cost, downgrade in their risk rating below B+, default on payments or other contractual terms, bankruptcy, debt restructuring or similar events. If objective evidence of impairment exists for available-for-sale financial assets, the cumulative loss is removed from equity and recognized in the consolidated statement of income.

If, in a subsequent period, the fair value of investment securities and other financial assets classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss the impairment loss is reversed through the consolidated statement of income.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

- *Securities Held to Maturity*

The value of any security is reduced to its fair value for any material loss due to a non-temporary impairment, by establishing a specific allowance for securities against the results of operations of the year.

- (f) *Derivative Financial Instruments*

Derivatives are accounted for at fair value in the consolidated statement of financial position, with transaction costs recognized in profit or loss when incurred, and subsequently accounted as either fair value hedge or cash flow hedge, when held for risk management purposes, or as trading when the instrument does not qualify for hedge accounting.

- *Fair value hedge*

Derivative instruments accounted for using the fair value method are instruments that hedge the exposure to change in the fair value of: (a) assets or liabilities or an identified portion of the value of assets or liabilities recognized in the consolidated statement of financial position, or (b) a firm commitment or a forecasted transaction which is almost certain to occur. Changes in the value of these instruments using the fair value method are recognized in the consolidated statement of income.

For hedged assets classified as available for sale, changes in fair value are recognized in equity. Starting on the date an available-for-sale asset becomes a hedged item, changes in fair value are recognized in the consolidated statement of income and the revaluation balance which is accounted in equity, remains recorded until these assets are sold or redeemed.

A hedged asset or liability otherwise carried at amortized cost is adjusted by the change in fair value that is attributable to the changes in interest rates. Amortization for these hedged assets and liabilities should begin when they cease to be adjusted for changes in their fair value, based on a recalculated effective interest rate. If the hedged asset carried at amortized cost suffers a permanent impairment, the loss is calculated based on the difference between its carrying value after fair value adjustments of the hedged asset attributable to the risk being hedged, and the present value of the estimated cash flows discounted at the adjusted effective interest rate.

- *Cash flow hedges*

Derivative instruments designated under the cash flow method are instruments that hedge the exposure to variability in cash flows of an asset or liability recognized in the consolidated statement of financial position affecting net income. The effective portion of changes in the fair value of the hedging instrument is recognized directly in equity, while the ineffective portion of changes in the fair value is recognized in the consolidated statement of income.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

- *Derivative without hedge accounting*

Derivative instruments that do not qualify for hedge accounting are classified as assets or liabilities at fair value and are recognized in the consolidated statement of financial position at their fair value. Changes in the fair value of these derivatives are recognized in the consolidated statement of income.

(g) *Loans and Interest*

Loans are reported at their principal amounts outstanding. Interest income on loans is recognized in profit or loss using the effective interest method.

The financial leases portfolio is reported as part of the loan portfolio and recorded under the financial method, which presents financial leases at the present value of the lease contracts. The difference between a contract's present value and the cost of the leased property is recorded as unearned interest and is recognized as interest income on loans during the life of the lease term using the effective interest rate method.

Factoring operations, net of guarantee deposits and prepaid interest, are reported as part of the loan portfolio.

(h) *Allowance for Loan Losses*

At the consolidated statement of financial position date, it is assessed whether there is objective evidence that a loan or portfolio of loans is impaired. The allowance method is used to account for impairment. The amount of loan losses determined during the period is recognized as a provision expense in the results of operations and is credited to the allowance for loan losses

The allowance is presented as a deduction from gross loans receivable in the consolidated statement of financial position. The Bank periodically reviews its impaired loan portfolio to identify loans that should be charged-off against the allowance for loan losses. Recoveries of loans previously charged-off as non-recoverable, are credited to the allowance.

Impairment losses are determined following two methodologies to assess whether objective evidence of impairment exists:

- *Individually Assessed Loans*

Impairment losses on individually assessed loans are determined by an evaluation of the exposures on a case-by-case basis. This procedure is applied to all loans, whether individually significant or not. If it is determined that no objective evidence of impairment exists for an individual loan, it is included in a group of loans with similar credit characteristics and collectively assessed for impairment.

The impairment loss is calculated by comparing the present value of the expected future cash flows, discounted at the original effective interest rate of the loan, to its current carrying value, and the amount of any loss is charged as a loss provision in the consolidated statement of income. The carrying amount of impaired loans is reduced through the use of an allowance account.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

- *Collectively Assessed Loans*

For the purpose of a collective evaluation of impairment, loans are grouped on the basis of similar credit risk characteristics. These characteristics are relevant to the estimation of future cash flows for groups of similar assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being assessed.

Future cash flows in a group of loans that are collectively assessed for impairment are estimated on the basis of the contractual cash flows of the assets in the group, historical loss experience for assets with credit risk characteristics similar to those in the group and Management's experienced judgment as to whether the current economy and credit conditions are such that the actual level of inherent losses is likely to be greater or less than the suggested historical experience.

- *Reversal of Impairment*

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed by reducing the loan impairment allowance account. The amount of any reversal is recognized in the consolidated statement of income.

(i) *Property, Furniture, Equipment and Improvements*

Property, furniture, equipment and improvements are stated at cost, less accumulated depreciation and amortization. Improvements are capitalized when they increase the useful life of the asset, while minor repairs and maintenance expenses which do not extend the useful life or improve the asset are charged directly to expenses when incurred.

Depreciation and amortization expenses are charged to current operations using the straight-line method over the estimated useful life of the following assets, except for land, which is not depreciated:

- Buildings	30 - 50 years
- Licenses and internally developed projects	3 - 7 years
- Furniture and equipment	3 - 10 years
- Improvements	5 - 15 years

(j) *Goodwill and Intangible Assets*

Goodwill

When an acquisition of a significant part of the equity of another company occurs, goodwill represents the portion of the cost of acquisition in excess of the fair value of the net assets acquired. Goodwill is recognized as an asset in the consolidated statement of financial position and is tested annually for impairment. When it is determined that an impairment exists, the difference between the carrying value of the goodwill and its fair value is recorded as an expense in the consolidated statement of income.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Intangible Assets

Intangible assets are recognized at cost less accrued amortization and impairment losses and are amortized using the straight-line method over a useful life of 20 years. Intangible assets are subject to annual review for impairment or when there are events or changes in circumstances that indicate their carrying value may not be recoverable.

(k) Foreclosed Assets

Foreclosed assets are recognized at the lower of the outstanding principal of the secured loan and the estimated realizable value of the acquired asset.

The Bank uses the allowance method in providing for significant impairment losses on foreclosed assets. The impairment provision is recognized in the consolidated statement of income and the allowance for losses is presented as a deduction from the carrying value of foreclosed assets.

(l) Impairment of Non-Financial Assets

The carrying value of non-financial assets is reviewed at the consolidated statement of financial position date to determine whether there is evidence of impairment. If an impairment exists, the asset's recoverable amount is estimated, and an impairment loss which is equivalent to the difference between the asset's carrying value and its estimated recoverable amount is recognized as an expense in the consolidated statement of income.

(m) Securities Sold Under Repurchase Agreements

Securities sold under repurchase agreements ("Repos") are short-term funding transactions guaranteed with securities, in which the Bank is obligated to repurchase the securities sold at a future date at a specified price. The difference between the selling price and the future purchase price is recognized as interest expense under the effective interest rate method.

Securities provided as collateral continue to be recognized in the consolidated financial statements, as the counterparty has no property right on these securities, unless there is a default by the Bank.

(n) Deposits, Borrowings and Debt Securities Issued

Deposits from customers, borrowings and debt securities issued are initially measured at fair value. Subsequently, they are measured at their amortized cost using the effective interest rate method.

(o) Other Financial Liabilities at Fair Value

This category includes financial liabilities measured at fair value; changes in valuation are recognized in the consolidated statement of income.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

(p) Financial Guarantees

Financial guarantees are contracts that require the Bank to make specific payments on behalf of its customers, to reimburse the beneficiary of the guarantee, in the event that the client fails to make payments when due in accordance with the terms and conditions of the contract.

Liabilities for financial guarantees are initially recognized at fair value; this initial value is amortized over the life of the financial guarantee. Financial guarantees are included in the consolidated statement of financial position within other liabilities.

(q) Interest Income and Expense

Interest income and expense are recognized in the consolidated statement of income for all financial instruments using the effective interest method.

The 'effective interest rate' is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial instrument to the carrying amount of the financial asset or financial liability. The calculation of the effective interest rate includes transaction costs and fees paid or received that are an integral part of the effective interest rate.

(r) Commission Income

Generally, the commission on short-term loans, letters of credit and other banking services are recognized as income on a cash basis due to their short-term maturity. Income recognized on a cash basis is not significantly different from the income that would be recognized under the accrual method.

Commission income on medium and long-term loans, net of certain direct loan origination costs, is deferred and amortized using the effective interest rate method over the average life of these loans.

(s) Insurance Operations

The portion of unearned premiums as of the date of the consolidated statement of financial position, considering the contractual term, is presented within the allowance for insurance operations caption as an allowance for unearned premiums.

Unearned premiums and reinsurers' participation in unearned premiums are calculated using the daily quota method.

Estimated claims pending settlement are represented by claims incurred but not settled at the consolidated statement of financial position date, whether reported or not including related claim management expenses, both internal and external, and an appropriate prudential margin.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Fees paid to insurance agents and taxes paid on premiums are deferred as acquisition costs in accordance with their relation to unearned premiums net of reinsurers' participation. They are presented within the other assets caption in the consolidated statement of financial position.

Premiums issued in advance are credited in the consolidated statement of financial position in accordance with their maturity date. The portion corresponding to the current year is recorded as premium income at their due dates while the remainder of the premiums, relating to future years, are maintained as premiums issued in advance and are presented in other liabilities in the consolidated statement of financial position.

(t) Trust Operations

Assets held in trust or where the Bank has a fiduciary function are not considered part of the Bank operations; consequently, such assets and their corresponding income are not included in the consolidated financial statements. The Bank is required by contractual agreements to manage the assets held in trust independently from its own equity.

Fees earned in relation to trust operations are recognized as fees and other commissions in the consolidated statement of income.

(u) Income Tax

Estimated income tax is calculated on net taxable income, using tax rates enacted at the consolidated statement of financial position date, and any adjustment to prior years' income tax.

Deferred income tax represents the amount of income tax payable and/or receivable in future years resulting from temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes, using the tax rates enacted at the consolidated statement of financial position date. These temporary differences are expected to be reversed in future years.

Deferred tax assets are reduced to the extent that it is no longer probable the related tax effect will be realized.

(v) Share-Based Compensation Plan and Restricted Share Option Plan

The Board of Directors of Grupo Financiero BG, S. A. authorized a grant to key executives ("participants") under the following plans:

- Option to purchase shares of Grupo Financiero BG, S. A. and its holding company
- Restricted Share Option Plan of Grupo Financiero BG, S. A.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The fair value of options granted to the participants is recognized as an administrative expense against the balance due to Grupo Financiero BG, S. A., and its holding company. The fair value of the options on the grant date is recognized as an expense of the Bank, during the vesting period.

The fair value of the restricted share options granted annually to the participants is recognized in the Bank's consolidated statement of income as an administrative expense during the year.

(w) *Segment Reporting*

A business segment is a component of the Bank for which financial information is available and whose operating results are reviewed regularly by management to make decisions regarding the allocation of resources to each segment and assess their respective performance.

(x) *Foreign Currency Transactions*

Transactions in foreign currencies are recorded at the exchange rates in effect at the transaction date. Assets and liabilities held in foreign currencies are converted into dollars at the exchange rate in effect at the consolidated statement of financial position date, and income and expense accounts are converted at the average yearly exchange rate.

Gains and losses from foreign currency conversion are reflected in other income or other expenses in the consolidated statement of income.

(y) *New International Financial Reporting Standards (IFRS) and Interpretations Not Yet Adopted*

As of the date of the consolidated statement of financial position, there are standards, amendments, and interpretations that are not yet effective; consequently they have not been applied in preparing these consolidated financial statements. The most significant are shown below:

- IFRS 9 Financial Instruments:

In July 2014, the International Accounting Standards Board (IASB) issued the final version of International Financial Reporting Standard No.9 (IFRS 9 or the "Standard") - Financial Instruments, which replaces the International Accounting Standard No. 39 (IAS 39).

IFRS 9 is effective for annual reporting periods beginning on or after January 1, 2018, with early adoption permitted.

Implementation strategy

The process of implementing IFRS 9 was overseen by an interdepartmental team whose members included representatives from the areas of Credit Risk, Treasury and Investments, Finance, Processes, Information Management, and Information Technology. The interdepartmental team met during 2017 to review and validate key assumptions, make decisions and monitor the progress of implementation.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The Bank has completed the preliminary evaluation of the impact and accounting analysis of IFRS 9, the design, development and execution of the models, systems and processes to establish the classification and measurement of financial assets, and generated the calculation of Expected Credit Losses (ECL), implementing a communication plan to update senior management and the Board of Directors regarding the process.

Classification and measurement - Financial assets

The new approach for the classification and measurement of financial assets is based on the business model and the contractual cash flow characteristics that apply to the corresponding assets.

The model includes three classification categories for financial assets, namely:

Amortized Cost (AC)

A financial asset is measured at amortized cost and not at fair value through profit or loss if it complies with both of the following conditions:

- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial asset establish specific dates for the receipt of cash flows derived solely from payments of principal and interest on the principal amount outstanding.

Fair value with changes in other comprehensive income (FVOCI)

A debt instrument is measured at FVOCI only if it meets both of the following conditions, and has not been designated at Fair value through profit or loss (FVTPL):

- The asset is held within a business model whose objective is to collect the contractual cash flows and sell the financial assets; and
- The contractual terms of the financial asset establish specific dates for the receipt of cash flows derived solely from payments of principal and interest on the principal amount outstanding.

During the initial recognition of investments in equity instruments not held for trading, the Bank may irrevocably elect to record the subsequent changes in fair value as part of other comprehensive income. This choice must be made on an instrument-by-instrument basis.

Fair value through profit or loss (FVTPL)

All other financial assets are measured at fair value through profit or loss.

The Standard eliminates the existing categories of IAS 39, namely, investments held to maturity, loans and receivables and investments available for sale.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Evaluation of the business model

The Bank completed an evaluation of the objective of the business model that applies to financial instruments at the portfolio and business segment levels of those portfolios in order to document how they are managed. The information that was considered included the following:

- The policies and objectives identified for the loan portfolio and the operation of these policies including management's strategy to define:
 - (i) the collection of contractual interest income
 - (ii) maintain a defined performance profile of interest
 - (iii) maintain a specific duration period
 - (iv) be able to sell at any time due to liquidity needs or in order to optimize the risk / return profile of a portfolio based on interest rates, risk margins, current duration and defined objective.
- The way in which the behavior of different portfolios is reported to the Bank's senior management;
- The risks that affect the performance of the business model (and the financial assets held in the business model) and the way in which those risk are managed;
- The frequency and value of sales in previous periods, the reasons for those sales and expectations regarding future sales activities.

Financial assets that are held for trading purposes and whose performance is evaluated solely based on changes in their fair value are measured at fair value through profit or loss as they are neither held to collect contractual cash flows nor both to collect contractual cash flows and to sell the financial assets.

Assessment of whether the contractual cash flows are solely payments of principal and interest

For the purpose of this evaluation, "principal" is defined as the fair value of the financial asset at the time of initial recognition. "Interest" is defined as the consideration of the time value of money and the credit risk associated with the amount of principal outstanding for a particular period of time and other basic risks of a loan agreement and other associated costs, as well as the profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank focused on the instrument's contractual terms.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

This assessment considered the following characteristics, among others:

- Contingent events that could change the amount and / or timing of cash flows
- Leverage conditions
- Prepayment and extension terms
- Terms that limit the Bank's ability to collect cash flows from specific assets
- Features that modify considerations for the time value of money

Principal classifications due to changes of the Standard

Based on the preliminary assessment of possible changes to the classification and measurement of financial assets held as of December 31, 2017, the preliminary results obtained are as follows:

- Investments in securities held to maturity, measured at amortized cost under IAS 39, will mostly be classified as FVOCI under IFRS 9.
- Bank loans and deposits that are classified as loans and deposits and measured at amortized cost under IAS 39 will maintain this measurement under IFRS 9.
- Debt instruments classified as available for sale under IAS 39 will be classified as FVOCI under IFRS 9, unless their contractual cash flows are not solely payments of principal and interest in which case they will be classified as FVTPL.
- Investment in securities measured at FVTPL under IAS 39 will mostly be classified to FVOCI under IFRS 9 unless their cash flows are not solely payments of principal and interest, or are a component of BG Valores, S. A. portfolios.
- Derivatives held to manage risks that are classified as FVTPL under IAS 39 will maintain this measurement under IFRS 9.

Impairment of financial assets

The Standard replaces the "incurred loss" model in IAS 39 with an "expected credit loss" (ECL) model. The Bank consulted experts in the matter to evaluate its financial assets and develop models to measure ECLs.

The new impairment model is applicable to the following financial assets that are not measured at FVTPL:

- Debt instruments;
- Leases receivable;
- Financial guarantee contracts issued; and
- Loan commitments issued

Impairment losses on investments in equity instruments are not recognized.

The assessment of whether credit risk of a financial asset has increased significantly is one of the critical judgments implemented in the impairment model.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Loss allowances are recognized for the amount equivalent to the 12-month ECL in the following cases:

- Investments in debt instruments that are determined to reflect low credit risk at the reporting date; and
- Other financial instruments over which the credit risk has not increased significantly since its initial recognition.

For all other cases, allowances are recognized at an amount equal to the assets' lifetime ECL.

Loss allowance for lease receivables will always be measured based on the assets' lifetime ECL.

The 12-month ECL is the portion of the ECL that results from default events on a financial instrument that are possible within a 12-month period after the reporting date.

Significant Increase in Credit Risk

The determination of whether the credit risk of a financial asset has increased significantly since its initial recognition, considers reasonable and sustainable information that is relevant and available without disproportionate cost or effort, including information and analysis of a quantitative and qualitative nature based on historical experience and the expert evaluation of credit including future projections.

The Bank has determined the main indicators of a significant increase in risk include the variations and days of delinquency, collection score and risk rating.

Credit Risk Rating

The Bank assigned a credit risk rating to each financial asset based on a model that incorporates a series of predictive data on the incurrence of losses. The models were developed and applied over several periods to evaluate their reasonableness. Risk ratings are used to identify significant increases in credit risk.

Credit risk ratings are defined using qualitative and quantitative factors that are indicative of risk of loss. These factors may vary depending on the nature of the exposure and the type of borrower. Regarding foreign investments and bank deposits, the international risk ratings of Fitch, Standard and Poor's or Moody's and associated changes to the ratings were used to establish whether there was a significant increase in risk and in the calculation of the Probability of Default (PD).

Credit risk ratings are defined and calibrated such that the risk of loss increases exponentially as the credit risk deteriorates.

Each exposure will be assigned to a credit risk rating at the time of initial recognition based on available information about the debtor. Exposures will be subject to continuous monitoring, which may result in an exposure being moved to a different credit risk rating.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Determine if the credit risk has increased significantly

The Bank has determined that an exposure to credit risk reflects a significant increase since its initial recognition if, based on credit risk classification models and / or days past due, there is a significant decline above a defined range.

In certain instances, based on expert judgment and where possible, relevant historical experience, the Bank determines an exposure has undergone a significant increase in credit risk based on particular qualitative indicators that it considers relevant and whose effect would not be fully reflected otherwise.

As a rule, and as required by IFRS 9, a significant increase in credit risk occurs when an asset shows delinquency of more than 30 or 60 days, depending on the asset. The Bank determines the delinquency period by counting the number of days since the last payment.

The Bank intends to monitor the effectiveness of the criteria used to identify significant increases in credit risk on a regular basis.

Definition of loss

The Bank considers a financial asset to be in default when:

- It is unlikely a debtor will fully pay its credit obligations to the Bank without taking actions to repossess collateral (if available); or
- The debtor is delinquent by more than 30 days for business overdrafts, 120 days for residential mortgages, or 90 days for any other credit obligation.

In assessing whether a debtor is in default, the Bank considers the following indicators:

- Quantitative – past due status and non-payment of other obligations of the same issuer; and
- Qualitative – breach of contract

The inputs used in the assessment of whether financial instruments are in default are specific to the type of portfolio and its significance, which may vary over time to reflect changes in circumstances and trends.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Measurement of the ECL

The ECL is a probability-weighted estimate of credit loss which is measured according to the following items:

- Financial assets that are not credit-impaired at the reporting date
- Financial assets that are impaired at the reporting date
- Undrawn loan commitments: the present value of the difference between the contractual cash flows that are due to the Bank in the event that the commitment is drawn down, and the cash flows the Bank expects to receive; and
- Financial guarantee contracts: the expected payments to reimburse the holder less any amount the Bank expects to recover.

Generating the term structure of the PD

The days of delinquency is the main input to determine the term structure of the PD for exposures in the consumer loan portfolio. For the corporate loan portfolio, the following factors are taken as primary inputs: days of delinquency, restructuring, risk classification, indicators of non-compliance and materiality thresholds. The Bank seeks to obtain performance and loss information on exposures to credit risk in order to complete the analysis on days of delinquency, segment, type of product and debtor as well as credit risk rating.

The Bank designed and evaluated statistical models to analyze the data collected and generate estimates of the remaining lifetime PD of credit exposures, and how they are expected to change over time.

It is expected that this analysis will include the identification and calibration of relationships between changes in the rate of loss with changes in key macroeconomic indicators affecting the risk of loss. The main macroeconomic indicator is the variation in Gross Domestic Product (GDP).

The PD of foreign investments and placed deposits was estimated using liquid market proxies (Credit Default Swaps "CDS") based on international risk ratings and the industry relating to the investment or deposit.

Inputs in the measurement of the ECL

The following variables are key inputs used in measuring ECL:

- Probability of default (PD)
- Loss given default (LGD)
- Exposure at default (EAD)

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

PD estimates are calculated at a specific date, using statistical rating models and tools adapted to the different categories of counterparties and exposure. Statistical models were acquired from internationally recognized firms or developed internally based on historical data. These models incorporate quantitative factors, and can also consider qualitative factors. If an exposure migrates between rating categories, then this will lead to a change in the estimate of the associated PD. The PD is estimated considering contractual maturities and estimated prepayment rates. In the case of foreign investments and deposits placed, the ECL is obtained from the probability of default implicit in the CDS used as proxies for each bond or deposit based on its international credit rating and industry.

The Bank estimated the levels of LGD based on historically observed recovery rates (corresponding to the portion of EAD in default that is effectively recovered) and estimated recoverable rates (corresponding to the portion of EAD in default that is estimated to be recoverable). The LGD model considers the financial asset, related collateral and recovery costs of any collateral. The Bank can calibrate the LGD estimate for different economic scenarios. The Bank used the LGD implicit in the CDS for foreign investments and placed deposits.

In most cases, the EAD is equivalent to the outstanding balance of the contract; except for credit cards and contingencies. For credit cards and contingencies, variables such as the current balance, disposed balance and the CCF (credit conversion factor), must be included, in order to estimate the exposure at the time of default of existing operations.

The Bank expects to determine the EAD from the current exposure to the counterparty and the potential changes to the current amount permitted under contract, including any amortization.

Overdrafts and credit card facilities are products that include both the loan and undrawn commitment component. These facilities do not have a fixed term or repayment structure and are managed on a collective basis; the Bank can cancel them immediately but this contractual right is typically not applied by the administration on a day-to-day basis, rather when the Bank is aware of an increase in credit risk of a specific exposure.

Forward-looking information

The Bank incorporated forward-looking information in its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and ECL measurement.

External information includes economic data and projections published by government entities and monetary authorities in the countries in which the Bank operates, supranational organizations such as the OECD and the International Monetary Fund, as well as academic and private sector projections.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The base case is expected to represent a most-likely outcome and be aligned with the information used by the Bank for other purposes, such as strategic planning and budgeting. The other scenarios would represent more optimistic and pessimistic outcomes. The Bank also plans to periodically perform extreme impact stress tests to calibrate the determination of these other representative scenarios.

Classification - financial liabilities

The Standard largely retains the existing requirements of IAS 39 for the classification of financial liabilities.

However, under IAS 39 all fair value changes of liabilities designated as FVTPL are recognized in profit or loss, whereas under the new Standard these fair value changes are generally presented as follows:

- The change in fair value that is attributable to changes in credit risk of the liability is presented in other comprehensive income; and
- The remaining amount of the change in fair value is presented in profit or loss.

The Bank has not designated any liabilities at FVTPL and does not have the intention to do so.

Hedge accounting

The Bank's current plan is to apply the requirements of hedge accounting under IFRS 9 as of the date of initial application.

Hedge relationships that meet the requirements of hedge accounting in accordance with IAS 39, which also meet the requirements of hedge accounting in accordance with the criteria of IFRS 9, after taking into account any new rebalancing of the coverage relationship at the time of transition, will be considered as a continuation of the coverage relationship.

At the initial application of hedge accounting under IFRS 9, the Bank will begin to apply the requirements from the moment it ceases the application of IAS 39 and will consider the reason of coverage in accordance with IAS 39 as the starting point to rebalance the coverage ratio of a continuing hedging relationship. Any gain or loss on this rebalancing will be recognized in the period's profit or loss.

The entity will discontinue the application of hedge accounting on a prospective basis only when the relationship or part of the coverage no longer satisfies the rating criteria after any rebalancing. This includes cases where the hedging instrument expires or is sold, terminated or exercised. Discontinuing hedge accounting can either affect the coverage ratio in its entirety or in part, maintaining the coverage ratio for the remainder.

The Bank plans to choose one or more hedging relationship(s) between a hedging instrument and a hedged item with one or more external entities, as well as opting for hedges between its subsidiaries.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Impact on capital planning

The main impact on the Bank's regulatory capital arises from the new impairment requirements under IFRS 9, which is reflected in retained earnings in Tier 1 Capital.

Transition

Changes in accounting policies resulting from the adoption of standards will generally be applied retrospectively, with the exception of the following:

The Bank plans to take advantage of the exemption that allows it not to restate comparative information of previous periods with respect to classification and measurement changes. The differences in the carrying amounts of financial assets and liabilities resulting from the adoption of IFRS 9 will be recognized in the retained earnings and reserves as of January 1, 2018.

Disclosure

The Standard will require new disclosures in particular with respect to hedge accounting, credit risk and expected credit losses.

Preliminary impact evaluation

Financial Assets:

The most significant impact in the Bank's financial statements caused by the implementation of this Standard are the new requirements for impairment reserves.

The Bank's preliminary assessment as of December 31, 2017 indicates the application of IFRS 9, as of January 1, 2018, will result in a lower allowance requirement compared to IAS 39; the level of allowance required for the consumer and mortgage portfolios will be very similar, while the allowance required for the corporate portfolio will be lower. The new allowance for investments will represent approximately 3% to 5% of the total allowance required under IFRS 9.

The expected loss allowance required under IFRS 9 will present an overall estimated decrease in the allowance of approximately 5% to 7%, as compared to the allowance required under IAS 39.

Financial liabilities:

The Bank's preliminary assessment indicates that there will be no material impact in the application of the requirements of IFRS 9 in relation to the classification of financial liabilities.

- IFRS 15 - Revenue from Contracts with Customers:

This standard establishes an integral framework to determine the amount of and when income must be recognized. This standard replaces existing guidelines, including IAS 18 - Revenue from Ordinary Activities, IAS 11 - Construction Contracts and IFRIC 13 - Customer Loyalty Programs.

IFRS 15 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

It is management's opinion that the application of this standard will not cause significant changes in the consolidated financial statements.

- **IFRS 16 – Leases replaces IAS 17 - Leases:**

This standard eliminates the classification of leases, and establishes that they shall be recognized similarly to financial leases and measured at the present value of future lease payments. IFRS 16 is effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted for entities that also adopt IFRS 15 - Revenue from Contracts with Customers.

Due to the nature of the Bank's financial operations, the adoption of this standard could lead to changes in the consolidated financial statements, an aspect that is under evaluation by management.

(4) Balances and Transactions with Related Parties

The consolidated statement of financial position and the consolidated statement of income include balances and transactions with related parties, which are summarized as follows:

	2017			
	Directors and Management	Related Companies	Affiliated Companies	Total
Assets:				
Investment securities and other financial assets	<u>0</u>	<u>262,034,590</u>	<u>49,628,440</u>	<u>311,663,030</u>
Loans	<u>6,349,512</u>	<u>111,478,360</u>	<u>22,651,923</u>	<u>140,479,795</u>
Investments in associates	<u>0</u>	<u>22,075,753</u>	<u>0</u>	<u>22,075,753</u>
Liabilities:				
Deposits:				
Demand	3,826,289	93,656,587	72,428,215	169,911,091
Savings	5,355,607	82,626,254	45,479	88,027,340
Time	<u>1,565,061</u>	<u>291,534,192</u>	<u>62,000,000</u>	<u>355,099,253</u>
	<u>10,746,957</u>	<u>467,817,033</u>	<u>134,473,694</u>	<u>613,037,684</u>
Perpetual bonds	<u>0</u>	<u>0</u>	<u>90,000,000</u>	<u>90,000,000</u>
Commitments and contingencies	<u>0</u>	<u>84,554,833</u>	<u>24,828,400</u>	<u>109,383,233</u>
Interest income:				
Loans	<u>299,111</u>	<u>5,146,321</u>	<u>426,491</u>	<u>5,871,923</u>
Investment securities and other financial assets	<u>0</u>	<u>12,917,178</u>	<u>2,517,486</u>	<u>15,434,664</u>
Interest expense:				
Deposits	<u>58,837</u>	<u>9,983,357</u>	<u>970,056</u>	<u>11,012,250</u>
Borrowings and debt securities issued	<u>0</u>	<u>0</u>	<u>5,850,000</u>	<u>5,850,000</u>
Other income:				
Equity participation in associates	<u>0</u>	<u>8,569,626</u>	<u>0</u>	<u>8,569,626</u>
Dividends	<u>0</u>	<u>1,293,134</u>	<u>0</u>	<u>1,293,134</u>
General and administrative expenses:				
Directors' fees	<u>134,500</u>	<u>0</u>	<u>0</u>	<u>134,500</u>
Benefits to key management personnel	<u>4,883,435</u>	<u>0</u>	<u>0</u>	<u>4,883,435</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

	2016			
	Directors and Management	Related Companies	Affiliated Companies	Total
Assets:				
Investment securities and other financial assets	<u>0</u>	<u>256,855,400</u>	<u>49,632,931</u>	<u>306,488,331</u>
Loans	<u>6,797,954</u>	<u>95,755,484</u>	<u>0</u>	<u>102,553,438</u>
Investments in associates	<u>0</u>	<u>18,590,561</u>	<u>0</u>	<u>18,590,561</u>
Liabilities:				
Deposits:				
Demand	1,302,223	90,853,850	131,091,927	223,248,000
Savings	4,310,328	94,196,820	45,479	98,552,627
Time	<u>1,108,841</u>	<u>212,818,835</u>	<u>0</u>	<u>213,927,676</u>
	<u>6,721,392</u>	<u>397,869,505</u>	<u>131,137,406</u>	<u>535,728,303</u>
Perpetual bonds	<u>0</u>	<u>0</u>	<u>90,000,000</u>	<u>90,000,000</u>
Commitments and contingencies	<u>725,525</u>	<u>15,502,953</u>	<u>23,378,809</u>	<u>39,607,287</u>
Interest income:				
Loans	<u>311,218</u>	<u>3,373,500</u>	<u>0</u>	<u>3,684,718</u>
Investment securities and other financial assets	<u>0</u>	<u>12,649,058</u>	<u>2,524,383</u>	<u>15,173,441</u>
Interest expense:				
Deposits	<u>51,014</u>	<u>8,389,581</u>	<u>16,388</u>	<u>8,456,983</u>
Borrowings and debt securities issued	<u>0</u>	<u>0</u>	<u>5,850,000</u>	<u>5,850,000</u>
Other income:				
Equity participation in associates	<u>0</u>	<u>8,040,022</u>	<u>0</u>	<u>8,040,022</u>
Dividends	<u>0</u>	<u>1,057,033</u>	<u>0</u>	<u>1,057,033</u>
General and administrative expenses:				
Directors' fees	<u>153,800</u>	<u>0</u>	<u>0</u>	<u>153,800</u>
Benefits to key management personnel	<u>4,601,278</u>	<u>0</u>	<u>0</u>	<u>4,601,278</u>

The benefits to key management personnel include salaries and other expenses in the amount of B/.4,679,455 (2016: B/.4,397,298) and options to purchase shares for B/.203,980 (2016: B/.203,980).

The conditions granted in transactions with related parties are substantially similar to those granted to third parties not related to the Bank.

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

(5) Cash and Cash Equivalents

Cash and cash equivalents are detailed as follows for purposes of reconciliation with the consolidated statement of cash flows:

	<u>2017</u>	<u>2016</u>
Cash and cash items	283,199,967	255,676,459
Demand deposits with banks	255,502,567	280,657,827
Time deposits with banks	<u>306,685,642</u>	<u>282,368,754</u>
Total cash and deposits	<u>562,188,209</u>	<u>563,026,581</u>
Less: time deposits with original maturities of more than three months	<u>172,654,043</u>	<u>162,365,437</u>
Cash and cash equivalents in the consolidated statement of cash flows	<u><u>672,734,133</u></u>	<u><u>656,337,603</u></u>

Demand deposits with banks include cash collateral accounts in the amount of B/.41.7 million (2016: B/.50.9 million) that secure derivatives operations and repos, in addition to the next quarterly payments of principal, interest and expenses of certain obligations. In 2016, these collateral accounts were presented within investments and other financial assets.

(6) Investment Securities and Other Financial Assets

Investment securities and other financial assets are summarized as follows:

Investment Securities and Other Financial Assets at Fair Value through Profit or Loss

The portfolio of investment securities and other financial assets measured at fair value through profit or loss amounted to B/.1,160,244,285 (2016: B/.1,039,742,841) and was comprised of held for trading securities and other securities at fair value through profit or loss, which are detailed as follows:

Held for Trading Securities and Other Financial Assets

Held for trading securities at fair value are detailed as follows:

	<u>2017</u>	<u>2016</u>
Local Corporate Bonds and Fixed Income Funds	2,440,759	11,548
Foreign Corporate Bonds and Fixed Income Funds	<u>334,702</u>	<u>18,325</u>
Total	<u><u>2,775,461</u></u>	<u><u>29,873</u></u>

The Bank sold held for trading securities and other financial assets in the amount of B/.665,774,734 (2016: B/.617,228,668). These sales generated a net gain of B/.4,029,277 (2016: B/.4,368,744), which is presented in the consolidated statement of income as gain on financial instruments, net.

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Other Securities and Financial Assets at Fair Value

The other securities and financial assets at fair value are detailed as follows:

	<u>2017</u>	<u>2016</u>
Local Treasury Bills	0	55,790,503
Local Corporate Bonds and Fixed Income Funds	63,536,875	63,320,644
Bonds issued by the Republic of Panama	2,778,813	2,252,105
Local Corporate Shares	37,792,019	32,836,569
Bonds issued by the US Government	8,225,780	9,130,926
Foreign Commercial Paper, Treasury Bills and Mutual Funds	68,076,805	311,251,324
Mortgage Backed Securities (MBS) and Collateralized Mortgage Obligations (CMOs)	710,114,094	499,067,152
Asset Backed Securities	28,089,707	15,107,069
Foreign Fixed Income Funds	238,843,387	50,939,913
Foreign Variable Income Mutual Funds	11,344	16,763
Total	<u>1,157,468,824</u>	<u>1,039,712,968</u>

The Bank sold other securities and financial assets at fair value in the amount of B/.4,865,166,899 (2016: B/.3,929,046,479). These sales generated a net gain of B/.2,761,459 (2016: B/.186,152), which is presented in the consolidated statement of income as gain on financial instruments, net.

The collateral accounts that were presented in the Commercial Paper, Treasury Bills and Foreign Mutual Funds category were reclassified to foreign demand deposits with banks for purposes of comparative presentation with 2017.

Securities and Other Financial Assets Available for Sale

The portfolio of securities and other financial assets available for sale are detailed as follows:

	<u>2017</u>	<u>2016</u>
	<u>Fair Value</u>	<u>Fair Value</u>
	<u>Amortized Cost</u>	<u>Amortized Cost</u>
Local Commercial Paper and Treasury Bills	7,355,857	14,087,508
Local Corporate Bonds and Fixed Income Funds	1,005,898,732	965,856,841
Local Borrowings	49,512,563	43,633,760
Bonds issued by the Republic of Panama	136,569,675	106,019,930
Local Corporate Shares	5,896,888	5,830,982
Bonds issued by the US Government and Agencies	30,787,360	29,244,216
Foreign Commercial Paper and Treasury Bills	196,445,930	191,693,062
Mortgage Backed Securities (MBS) and Collateralized Mortgage Obligations (CMOs)	891,556,118	907,094,033
Asset Backed Securities (ABS)	78,948,933	86,883,763
Foreign Corporate Bonds and Fixed Income Funds	743,362,727	536,984,958
Other Government Bonds	58,130,917	77,415,652
Foreign Corporate Shares and Variable Income Mutual Funds	91,048	97,486
Total	<u>3,204,556,748</u>	<u>2,964,842,191</u>
	<u>110,842</u>	<u>142,655</u>
	<u>3,168,760,133</u>	<u>2,933,232,459</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The Bank sold securities and other financial assets available for sale in the amount of B/.2,569,582,573 (2016: B/.1,999,410,629). These sales generated a net loss of B/.1,029,905 (2016: B/.3,120,056), which is presented in the consolidated statement of income as gain on financial instruments, net.

The Bank holds corporate shares amounting to B/.2,182,317 (2016: B/.2,225,694), which are carried at their acquisition cost since the Bank was not able to reliably determine their fair value. The Bank conducts annual reviews to validate that the value of these securities has not suffered prolonged impairment for which there is a need to adjust their value. The equity shares, that are held at cost, do not have an active market and the entity does not intend to dispose them. During 2017 the Bank did not acquire corporate shares (2016: acquired corporate shares for B/.361,260), and had sales for the amount of B/.43,377 (2016: B/.59,595).

Securities Held to Maturity

The portfolio of securities held to maturity amounted to B/.50,074,183 (2016: B/.59,458,802) less a valuation allowance of B/.91,361 (2016: B/.90,421), due to the permanent impairment of some securities.

	<u>2017</u>		<u>2016</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Local Corporate Bonds	9,178,390	8,880,563	11,329,535	10,750,303
Bonds issued by the Republic of Panama	26,394,768	37,557,420	26,331,295	35,815,995
Mortgage Backed Securities (MBS) and Collateralized Mortgage Obligations (CMOs)	14,316,014	14,839,727	21,513,340	22,775,665
Asset Backed Securities (ABS), net	<u>93,650</u>	<u>147,991</u>	<u>194,211</u>	<u>260,439</u>
Total	<u>49,982,822</u>	<u>61,425,701</u>	<u>59,368,381</u>	<u>69,602,402</u>

The movement of the valuation allowance for investment securities held to maturity is as follows:

	<u>2017</u>	<u>2016</u>
Balance at beginning of year	90,421	54,128
Provision registered to expense	<u>940</u>	<u>36,293</u>
Balance at end of year	<u>91,361</u>	<u>90,421</u>

The payment of capital and interest on 99.9% of the Bank's MBS portfolio is 100% guaranteed by the following agencies: the Government National Mortgage Association (GNMA), which is an agency of the Federal Government of the United States and counts on the explicit guarantee of the Federal Government, the Federal National Mortgage Association (FNMA) or the Federal Home Loan Mortgage Association (FHLMC), who rely on AAA ratings provided by Moody's and Fitch, on its counterparty debt. The guarantee and primary source of payment of the MBS guaranteed by the aforementioned agencies is a set of residential mortgages on houses that must fulfill credit policies that are required by these programs. Similarly, 78% of the CMO portfolio of the Bank is 100% guaranteed by GNMA, FNMA or FHLMC.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The average life of the portfolio of MBS and CMOs is 2.88 years for MBS and 1.71 years for CMOS (2016: 2.75 years for MBS and 1.54 years for CMOS).

The Bank has in place a documented procedure to determine fair value and the responsibilities of the areas involved in this process. This process has been approved by the Assets and Liabilities Committee, the Risk Committee of the Board of Directors, and the Bank's Board of Directors.

The Bank uses price vendors for most of the prices of assets and liabilities at fair value which are processed by the department of Operations and validated by the area of Management and Control of the Treasury and Risk department.

The Bank uses internal valuation methodologies for certain assets and liabilities at fair value classified in Level 3 of the fair value hierarchy. The calculation of fair values using internal methodologies is performed by the area of management and control of the Treasury and validated by the Risk department.

The Bank measures fair value using the fair value hierarchy, which categorizes the variables used in valuation techniques to measure fair value into three levels. The hierarchy is based on the transparency of the inputs used in measuring the fair values of financial assets and financial liabilities at their valuation date. The three levels are defined as follows:

Level 1: Inputs that are quoted market prices (unadjusted) in active markets accessible to the Bank, for identical instruments.

Level 2: Inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.

Level 3: Unobservable inputs for assets or liabilities. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The classification of the valuation of fair value is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. The relevance of a variable should be evaluated with respect to the entire fair value measurement.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements**Fair Value Measurement of Securities and Other Financial Assets at Fair Value through Profit or Loss**

	<u>2017</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Local Corporate Bonds and Fixed Income Funds	65,977,634	0	0	65,977,634
Bonds issued by the Republic of Panama	2,778,813	0	2,778,813	0
Local Corporate Shares	37,792,019	0	0	37,792,019
Bonds issued by the US Government	8,225,780	8,225,780	0	0
Foreign Commercial Paper, Treasury Bills and Mutual Funds	68,076,805	246,283	67,830,522	0
Mortgage Backed Securities (MBS) and Collateralized Mortgage Obligations (CMOs)	710,114,094	0	709,298,574	815,520
Asset Backed Securities (ABS)	28,089,707	0	28,089,707	0
Foreign Corporate Bonds and Fixed Income Funds	239,178,089	0	150,027,467	89,150,622
Foreign Variable Income Mutual Funds	11,344	0	486	10,858
Total	<u>1,160,244,285</u>	<u>8,472,063</u>	<u>958,025,569</u>	<u>193,746,653</u>

	<u>2016</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Local Treasury Bills	55,790,503	0	0	55,790,503
Local Corporate Bonds and Fixed Income Funds	63,332,192	0	0	63,332,192
Bonds issued by the Republic of Panama	2,252,105	0	2,252,105	0
Local Corporate Shares	32,836,569	0	0	32,836,569
Bonds issued by US Government and Agencies	9,130,926	9,130,926	0	0
Foreign Commercial Paper, Treasury Bills and Mutual Funds	311,251,324	60,242,248	251,008,816	0
Mortgage Backed Securities (MBS) and Collateralized Mortgage Obligations (CMOs)	499,067,152	0	498,163,488	903,664
Asset Backed Securities (ABS)	15,107,069	0	15,107,069	0
Foreign Fixed Income Funds	50,939,913	0	0	50,939,913
Foreign Variable Income Mutual Funds	35,088	0	911	34,177
Total	<u>1,039,742,841</u>	<u>69,373,434</u>	<u>766,532,389</u>	<u>203,837,018</u>

Fair Value Measurement of Securities and Other Financial Assets Available for Sale

	<u>2017</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Local Commercial Paper and Treasury Bills	7,355,857	0	0	7,355,857
Local Corporate Bonds and Fixed Income Funds	1,005,898,732	0	132,997,971	872,900,761
Local Borrowings	49,512,563	0	0	49,512,563
Bonds issued by the Republic of Panama	136,569,675	0	136,569,675	0
Local Corporate Shares	3,784,212	5,461	0	3,778,751
Bonds issued by US Government and Agencies	30,787,360	30,787,360	0	0
Foreign Commercial Paper and Treasury Bills	196,445,930	29,878,452	166,567,478	0
Mortgage Backed Securities (MBS) and Collateralized Mortgage Obligations (CMOs)	891,556,118	0	891,556,118	0
Asset Backed Securities (ABS)	78,948,933	0	78,948,933	0
Foreign Corporate Bonds and Fixed Income Funds	743,362,727	0	743,352,210	10,517
Bonds issued by Other Governments	58,130,917	0	44,315,941	13,814,976
Foreign Variable Income Mutual Funds	21,407	0	21,407	0
Total	<u>3,202,374,431</u>	<u>60,671,273</u>	<u>2,194,329,733</u>	<u>947,373,425</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Fair Value Measurement of Securities and Other Financial Assets Available for Sale

	<u>2016</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Local Commercial Paper and Treasury Bills	14,087,508	0	0	14,087,508
Local Corporate Bonds and Fixed Income Funds	965,856,841	0	132,838,896	833,017,945
Local Borrowings	43,633,760	0	0	43,633,760
Bonds issued by the Republic of Panama	106,019,930	0	106,019,930	0
Local Corporate Shares	3,674,930	5,917	0	3,669,013
Bonds issued by US Government and Agencies	29,244,216	26,132,580	3,111,636	0
Foreign Commercial Paper and Treasury Bills	191,693,062	5,777,039	185,916,023	0
Mortgage Backed Securities (MBS) and Collateralized Mortgage Obligations (CMOs)	907,094,033	0	907,094,033	0
Asset Backed Securities (ABS)	86,883,763	0	86,883,763	0
Foreign Corporate Bonds and Fixed Income Funds	536,984,958	0	536,975,898	9,060
Bonds issued by Other Governments	77,415,652	0	65,508,331	11,907,321
Foreign Variable Income Mutual Funds	27,844	0	27,844	0
Total	<u>2,962,616,497</u>	<u>31,915,536</u>	<u>2,024,376,354</u>	<u>906,324,607</u>

Changes in the Fair Value Measurement of the Level 3 Hierarchy

	<u>Investment Securities and Other Financial Assets Fair Value through Profit or Loss</u>	<u>Available-for- Sale</u>	<u>Total</u>
December 31, 2016	<u>203,837,018</u>	<u>906,324,607</u>	<u>1,110,161,625</u>
Gain recognized in income	8,006,852	304,214	8,311,066
Loss recognized in equity	0	(721,310)	(721,310)
Purchases	100,601,967	333,978,366	434,580,333
Amortization, sales and redemptions	(118,699,184)	(292,512,452)	(411,211,636)
December 31, 2017	<u>193,746,653</u>	<u>947,373,425</u>	<u>1,141,120,078</u>
Total gains related to instruments held at December 31, 2017	<u>7,705,032</u>	<u>823,956</u>	<u>8,528,988</u>
December 31, 2015	<u>209,832,146</u>	<u>874,370,364</u>	<u>1,084,202,510</u>
Gain recognized in income	4,140,257	32,589	4,172,846
Gain recognized in equity	0	46,384,655	46,384,655
Purchases	156,815,076	120,348,721	277,163,797
Amortization, sales and redemptions	(164,756,250)	(134,811,722)	(299,567,972)
Transfer out of level 3	(2,194,211)	0	(2,194,211)
December 31, 2016	<u>203,837,018</u>	<u>906,324,607</u>	<u>1,110,161,625</u>
Total gains related to instruments held at December 31, 2016	<u>3,736,201</u>	<u>45,488,317</u>	<u>49,224,518</u>

The Bank recognizes transfers between levels of the fair value hierarchy at the end of the reporting period in which the change has occurred.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

During 2016, there were transfers from Level 3 to 2 of the fair value hierarchy, due to changes in valuation techniques using quoted market prices for local fixed income securities at fair value through profit or loss.

The table below sets out information about significant unobservable inputs used in measuring financial instruments categorized as Level 3 in the fair value hierarchy.

Type of financial instruments	Valuation technique	Significant unobservable input	Range of estimates for unobservable inputs				Fair value measurement sensitivity to unobservable inputs
			2017		2016		
Corporate Shares	Dividend discount model and Dividend free cash flow model (DCF)	Equity risk premium	Minimum	5.51%	Minimum	6.10%	If equity risk premiums increase the price decreases and vice versa
			Maximum	9.86%	Maximum	8.35%	
		Growth rate of assets, liabilities, equity, profits and dividends	Minimum	(20.50%)	Minimum	(6.70%)	If the growth increases the price increases and vice versa
			Maximum	29.32%	Maximum	25.95%	
Fixed Income	Discounted cash flow model	Credit spreads	Minimum	0.37%	Minimum	0.78%	If the credit spreads increase the price decreases and vice versa
			Maximum	5.87%	Maximum	6.94%	
			Average	2.73%	Average	2.68%	

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The main valuation techniques, assumptions and inputs used to measure the fair value of financial instruments are as follows:

<u>Instrument</u>	<u>Valuation technique</u>	<u>Inputs</u>	<u>Level</u>
Local Fixed Income	Quoted prices in active markets	Observable quoted prices	2-3
	Discounted cash flows model	Benchmark interest rate Liquidity risk premiums Credit spreads	
Local Corporate Shares	Quoted prices in active markets	Quoted prices in active markets	1-3
	Dividend discount model Discount free cash flows model, which are compared with the stock prices	Benchmark interest rate Equity risk premium Growth rate of assets, liabilities, equity, profits and dividends	
Foreign Fixed Income	Quoted prices in active markets	Quoted prices in active markets	1-2
	Quoted prices in active markets for similar instruments	Observable quoted prices	
	Bid and ask prices from market participants	Prices from a broker	
	Discounted cash flows model	Credit spreads Benchmark interest rate Liquidity risk premiums	
Agency MBS / CMOs	Discounted cash flows model	Features of collateral TBA's price Treasury yield Yield curves Prepayment speeds Market analysis	2-3
Private MBS / CMOs and ABS	Discounted cash flows model	Features of collateral Treasury yield Yield curves Expected cash flow and losses Market assumptions related to discount rates, prepayments, losses and recoveries	2
Foreign Corporate Shares	Quoted prices in active markets	Quoted prices in active markets	1
Investment vehicles	Net asset value	Net asset value	2-3

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The Bank considers that its methodologies for valuation of investment securities classified as Level 3 are appropriate; however, the use of different estimates for the unobservable variable could lead to different measurements of fair value. For investment securities classified in Level 3, adjustments to the credit spread (in the case of fixed income) and to the equity risk premium (in the case of the corporate shares) of +50bp and -50bp would result in favorable and unfavorable impacts in the Bank's consolidated statement of income and in the consolidated equity, as described below:

	2017			
	Fair Value		Available for sale	
	Effect of profit or loss		Effect in equity	
	Favorable	(Unfavorable)	Favorable	(Unfavorable)
Fixed Income	153,440	(150,633)	8,459,331	(10,166,208)
Corporate Shares	<u>3,310,175</u>	<u>(2,662,145)</u>	<u>68,001</u>	<u>(65,906)</u>
Total	<u>3,463,615</u>	<u>(2,812,778)</u>	<u>8,527,332</u>	<u>(10,232,114)</u>

	2016			
	Fair Value		Available for sale	
	Effect of profit or loss		Effect in equity	
	Favorable	(Unfavorable)	Favorable	(Unfavorable)
Fixed Income	282,499	(277,728)	10,396,015	(12,269,321)
Corporate Shares	<u>2,259,800</u>	<u>(1,881,004)</u>	<u>65,522</u>	<u>(63,065)</u>
Total	<u>2,542,299</u>	<u>(2,158,732)</u>	<u>10,461,537</u>	<u>(12,332,386)</u>

For investments and other financial assets pledged to secure repurchase agreements, see note 13.

(7) Loans

The composition of the loan portfolio is summarized as follows:

	2017	2016
Local loans:		
Residential mortgages	3,798,892,418	3,405,347,477
Personal, auto and credit cards	1,652,578,497	1,513,915,691
Commercial mortgages	1,789,765,115	1,644,394,044
Lines of credit and commercial loans	1,673,245,046	1,534,366,420
Interim financing	807,677,587	780,854,834
Financial leases, net	120,390,513	123,186,450
Factoring operations, net	0	1,691,078
Other secured loans	185,068,481	157,411,158
Overdrafts	<u>148,591,673</u>	<u>156,079,020</u>
Total local loans	<u>10,176,209,330</u>	<u>9,317,246,172</u>
Foreign loans:		
Residential mortgages	254,472,419	251,638,840
Personal, auto and credit cards	17,033,882	15,367,333
Commercial mortgages	259,841,921	276,621,751
Lines of credit and commercial loans	700,260,919	825,717,596
Other secured loans	31,972,343	17,310,717
Overdrafts	<u>66,269,938</u>	<u>65,107,869</u>
Total foreign loans	<u>1,329,851,422</u>	<u>1,451,764,106</u>
Total	<u>11,506,060,752</u>	<u>10,769,010,278</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The movement of the allowance for loan losses is summarized as follows:

	<u>2017</u>	<u>2016</u>
Balance at beginning of year	128,917,367	112,275,164
Provision charged to expenses, net	44,484,763	45,532,128
Recoveries of written-off loans	21,367,866	18,197,914
Loans written-off	<u>(49,937,691)</u>	<u>(47,087,839)</u>
Balance at end of year	<u>144,832,305</u>	<u>128,917,367</u>

The Bank's loan portfolio is composed 53% (2016: 52%) of residential and commercial mortgage loans backed by residential units and commercial or industrial buildings.

The loan portfolio classification by type of guarantee, mainly mortgages on real estate and chattels, and other collateral such as deposits, securities, and corporate guaranties, is detailed as follows:

	<u>2017</u>	<u>2016</u>
	(in thousands)	
Mortgages on real estate	7,704,167	7,064,936
Chattel mortgages	720,421	738,067
Deposits	360,553	310,865
Other guaranties	386,699	304,529
Unsecured	<u>2,334,221</u>	<u>2,350,613</u>
Total	<u>11,506,061</u>	<u>10,769,010</u>

For loans pledged to secure borrowings, see Note 15.

The Bank recognized a tax credit in the amount of B/.36,228,726 (2016: B/.33,760,531), originating from the annual benefit awarded on mortgage loans granted with preferential interest rates on the first fifteen (15) years of the loan.

This benefit is equivalent to the difference between the income the Bank would have earned on these mortgage loans had it used the market reference interest rate in effect for that year, and the interest income actually earned.

Financial Leases, Net

The balance of financial leases, net of unearned interest, and the maturity schedule of the minimum payments are summarized as follows:

	<u>2017</u>	<u>2016</u>
Minimum payments up to 1 year	53,511,398	53,686,482
Minimum payments from 1 to 6 years	<u>81,097,686</u>	<u>84,472,954</u>
Total minimum payments	134,609,084	138,159,436
Less unearned interest	<u>(14,218,571)</u>	<u>(14,972,986)</u>
Total financial leases, net	<u>120,390,513</u>	<u>123,186,450</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

(8) Investments in Associates

The investments in associates are detailed as follows:

<u>Associates</u>	<u>Activity</u>	<u>Equity Participation</u>		<u>2017</u>	<u>2016</u>
		<u>2017</u>	<u>2016</u>		
Telered, S. A.	Processing of electronic transactions	40%	40%	7,427,075	6,784,619
Proyectos de Infraestructura, S. A.	Real estate investors	38%	38%	5,961,080	6,005,823
Processing Center, S. A.	Credit card processing	49%	49%	6,317,596	3,692,259
Financial Warehousing of Latin America	Administrator of trust funds	38%	38%	<u>2,370,002</u>	<u>2,107,860</u>
				<u>22,075,753</u>	<u>18,590,561</u>

The financial information of investments in associates is summarized as follows:

<u>Associates</u>	<u>Financial Information Date</u>	<u>2017</u>						<u>Equity Participation</u>
		<u>Assets</u>	<u>Liabilities</u>	<u>Equity</u>	<u>Income</u>	<u>Expenses</u>	<u>Net Profit (Loss)</u>	
Telered, S. A.	30-nov-2017	<u>30,316,995</u>	<u>7,109,684</u>	<u>23,207,311</u>	<u>39,213,896</u>	<u>28,779,231</u>	<u>10,434,665</u>	4,579,435
Proyectos de Infraestructura, S. A.	31-dic-2017	<u>15,584,414</u>	<u>0</u>	<u>15,584,414</u>	<u>2,092,387</u>	<u>509</u>	<u>2,091,878</u>	815,433
Processing Center, S. A.	30-nov-2017	<u>16,813,365</u>	<u>4,277,455</u>	<u>12,535,910</u>	<u>16,504,377</u>	<u>11,422,611</u>	<u>5,081,766</u>	2,625,336
Financial Warehousing of Latin America	30-nov-2017	<u>7,383,971</u>	<u>1,302,805</u>	<u>6,081,166</u>	<u>4,235,069</u>	<u>1,927,571</u>	<u>2,307,498</u>	<u>549,422</u>
Total								<u>8,569,626</u>

<u>Associates</u>	<u>Financial Information Date</u>	<u>2016</u>						<u>Equity Participation</u>
		<u>Assets</u>	<u>Liabilities</u>	<u>Equity</u>	<u>Income</u>	<u>Expenses</u>	<u>Net Profit (Loss)</u>	
Telered, S. A.	30-nov-2016	<u>39,344,772</u>	<u>16,527,084</u>	<u>22,817,688</u>	<u>35,509,572</u>	<u>26,002,300</u>	<u>9,507,272</u>	4,000,707
Proyectos de Infraestructura, S. A.	31-dic-2016	<u>15,742,536</u>	<u>0</u>	<u>15,742,536</u>	<u>3,027,947</u>	<u>607</u>	<u>3,027,340</u>	991,667
Processing Center, S. A.	30-nov-2016	<u>15,883,230</u>	<u>5,201,989</u>	<u>10,681,241</u>	<u>15,722,053</u>	<u>11,251,011</u>	<u>4,471,042</u>	2,386,872
Financial Warehousing of Latin America	30-nov-2016	<u>7,443,538</u>	<u>2,042,843</u>	<u>5,400,695</u>	<u>4,023,157</u>	<u>1,864,427</u>	<u>2,158,730</u>	<u>660,776</u>
Total								<u>8,040,022</u>

(9) Property, Furniture, Equipment and Improvements

Property, furniture, equipment and improvements are summarized as follows:

	<u>Land</u>	<u>Buildings</u>	<u>2017</u>		<u>Improvements</u>	<u>Total</u>
			<u>Licenses and Internally developed projects</u>	<u>Furniture and Equipment</u>		
Cost:						
At beginning of year	36,142,044	128,747,027	71,575,101	89,350,561	36,583,555	362,398,288
Additions	0	7,599,962	16,729,142	29,350,825	2,942,572	56,622,501
Sales and disposals	<u>4,065,234</u>	<u>5,931,552</u>	<u>1,085,399</u>	<u>3,410,963</u>	<u>2,952,350</u>	<u>17,445,498</u>
At end of year	<u>32,076,810</u>	<u>130,415,437</u>	<u>87,218,844</u>	<u>115,290,423</u>	<u>36,573,777</u>	<u>401,575,291</u>
Accumulated depreciation and amortization:						
At beginning of year	0	27,277,540	48,584,123	62,698,862	28,295,868	166,856,393
Expense of the year	0	2,641,014	8,621,730	9,328,071	1,623,629	22,214,444
Sales and disposal	<u>0</u>	<u>3,408,359</u>	<u>1,084,565</u>	<u>3,278,558</u>	<u>2,924,216</u>	<u>10,695,698</u>
At end of year	<u>0</u>	<u>26,510,195</u>	<u>56,121,288</u>	<u>68,748,375</u>	<u>26,995,281</u>	<u>178,375,139</u>
Net balance	<u>32,076,810</u>	<u>103,905,242</u>	<u>31,097,556</u>	<u>46,542,048</u>	<u>9,578,496</u>	<u>223,200,152</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

2016						
	<u>Land</u>	<u>Buildings</u>	<u>Licenses and Internally developed projects</u>	<u>Furniture and Equipment</u>	<u>Improvements</u>	<u>Total</u>
Cost:						
At beginning of year	36,142,044	94,609,186	61,427,026	89,067,664	40,148,327	321,015,795
Additions	0	34,137,841	20,517,789	4,207,665	1,767,899	60,631,194
Sales and disposals	<u>0</u>	<u>0</u>	<u>10,369,714</u>	<u>3,924,768</u>	<u>5,332,671</u>	<u>19,627,153</u>
At end of year	<u>36,142,044</u>	<u>128,747,027</u>	<u>71,575,101</u>	<u>89,350,561</u>	<u>36,583,555</u>	<u>362,398,288</u>
Accumulated depreciation and amortization:						
At beginning of year	0	25,469,427	53,123,104	57,933,375	30,992,264	167,518,170
Expense of the year	0	1,808,113	5,827,390	8,689,279	2,636,275	18,961,057
Sales and disposal	<u>0</u>	<u>0</u>	<u>10,366,371</u>	<u>3,923,792</u>	<u>5,332,671</u>	<u>19,622,834</u>
At end of year	<u>0</u>	<u>27,277,540</u>	<u>48,584,123</u>	<u>62,698,862</u>	<u>28,295,868</u>	<u>166,856,393</u>
Net balance	<u>36,142,044</u>	<u>101,469,487</u>	<u>22,990,978</u>	<u>26,651,699</u>	<u>8,287,687</u>	<u>195,541,895</u>

(10) Securities and Other Financial Assets Sold and Purchased Pending Settlement

The Bank recognizes each sale and purchase of financial instruments on a trade-date basis; the settlement of the transaction generally occurs within three to thirty working days following the trade date. The period between the trade date and the settlement date varies depending on the type of financial instrument traded and the regulations in effect at the market where the negotiation occurred.

Securities and other financial assets pending settlement amounted to B/.350,981,692 (2016: B/.365,660,394) for sales of securities and other financial assets and B/.405,771,013 (2016: B/.490,615,466) for purchases of securities and other financial assets.

(11) Goodwill and Intangible Assets, Net

The following table summarizes the goodwill generated from the acquisition of the following entities:

<u>Company</u>	<u>Date of acquisition</u>	<u>Equity</u>	<u>% Acquisition</u>	<u>Balance</u>
Banco General, S. A.	March 2004	ProFuturo-Administradora de Fondos de Pensiones y Cesantías, S. A.	17%	679,018
Banco General, S. A.	March 2005	BankBoston, N.A. – Panama (banking operations)	100%	12,056,144
ProFuturo - Administradora de Fondos de Pensiones y Cesantías, S. A.	March 2005	Purchase of trust fund	100%	861,615
Banco General, S. A.	March 2007	Banco Continental de Panama, S. A. and subsidiaries (banking and fiduciary activities)	100%	<u>27,494,722</u> <u>41,091,499</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The movement of goodwill and intangible assets is summarized as follows:

	<u>Goodwill</u>	<u>2017</u> <u>Intangible</u> <u>assets</u>	<u>Total</u>
Cost:			
Balance at the beginning and end of the year	41,091,499	47,462,084	88,553,583
Accumulated amortization:			
Balance at the beginning of the year	0	24,210,833	24,210,833
Expense of the year	<u>0</u>	<u>2,617,392</u>	<u>2,617,392</u>
Balance at the end of the year	<u>0</u>	<u>26,828,225</u>	<u>26,828,225</u>
Net balance at the end of the year	<u>41,091,499</u>	<u>20,633,859</u>	<u>61,725,358</u>
		<u>2016</u> <u>Intangible</u> <u>assets</u>	
	<u>Goodwill</u>		<u>Total</u>
Cost:			
Balance at the beginning and end of the year	41,091,499	47,462,084	88,553,583
Accumulated amortization:			
Balance at the beginning of the year	0	21,593,446	21,593,446
Expense of the year	<u>0</u>	<u>2,617,387</u>	<u>2,617,387</u>
Balance at the end of the year	<u>0</u>	<u>24,210,833</u>	<u>24,210,833</u>
Net balance at the end of the year	<u>41,091,499</u>	<u>23,251,251</u>	<u>64,342,750</u>

To test for impairment of goodwill or other intangible assets, a valuation of several assets (contracts, portfolios) or businesses acquired by the Bank is made annually to determine if the recoverable amount of an asset or business is greater than its carrying amount. In assessing value in use, the Bank mainly uses a discounted future cash flows model or alternative valuation models including multiples of earnings and equity, as applicable.

It is the Bank's policy to conduct an impairment test on an annual basis or when there is evidence of impairment. As of December 31, 2017 and 2016, no impairment losses on goodwill or intangibles assets was recognized. The valuation used by discounting the future cash flows generated from the acquisition of assets or businesses resulted in a present value which exceeded their carrying value.

To carry out the valuation of assets and businesses acquired, expected net cash flows of assets or businesses were projected for periods ranging from six to ten years and included a perpetual growth at the end of the period to estimate terminal cash flows. The growth rates in assets or businesses fluctuate based on their individual nature, and the current range is between 0% and 10%, while the perpetual growth rate ranged from 0% to 5%.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

- To determine the growth rates of assets or businesses, the Bank used reference growth, performance, and actual historical metrics of relevant assets or businesses, future prospects, anticipated macroeconomic growth of the country, business segments or evaluated business; as well as the Bank's business plans and expected growth rates in general, and for specific business assessment.
- To calculate the present value of future cash flows and determine the value of the assets or businesses being evaluated, the Bank's estimated average cost of capital was used as a discount rate for the periods referred to, when the business unit being assessed is the Bank; when discounting cash flows of assets or units with a profile other than that of the Bank, the applicable cost of capital to that unit is used. The Bank's capital cost is based on the average interest rates of long-term AAA dollar instruments, the country risk premium and return premium applicable for capital investments. The cost of capital used fluctuates between 9.25% and 10.25% and changes over time.

The key assumptions described above may change as economic and market conditions change. The Bank estimates that reasonable possible changes under these assumptions do not affect the recoverable amount of the business units or decreases them below their carrying amounts.

The amortization expense is presented in the consolidated statement of income as commission and other expenses.

(12) Foreclosed Assets, Net

The Bank holds foreclosed assets, amounting to B/.6,867,857 (2016: B/.5,173,051), less a reserve of B/.1,200,286 (2016: B/.1,300,482).

The movement of the reserve for foreclosed assets is summarized as follows:

	<u>2017</u>	<u>2016</u>
Balance at beginning of year	1,300,482	697,688
Provisions charged to expenses	1,035,369	921,648
Reversal of provision	(496,368)	(169,048)
Foreclosed assets sold	<u>(639,197)</u>	<u>(149,806)</u>
Balance at end of year	<u>1,200,286</u>	<u>1,300,482</u>

(13) Securities sold under repurchase agreements

The Bank held obligations from securities sold under repurchase agreements which amounted to B/.45,814,600 (2016: B/.273,299,978), with various maturities until April 2020 (2016: January 2017) at an annual interest rate 3.63% (2016: between 0.95% and 1.16%); the average interest rate of these securities was 3.63% (2016: 1.04%). These securities were secured by investment securities for B/.47,027,583 (2016: B/.279,539,162).

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

(14) Other Financial Liabilities at Fair Value

The Bank holds, within other liabilities caption, financial liabilities of debt instruments at fair value arising from short sales, which are summarized as follows:

	<u>Level</u>	<u>2017</u>	<u>2016</u>
"Mortgage Backed Securities" (MBS)	2	124,725,921	45,040,193
Bonds issued by the US Government	1	<u>13,541,088</u>	<u>13,635,835</u>
Total		<u>138,267,009</u>	<u>58,676,028</u>

See the description of the Levels in Note 6.

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

(15) Borrowings and Debt Securities Issued

The Bank issued bonds payable and other borrowings, as follows:

	<u>2017</u>	<u>2016</u>
Corporate bonds with maturities in 2018, at an annual interest rate of 1.625%, issued in CHF 180MM	184,710,108	176,713,136
Corporate bonds with maturities in 2018, at an annual interest rate of 2.50%	5,200,000	5,200,000
Corporate bonds with maturities in 2019, at an annual interest rate of 2.75%	25,000,000	25,000,000
Corporate bonds with maturities in 2021, at an interest rate of 3 month Libor plus a margin	75,000	75,000
Corporate bonds with maturities in 2026, at an interest rate of 3 month Libor plus a margin	2,680,000	2,680,000
Corporate bonds with maturities in 2027, at an annual interest rate of 4.125%	550,000,000	0
Borrowing with maturity in 2017, at interest rates of 3, 6 and 12 month Libor plus a margin	0	221,260,621
Borrowing with maturity in 2018, at interest rates of 3 and 6 month Libor plus a margin	290,828,863	799,790,000
Borrowing with maturity in 2019, at interest rates of 3 and 6 month Libor plus a margin	267,515,625	295,875,000
Borrowing with maturity in 2020, at interest rates of 6 month Libor plus a margin	904,444,444	106,222,222
Borrowing with maturity in 2022, at interest rates of 3 and 6 month Libor plus a margin	101,923,077	63,461,538
Borrowing with maturity in 2023, at an interest rate of 3 month Libor plus a margin	50,000,000	50,000,000
Borrowing under USAID (guarantor) program with maturity in 2025, at a fixed annual interest rate of 7.65%	3,988,091	4,346,823
Notes with maturities in 2024, at a fixed interest rate	200,000,000	200,000,000
Notes with maturities in 2027, at a fixed interest rate	<u>75,000,000</u>	<u>0</u>
Total borrowings and debt securities issued	<u>2,661,365,208</u>	<u>1,950,624,340</u>

The funds obtained under the USAID Housing Program resulted from the Bank's participation in the Housing Program No.525-HG-013 with the United States of America Agency for International Development (USAID), which involves the financing of low cost housing by foreign investors. These borrowings have a maturity of thirty (30) years, and a grace period of ten (10) years for repayment of principal. These borrowings are guaranteed by USAID. In turn, the Bank must keep these borrowings secured by mortgage loans pledged on behalf of USAID that amounted to B/.4,985,114 (2016: B/.5,433,529), representing 1.25 times the amount of the borrowed funds.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The Bank is the residual beneficiary of the liquid assets of Banco General DPR Funding Limited, a special purpose entity. The following transactions have been executed through this entity: in 2012 a borrowing in the amount of B/.100,000,000; in 2016 a borrowing in the amount of B/.50,000,000 and notes in the amount of B/.200,000,000; in 2017 a borrowing in the amount of B/.50,000,000 and notes in the amount of B/.75,000,000 collateralized with future cash flows of remittances received (MT103). The Bank must maintain a money market deposit with an amount equivalent to the next quarterly payment of principal, interest and expense, which is presented within the Deposits with banks caption. The balance of the financing received is B/.375,000,000 (2016: B/.295,000,000).

The borrowings detailed above were agreed to following terms and types of fees: 7 years with capital repayments from the second year and an interest rate of 3 month Libor plus a margin (2012), 7 years with capital repayments from the second year and an interest rate of 3 month labor plus a margin for the borrowing (2016), 8 years with capital repayments from the third year and a fixed interest rate for the notes (2016), 5 years with capital repayments from the second year and a interest rate of 3 month Libor plus a margin for the borrowing (2017) and 10 years with capital repayments from the fifth year and a fixed interest rate for notes (2017).

In June 2014, the Bank issued bonds in the Swiss market for CHF 180,000,000 with a coupon of 1.625% and a maturity date of June 18, 2018.

During 2016, the Bank obtained midterm financing for the amount of B/.206,500,000 with quarterly interest payments at a rate of 3 month Libor plus a margin and principal payment at maturity. These are syndicated loans among commercial banks of the United States, Europe, Asia, Middle East and Latin America.

In August 2017, the Bank issued bonds in the international market under the Standard 144A/Reg S for the amount of B/.550,000,000 with a ten-year fixed coupon of 4.125 and a maturity date of August 7, 2027. The bonds have biannual interest payments on the 7th day of February and August of each year, beginning on February 7, 2018. The principal amount will be paid at maturity.

In December 2017, the Bank obtained midterm financing of B/.800,000,000 with an interest rate of 3 month Libor plus a margin. The loans were syndicated among commercial banks in the United States, Europe, Asia, Middle East and Latin America. These funds were used to prepay the 2015 B/.500,000,000 financing with expiration on May 21, 2018.

The Bank had no default events and is in compliance as to principal, interest or other contractual clauses relating to its borrowings and debt securities issued.

The movement during the year of borrowings and debt securities issued is detailed below for the reconciliation with the consolidated statement of cash flows:

	<u>2017</u>	<u>2016</u>
Balance at beginning of the year	1,950,624,340	1,595,931,814
Proceeds from borrowings and debt securities issued	1,538,668,863	892,134,724
Repayment and redemptions of bonds and other obligations	(835,924,967)	(534,462,608)
Effect of currency exchange fluctuations	<u>7,996,972</u>	<u>(2,979,590)</u>
Balance at end of the year	<u>2,661,365,208</u>	<u>1,950,624,340</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements**(16) Perpetual Bonds**

Under Resolution No.366-08 of November 24, 2008, issued by the Superintendence of the Securities Markets of the Republic of Panama, Banco General, S. A. is authorized to offer Perpetual Bonds with a face value of up to B/.250,000,000 through public offering. The bonds will be issued in nominative, registered form, with no coupons, in one series, in denominations of B/.10,000 and multiples of B/.1,000, with no specific maturity or redemption date. Also, they can be redeemed by the Issuer, at its discretion either totally or partially, starting on the fifth year after the issuance date and at any interest payment day after that first redemption date. The bonds will earn a 6.5% interest rate and interest will be paid quarterly. The Bank, under certain circumstances, as described in the informative prospectus, may suspend interest payment without being considered in default. The bond's repayment is subordinated to all existing and future preferential borrowings of the issuer, and backed solely by the general credit worthiness of Banco General, S. A.

The balance of perpetual bonds is B/.217,680,000 (2016: B/.217,680,000).

(17) Liabilities from Insurance Operations

Liabilities from insurance operations amounted to B/.16,999,292 (2016: B/.14,956,842) and are comprised of unearned premiums and estimated insurance claims incurred. The movement of the reserves for insurance operations is summarized as follows:

	<u>2017</u>	<u>2016</u>
Unearned Premiums		
Balance at beginning of year	18,137,706	18,267,674
Issued premiums	36,703,164	36,164,189
Earned premiums	<u>(35,797,225)</u>	<u>(36,294,157)</u>
Balance at end of year	19,043,645	18,137,706
Reinsurers participation	<u>(4,379,851)</u>	<u>(4,609,138)</u>
Unearned premiums, net	<u>14,663,794</u>	<u>13,528,568</u>
Insurance Claims Incurred, Estimated		
Balance at beginning of year	1,868,969	2,063,895
Incurred claims	6,930,692	6,548,105
Paid claims	<u>(6,269,021)</u>	<u>(6,743,031)</u>
Balance at end of year	2,530,640	1,868,969
Reinsurer participation	<u>(195,142)</u>	<u>(440,695)</u>
Insurance claims incurred, net estimated	<u>2,335,498</u>	<u>1,428,274</u>
Total insurance claims reserves	<u>16,999,292</u>	<u>14,956,842</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

(18) Concentration of Financial Assets and Liabilities

The geographical concentration of the most significant financial assets and liabilities is as follows:

	2017			
	Panama	Latin America and the Caribbean	United States of America and Others	Total
Assets:				
Deposits with banks:				
Demand deposits	11,262,993	77,961,915	166,277,659	255,502,567
Time deposits	212,247,017	412,458	94,026,167	306,685,642
Securities and other financial assets at fair value through profit or loss	80,365,271	57,774,648	1,022,104,366	1,160,244,285
Securities and other financial assets available-for-sale	1,205,215,330	179,082,214	1,820,259,204	3,204,556,748
Securities held to maturity, net	35,573,158	0	14,409,664	49,982,822
Loans	10,176,209,330	1,329,437,283	414,139	11,506,060,752
Total	11,720,873,099	1,644,668,518	3,117,491,199	16,483,032,816
Liabilities:				
Deposits:				
Demand	2,355,393,070	123,475,612	15,516,346	2,494,385,028
Saving	3,323,170,618	65,533,137	9,851,164	3,398,554,919
Time	5,236,970,748	320,189,943	8,326,448	5,565,487,139
Securities sold under repurchase agreements	0	0	45,814,600	45,814,600
Borrowings and debt securities issued	78,970,625	55,000,000	2,527,394,583	2,661,365,208
Perpetual bonds	217,680,000	0	0	217,680,000
Other liabilities/securities sold short	0	0	138,267,009	138,267,009
Total	11,212,185,061	564,198,692	2,745,170,150	14,521,553,903
Commitments and contingencies	1,103,425,566	9,205,076	0	1,112,630,642
	2016			
	Panama	Latin America and the Caribbean	United States of America and Others	Total
Assets:				
Deposits with banks:				
Demand deposits	8,799,034	78,747,193	193,111,600	280,657,827
Time deposits	199,245,799	1,159,476	81,963,479	282,368,754
Securities and other financial assets at fair value through profit or loss	134,867,481	104,689,977	800,185,383	1,039,742,841
Securities and other financial assets available-for-sale	1,135,413,190	204,753,557	1,624,675,444	2,964,842,191
Securities held to maturity, net	37,660,830	0	21,707,551	59,368,381
Loans	9,317,246,172	1,451,732,726	31,380	10,769,010,278
Total	10,833,232,506	1,841,082,929	2,721,674,837	15,395,990,272
Liabilities:				
Deposits:				
Demand	2,498,265,620	122,464,073	18,880,493	2,639,610,186
Saving	3,201,606,542	67,224,631	11,196,825	3,280,027,998
Time	4,853,727,027	290,735,026	8,585,467	5,153,047,520
Securities sold under repurchase agreements	0	3,283,593	270,016,385	273,299,978
Borrowings and debt securities issued	110,621,667	30,000,000	1,810,002,673	1,950,624,340
Perpetual bonds	217,680,000	0	0	217,680,000
Other liabilities/securities sold short	0	0	58,676,028	58,676,028
Total	10,881,900,856	513,707,323	2,177,357,871	13,572,966,050
Commitments and contingencies	1,272,837,024	8,268,295	0	1,281,105,319

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements**(19) Segment Information**

The Bank maintains three business segments for its financial analysis, which offer different products and services and are managed separately, consistent with the way in which management receives data, budgets and assesses their performance.

Segments**Operations****Banking and Financial Activities**

Various financial services, mainly corporate, mortgage and consumer banking, financial leases, discounted bills, administration of trusts, administration and marketing of pretax food and health related contributions and securities brokerage

Insurance and Reinsurance

Insurance and reinsurance of policies of general lines, collective life and various risks

Pension and Retirement Fund Management

Administration of pension and retirement, severance and investment funds

The Bank's management prepared the following segment information based on the bank's businesses for its financial analysis:

	<u>Banking and financial activities</u>	<u>Insurance and reinsurance</u>	<u>2017 Pension and retirement fund management</u>	<u>Eliminations</u>	<u>Total</u>
Interest and commission income	888,013,229	5,112,307	775,724	2,250,703	891,650,557
Interest and provision expenses	340,536,031	0	0	2,250,703	338,285,328
Other income, net	169,811,364	22,525,065	11,825,719	10,234	204,151,914
General and administrative expenses	250,118,976	2,836,473	5,239,576	10,234	258,184,791
Depreciation and amortization expense	21,764,803	228,649	220,992	0	22,214,444
Equity participation in associates	8,569,626	0	0	0	8,569,626
Net income before income tax	453,974,409	24,572,250	7,140,875	0	485,687,534
Net Income tax	50,606,331	3,730,890	1,603,786	0	55,941,007
Net income	403,368,078	20,841,360	5,537,089	0	429,746,527
Total assets	17,432,536,491	230,925,596	27,203,051	118,743,190	17,571,921,948
Total liabilities	15,572,481,802	53,384,063	850,401	100,637,128	15,526,079,138

	<u>Banking and financial activities</u>	<u>Insurance and reinsurance</u>	<u>2016 Pension and retirement fund management</u>	<u>Eliminations</u>	<u>Total</u>
Interest and commission income	805,349,060	4,372,438	560,058	1,884,721	808,396,835
Interest and provision expenses	302,031,834	0	0	1,884,721	300,147,113
Other income, net	123,723,620	18,334,074	10,658,862	8,891	152,707,665
General and administrative expenses	228,661,578	2,451,156	4,830,718	8,891	235,934,561
Depreciation and amortization expense	18,698,044	22,130	240,883	0	18,961,057
Equity participation in associates	8,040,022	0	0	0	8,040,022
Net income before income tax	387,721,246	20,233,226	6,147,319	0	414,101,791
Net Income tax	45,034,812	2,223,653	1,455,271	0	48,713,736
Net income	342,686,434	18,009,573	4,692,048	0	365,388,055
Total assets	16,295,477,166	206,317,442	21,981,929	107,953,036	16,415,823,501
Total liabilities	14,623,257,838	49,240,902	985,893	89,846,974	14,583,637,659

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The composition of the secondary segment based on geographical distribution is as follows:

	2017			
	Panama	Latin America and the Caribbean	United States of America and Others	Total
Total income, net	<u>952,263,626</u>	<u>84,795,390</u>	<u>67,313,081</u>	<u>1,104,372,097</u>
Nonfinancial assets	<u>279,285,496</u>	<u>5,640,014</u>	<u>0</u>	<u>284,925,510</u>

	2016			
	Panama	Latin America and the Caribbean	United States of America and Others	Total
Total income, net	<u>818,477,921</u>	<u>97,001,284</u>	<u>53,665,317</u>	<u>969,144,522</u>
Nonfinancial assets	<u>253,492,716</u>	<u>6,391,929</u>	<u>0</u>	<u>259,884,645</u>

(20) Equity

The authorized share capital of Banco General, S. A. is represented by 10,000,000 common shares without par value (2016: 10,000,000 common shares); of which there are 9,787,108 shares issued and outstanding (2016: 9,787,108 common shares).

The legal reserves are established pursuant to regulations of the Superintendence of Banks of Panama, the Superintendence of Insurance and Reinsurance of Panama and the General Superintendence of Financial Entities of Costa Rica.

The detail of the legal reserve and its transfer from retained earnings is summarized as follows:

	2017				
	Reserves				
	Dynamic	Foreclosed Assets	Legal	Insurance	Total
Banco General, S. A.	133,877,476	381,637	0	0	134,259,113
Finanzas Generales, S. A.	2,810,061	0	0	0	2,810,061
General de Seguros, S. A.	0	0	0	27,328,263	27,328,263
Banco General (Overseas), Inc.	9,480,047	0	0	0	9,480,047
Banco General (Costa Rica), S. A.	<u>4,580,865</u>	<u>0</u>	<u>1,002,898</u>	<u>0</u>	<u>5,583,763</u>
Total	<u>150,748,449</u>	<u>381,637</u>	<u>1,002,898</u>	<u>27,328,263</u>	<u>179,461,247</u>

	2016				
	Reserves				
	Dynamic	Foreclosed Assets	Legal	Insurance	Total
Banco General, S. A.	133,877,476	337,957	0	0	134,215,433
Finanzas Generales, S. A.	2,810,061	0	0	0	2,810,061
General de Seguros, S. A.	0	0	0	25,656,594	25,656,594
Banco General (Overseas), Inc.	9,480,047	0	0	0	9,480,047
Banco General (Costa Rica), S. A.	<u>4,580,865</u>	<u>0</u>	<u>976,221</u>	<u>0</u>	<u>5,557,086</u>
Total	<u>150,748,449</u>	<u>337,957</u>	<u>976,221</u>	<u>25,656,594</u>	<u>177,719,221</u>

Transfer from retained earnings of the year	<u>0</u>	<u>43,680</u>	<u>26,677</u>	<u>1,671,669</u>	<u>1,742,026</u>
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BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The Bank, through its subsidiary General de Seguros, S. A., maintains legal reserves and reserves for statistical deviations and catastrophic risks as established by the Superintendence of Insurance and Reinsurance of Panama. The use and restitution of these reserves shall be regulated by the Superintendence of Insurance and Reinsurance of the Republic of Panama.

The complementary tax corresponds to the advance of the dividend tax that is applied to the net income of the year and that the taxpayer must retain and pay to the tax authorities within the stipulated years. The tax is attributable to the shareholder and it is applied as a tax credit at the time of distribution of dividends.

(21) Gain on Financial Instruments, Net

The net gain on financial instruments included in the consolidated income statement is summarized as follows:

	<u>2017</u>	<u>2016</u>
Unrealized gain (loss) on securities and other financial assets	22,024,053	(2,034,700)
Unrealized (loss) gain on derivative instruments	(4,700,900)	63,870
Gain on sale of securities and other financial assets at fair value through profit or loss	4,102,716	2,080,699
Loss on sale of securities and other financial assets available-for-sale	(1,029,905)	(3,120,056)
Realized (loss) gain on derivative instruments	<u>(3,918,587)</u>	<u>7,648,834</u>
Total gain on financial instruments, net	<u>16,477,377</u>	<u>4,638,647</u>

Detail of gain on sale of securities and other financial assets, net by type of classification, is disclosed in Note 6.

(22) Other Income, Net

Other income, net included in the consolidated income statement, is summarized as follows:

	<u>2017</u>	<u>2016</u>
Dividends	2,424,611	1,937,451
Foreign exchange fluctuations, net	(5,791,607)	3,358,032
Various banking services	15,730,344	5,801,309
Gain on sale of fixed assets, net	18,374,575	113,387
Fiduciary services	155,314	162,134
Other income	<u>8,192,372</u>	<u>6,707,296</u>
Total other income, net	<u>39,085,609</u>	<u>18,079,609</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

(23) Personnel Benefits

Contributions made by the Bank corresponding to personnel benefits are recognized as salaries and other employee expenses in the consolidated statement of income.

Share-Based Compensation Plan

The total options granted by the Bank to its key participating executives to purchase shares from the controlling company, Grupo Financiero BG, S. A., is 472,000 (2016 : 472,000). The options outstanding are 96,800 (2016: 114,794), which have an average exercise price of B/.76.55 (2016: B/.72.18). The total expense relating to the options granted to the participants, based on their fair value, amounted to B/.13,491 (2016: B/.13,491). This plan will be in effect until 2021.

The balance of options granted by the Bank to its key participating executives to purchase shares from Grupo Financiero BG, S. A. is 3,909,010 (2016: 3,848,160). The options outstanding are 1,340,480 (2016: 1,544,995), which have an average exercise price of B/.52.54 (2016: B/.51.32). The total expense relating to the options granted to the participants, based on their fair value, amounted to B/.1,429,349 (2016: B/.1,450,598). This plan will be in effect until 2022.

Restricted Share Plan

On October 2010, the Board of Directors of Grupo Financiero BG, S. A. approved to grant up to 325,000 common share of its authorized share capital in order to be awarded under the Restricted Share Plan for participants, which applies for the 2010-2015 period. On December 2016, the Board of Directors of Grupo Financiero BG, S. A. approved the plan's extension until all restricted common shares are distributed.

The number of shares to be granted will be determined annually by the Compensation Committee of the Board of Grupo Financiero BG, S. A. based on the performance of the Bank and its participants.

The shares to be issued to the participants are awarded at the average price of the month preceding the grant quoted in the Stock Exchange of Panama.

Once the restricted shares are issued, the participant may dispose of them as follows: 50% after the first year and 50% after the second year.

As the restricted share plan is a voluntary plan it may be discontinued by the Board of Directors of Grupo Financiero BG, S. A. at its sole discretion.

In 2017, 36,694 (2016: 45,834) shares were granted under the restricted share plan and recognized as an expense of B/.3,290,103 (2016: B/.2,916,252). The reconciliation of the balance for these shares is as follows:

	<u>2017</u>	<u>2016</u>
Shares at the beginning of year	36,694	82,528
Shares issued	<u>(36,694)</u>	<u>(45,834)</u>
Balance at end of year	<u><u>0</u></u>	<u><u>36,694</u></u>

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Retirement Plan

The Bank maintains a closed retirement plan, which was amended and approved by the Board of Directors in 1998; this plan is under independent administration by a fiduciary agent.

The contribution to the retirement plan was B/.134,568 (2016: B/.134,568) and the disbursements to former employees who are covered under the retirement plan amounted to B/.178,022 (2016: B/.179,338).

(24) Income Tax

Income tax returns of companies incorporated in the Republic of Panama, are subject to examination by local tax authorities for the last three years.

In accordance with current tax regulations, companies incorporated in Panama are exempt from income taxes on the following: profits derived from foreign operations, interest earned on deposits with local banks, securities issued by the Government of Panama, securities listed with the Superintendence of the Securities Markets and the Panama stock exchange and, lastly, securities and loans to the Panamanian government and its autonomous and semi-autonomous institutions.

Companies incorporated in the following jurisdictions are subject to income tax rates imposed by the respective local tax authorities:

<u>Country</u>	<u>Tax rate</u>
Panama	25%
Costa Rica	30%

The companies incorporated in Cayman Islands and British Virgin Islands are not subject to the payment of income tax, due to the nature of their foreign operations.

The income tax amounted to B/.58,287,286 (2016: B/.53,114,421) on financial income generated by companies incorporated in the Republic of Panama B/.417,714,272 (2016: B/.357,806,370). The average effective income tax rate for the year ended December 31, 2017 was 14% (2016: 15%). The income tax rate applicable according to current legislation in the Republic of Panama is 25% (2016: 25%) or based on the alternative calculation, whichever is greater.

Income tax, net is detailed as follows:

	<u>2017</u>	<u>2016</u>
Estimated income tax	58,937,544	53,333,200
Prior year income tax adjustments	533,726	127,805
Deferred income tax	<u>(3,530,263)</u>	<u>(4,747,269)</u>
	<u>55,941,007</u>	<u>48,713,736</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The reconciliation between financial income before income tax and net taxable income, from companies incorporated in the Republic of Panama, is detailed as follows:

	<u>2017</u>	<u>2016</u>
Financial income before income tax	417,714,272	357,806,370
Foreign, exempt and non taxable income, net	(290,665,546)	(232,356,433)
Non deductible costs and expenses	<u>106,100,418</u>	<u>87,007,746</u>
Net taxable income	<u>233,149,144</u>	<u>212,457,683</u>

The income tax paid during 2017 was B/.47,670,493 (2016: B/.8,711,737).

The detail of deferred income tax asset and liability, recorded by the Bank, is as follows:

	<u>2017</u>	<u>2016</u>
Deferred income tax – asset:		
Allowance for loan losses	33,623,858	30,222,339
Allowance for other real estate owned	<u>132,583</u>	<u>58,519</u>
Total deferred income tax – asset	<u>33,756,441</u>	<u>30,280,858</u>
Deferred income tax – liability:		
Allowance for losses on financial leases	(448,264)	(515,085)
Allowance for other real estate owned	(3,878)	(5,688)
Financial lease operations	3,554,643	3,743,247
Deferred commission expense	<u>437,068</u>	<u>371,775</u>
Total deferred income tax – liability	<u>3,539,569</u>	<u>3,594,249</u>

Based on the current and projected results, the Bank's management considers that there will be sufficient taxable income to absorb the deferred taxes detailed above.

(25) Commitments and Contingencies

In the normal course of business, the Bank holds commitments and contingencies which are not reflected in the consolidated statement of financial position that involve certain levels of credit and liquidity risks.

Guarantees issued on behalf of customers, letters of credit and promissory notes include certain exposure to credit loss in the event of non-compliance by the customer, net of collateral guarantees securing these transactions. The Bank's policies and procedures to approve these commitments are similar to those for extending loan facilities recorded within the Bank's assets.

The Bank's management believes that no losses will result from these commitments on behalf of customers.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Off balance sheet commitments, by maturity are summarized as follows:

	0 – 1 year	<u>2017</u> <u>1 – 5</u> <u>years</u>	<u>Total</u>
Letters of credit	166,621,110	30,657,714	197,278,824
Financial guarantees	59,492,310	23,496,047	82,988,357
Mortgage disbursement commitment	<u>832,363,461</u>	<u>0</u>	<u>832,363,461</u>
Total	<u>1,058,476,881</u>	<u>54,153,761</u>	<u>1,112,630,642</u>

	0 – 1 year	<u>2016</u> <u>1 – 5</u> <u>years</u>	<u>Total</u>
Letters of credit	197,666,761	30,614,005	228,280,766
Financial guarantees	56,886,726	21,546,878	78,433,604
Mortgage disbursement commitment	<u>974,390,949</u>	<u>0</u>	<u>974,390,949</u>
Total	<u>1,228,944,436</u>	<u>52,160,883</u>	<u>1,281,105,319</u>

Credit Quality Analysis of Commitments and Contingencies

The table below presents information about the credit quality of commitments and contingencies held by the Bank:

	<u>2017</u>	<u>2016</u>
<u>Maximum exposure</u>		
Carrying amount	<u>1,112,630,642</u>	<u>1,281,105,319</u>
<u>Letters of credit</u>		
Grade 1: Standard	193,134,894	222,768,813
Grade 2: Special mention	2,830,305	4,443,460
Grade 3: Sub-standard	<u>1,313,625</u>	<u>1,068,493</u>
Gross amount	<u>197,278,824</u>	<u>228,280,766</u>
<u>Financial guarantees</u>		
Grade 1: Standard	82,416,773	78,055,585
Grade 2: Special mention	381,178	301,721
Grade 3: Sub-standard	<u>190,406</u>	<u>76,298</u>
Gross amount	<u>82,988,357</u>	<u>78,433,604</u>
<u>Mortgage disbursement commitment</u>		
Grade 1: Standard	824,946,709	968,842,500
Grade 2: Special mention	2,687,087	3,442,572
Grade 3: Sub-standard	2,323,727	1,102,281
Grade 4: Doubtful	1,654,202	643,596
Grade 5: Loss	<u>751,736</u>	<u>360,000</u>
Gross amount	<u>832,363,461</u>	<u>974,390,949</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The Bank is not involved in any litigation that in management's opinion may result in a material adverse effect on the Bank, its consolidated financial position or to its consolidated financial performance.

(26) Investment Entities and Separate Vehicles

The Bank managed trust contracts at client's own risk in the amount of B/.2,357,209,093 (2016: B/.2,250,086,012), and had the custody of securities in investment accounts at client's own risk amounting to B/.10,219,936,357 (2016: B/.8,946,364,598). Given the nature of these services, the Bank's management considers that there are no significant risks attributable to the Bank.

At December 31, 2017 the Bank does not hold assets under discretionary investment management.

(27) Structured Entities

The following table describes the structured entity designed by the Bank:

Type of structured entity	Nature and purpose	Interest held by the Bank
- Investment funds	To offer an alternative to investors through a diversified portfolio while preserving capital	11.72% (2016:13.49%)

The funds managed at client's own risk amount to B/.468,477,962 (2016: B/.390,082,236); income fees for administration and custody amount to B/.4,935,381 (2016: B/.4,255,961), and are presented as Fees and other commissions in the consolidated statement of income.

The Bank has no contractual obligation to provide financial or other types of support to this unconsolidated structured entity.

(28) Derivative Financial Instruments

The Bank uses interest rate swap contracts to reduce interest rate risk of both financial assets and financial liabilities. The Bank reduces the credit risk of these contracts by using solid financial institutions as counterparties. These contracts are recorded in the consolidated statement of financial position at fair value using the fair value hedge or cash flow hedge method, in other assets and other liabilities.

For fixed income portfolios under management of third parties, the Bank sometimes makes use of derivatives on fixed income instruments and currencies under defined limits and parameters. These derivatives are recorded at fair value in the consolidated statement of financial position.

The following table summarizes the accounting method applied on the interest rate swaps held by the Bank:

Accounting method	2017			Fair Value	
	Remaining maturity		Total	Assets	Liabilities
	Up to 1 year	More than 1 year			
	Notional Value	Notional Value			
Fair value	0	7,250,000	7,250,000	0	655
Trading	1,313,537,438	1,009,781,822	2,323,319,260	2,713,916	32,682,240
Total	1,313,537,438	1,017,031,822	2,330,569,260	2,713,916	32,682,895

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

<u>Accounting method</u>	<u>Remaining maturity</u>		<u>2016</u>	<u>Fair Value</u>	
	<u>Notional Value</u>		<u>Total</u>	<u>Assets</u>	<u>Liabilities</u>
	<u>Up to</u>	<u>More than</u>			
	<u>1 year</u>	<u>1 year</u>			
Cash flow	1,250,000	100,000,000	101,250,000	683,871	561
Fair value	0	7,250,000	7,250,000	0	1,314,209
Trading	<u>562,222,715</u>	<u>731,320,561</u>	<u>1,293,543,276</u>	<u>2,905,810</u>	<u>28,497,485</u>
Total	<u>563,472,715</u>	<u>838,570,561</u>	<u>1,402,043,276</u>	<u>3,589,681</u>	<u>29,812,255</u>

The Bank holds derivatives contracts with a notional value of B/.2,330,569,260 (2016: B/.1,402,043,276), of which B/.1,448,484,975 (2016: B/.527,441,432) were managed by third parties. Of these derivatives managed by third parties, B/.1,203,722,835 (2016: B/.278,567,249) are intended to manage the duration and the interest rate risk on these portfolios.

The Bank recognized the amount of B/.(677,080) (2016: B/.682,173), in the consolidated statement of changes in equity as a result of changes in fair values of hedging derivative financial instruments.

The net impact of the derivative instruments on the interest expense on borrowings in the consolidated statement of income was B/.(388,299) (2016: B/.(13,296)).

The three Levels of the fair value hierarchy for derivatives instruments are as follows:

<u>Fair Value Measurement of Derivatives Instruments</u>				
	<u>2017</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Financial assets at fair value	<u>2,713,916</u>	<u>0</u>	<u>2,713,916</u>	<u>0</u>
Financial liabilities at fair value	<u>32,682,895</u>	<u>0</u>	<u>32,682,895</u>	<u>0</u>
	<u>2016</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Financial assets at fair value	<u>3,589,681</u>	<u>0</u>	<u>3,589,681</u>	<u>0</u>
Financial liabilities at fair value	<u>29,812,255</u>	<u>0</u>	<u>29,812,255</u>	<u>0</u>

The main valuation techniques, assumptions and inputs used to measure the fair value of derivatives are as follows:

<u>Derivative</u>	<u>Valuation Technique</u>	<u>Inputs</u>	<u>Level</u>
Organized Market	Quoted prices	Observable quoted prices in active markets	1-2
Over the Counter (OTC)	Discounted cash flow	Yield curves Yield foreign exchange Credit spreads Volatility	2

See Note 6, for the description of these Levels.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

(29) Fair Value of Financial Instruments

The following assumptions, where practical, have been made by Management to estimate the fair value of financial assets and liabilities not measured at fair value:

(a) *Securities and other financial assets*

For securities and others financial assets, the fair value measurement is determined using quoted prices in active markets, prices from a third party pricing vendors, brokers, custodians, investment management companies and banks. In addition, for some cases the fair value measurement is determined using valuation techniques mainly by discounting cash flows at the appropriate discount rate for that instrument. The main valuation techniques are presented in Note 6.

(b) *Demand deposits from customers/savings deposits from customers/securities sold under agreements to repurchase*

For these financial instruments described above, the carrying value approximates their fair value due to their short-term nature.

(c) *Loans*

The fair value of the loan portfolio was determined by discounting the future cash flows at an interest rate that represents: (i) current market rates, and (ii) the future expected interest rates, for a term that takes into account the expected anticipated prepayments in the loan portfolio.

(d) *Time deposits from customers and banks/borrowings and debt securities issued /perpetual bonds*

The fair value of these financial instruments was determined by discounting the future cash flows at an interest rate that reflects: (i) current market rates, and (ii) the future expected interest rates, for a term that shows the remaining life of these instruments.

Fair value estimates are made at a specific date based on relevant market estimates and information about the financial instruments. These estimates do not reflect any premium or discount that could result from the offer to sell a specific financial instrument at a given date. These estimates are subjective in nature and involve uncertainties and significant judgment; therefore, these estimates cannot be determined with precision. Changes in the assumptions or criteria could significantly affect the estimates.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The following table summarizes the carrying value and fair value of those significant financial assets and liabilities not measured at fair value in the Bank's consolidated statement of financial position:

	<u>2017</u>		<u>2016</u>	
	<u>Book Value</u>	<u>Fair Value</u>	<u>Book Value</u>	<u>Fair Value</u>
<u>Assets:</u>				
Time deposits	306,685,642	306,934,362	282,368,754	282,867,667
Securities held to maturity, net	49,982,822	61,425,701	59,368,381	69,602,402
Loans, net	<u>11,322,973,693</u>	<u>11,295,615,060</u>	<u>10,604,581,826</u>	<u>10,593,456,350</u>
	<u>11,679,642,157</u>	<u>11,663,975,123</u>	<u>10,946,318,961</u>	<u>10,945,926,419</u>
<u>Liabilities:</u>				
Deposits	11,458,427,086	11,474,663,716	11,072,685,704	11,084,861,769
Securities sold under repurchase agreements, borrowings and debt securities issued	<u>2,924,859,808</u>	<u>2,871,051,545</u>	<u>2,441,604,318</u>	<u>2,396,934,326</u>
	<u>14,383,286,894</u>	<u>14,345,715,261</u>	<u>13,514,290,022</u>	<u>13,481,796,095</u>

The table below summarizes the fair value hierarchy of financial instruments which are not measured at fair value in the Bank's consolidated statement of financial position:

	<u>2017</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>Assets:</u>				
Time deposits	306,934,362	0	0	306,934,362
Securities held to maturity, net	61,425,701	0	52,545,138	8,880,563
Loans, net	<u>11,295,615,060</u>	<u>0</u>	<u>0</u>	<u>11,295,615,060</u>
	<u>11,663,975,123</u>	<u>0</u>	<u>52,545,138</u>	<u>11,611,429,985</u>
<u>Liabilities:</u>				
Deposits	11,474,663,716	0	0	11,474,663,716
Securities sold under repurchase agreements, borrowings and debt securities issued	<u>2,871,051,545</u>	<u>0</u>	<u>0</u>	<u>2,871,051,545</u>
	<u>14,345,715,261</u>	<u>0</u>	<u>0</u>	<u>14,345,715,261</u>
	<u>2016</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>Assets:</u>				
Time deposits	282,867,667	0	0	282,867,667
Securities held to maturity, net	69,602,402	0	58,852,099	10,750,303
Loans, net	<u>10,593,456,350</u>	<u>0</u>	<u>0</u>	<u>10,593,456,350</u>
	<u>10,945,926,419</u>	<u>0</u>	<u>58,852,099</u>	<u>10,887,074,320</u>
<u>Liabilities:</u>				
Deposits	11,084,861,769	0	0	11,084,861,769
Securities sold under repurchase agreements, borrowings and debt securities issued	<u>2,396,934,326</u>	<u>0</u>	<u>0</u>	<u>2,396,934,326</u>
	<u>13,481,796,095</u>	<u>0</u>	<u>0</u>	<u>13,481,796,095</u>

See Note 6, for the description of these levels.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

(30) Financial Instruments Risk Management

A financial instrument is any contract that originates a financial asset in one enterprise and a financial liability or equity instrument in another enterprise. The Bank's consolidated statement of financial position is primarily composed of financial instruments.

Financial instruments expose the Bank to various types of risks. The Bank's Board of Directors has approved a Risk Management Policy to identify each significant risk the Bank is exposed to. In order to manage and monitor the several risks faced by the Bank, the Board of Directors has created the Credit Risk Committee of the Board of Directors, to oversee the liquidity, market, interest rate, exchange rate and counterparty risks. Likewise, the Board of Directors has established executive Committees, which are composed of key executives that monitor several risks faced by the Bank. These committees have established policies and limits in order to monitor, control and manage these risks. There is also an Audit Committee, composed of members of the Bank's Board of Directors that oversees the establishment of appropriate internal controls for reporting the Bank's financial information.

The main risks identified by the Bank are credit, counter-party, market, liquidity and financing, operational and capital management risks which are described as follows:

(a) *Credit Risk*

Is the risk that the debtor or issuer of a financial asset owned by the Bank does not fully and timely comply with any required payment, in conformity with terms and conditions agreed upon when the respective financial asset was acquired or originated by the Bank.

To mitigate credit risk, risk management policies establish limits by country, industry, and debtor. The Credit Committee appointed by the Board of Directors, periodically watches over the financial condition of debtors and issuers of financial instruments in the consolidated statement of financial position of the Bank.

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Credit Quality Analysis

The table below sets out information on the credit quality of the loan portfolio and the allowance for impairment loss held by the Bank against those assets:

	Loans	
	<u>2017</u>	<u>2016</u>
	(in thousands)	
<u>Maximum exposure</u>		
Carrying amount	<u>11,506,061</u>	<u>10,769,010</u>
<u>At amortized cost</u>		
Grade 1: Standard	10,968,299	10,299,349
Grade 2: Special mention	324,854	304,962
Grade 3: Sub-standard	99,966	90,008
Grade 4: Doubtful	61,448	29,951
Grade 5: Loss	<u>51,494</u>	<u>44,740</u>
Gross amount	11,506,061	10,769,010
Allowance for impairment	144,832	128,917
Unearned commissions	<u>38,255</u>	<u>35,511</u>
Net carrying amount	<u>11,322,974</u>	<u>10,604,582</u>
<u>Loans with renegotiated terms</u>		
Gross carrying amount	148,250	92,022
Impaired amount	148,250	92,022
Allowance for impairment	<u>24,375</u>	<u>6,673</u>
Net carrying amount	<u>123,875</u>	<u>85,349</u>
<u>Neither past due nor impaired</u>		
Grade 1	<u>10,811,611</u>	<u>10,187,566</u>
Total	<u>10,811,611</u>	<u>10,187,566</u>
<u>Past due but not impaired</u>		
31 - 60 days	<u>156,688</u>	<u>111,783</u>
Total	<u>156,688</u>	<u>111,783</u>
<u>Individually impaired</u>		
Grade 2	118,404	127,097
Grade 3	67,659	50,323
Grade 4	35,823	9,037
Grade 5	<u>25,709</u>	<u>19,716</u>
Total	<u>247,595</u>	<u>206,173</u>
<u>Allowance for impairment</u>		
Individual	29,750	12,524
Collective	<u>115,082</u>	<u>116,393</u>
Total	<u>144,832</u>	<u>128,917</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The aging of the loan portfolio delinquency is presented as follows:

	<u>2017</u>		
	Banco General, S. A.	<u>Subsidiaries</u>	<u>Total</u>
Current	10,132,782,826	994,115,440	11,126,898,266
From 31 to 90 days	255,148,953	5,917,684	261,066,637
More than 90 days (capital or interest)	101,577,594	4,481,197	106,058,791
More than 30 days past due (capital)	11,933,900	103,158	12,037,058
Total	<u>10,501,443,273</u>	<u>1,004,617,479</u>	<u>11,506,060,752</u>

	<u>2016</u>		
	Banco General, S. A.	<u>Subsidiaries</u>	<u>Total</u>
Current	9,436,285,262	1,018,866,926	10,455,152,188
From 31 to 90 days	206,203,451	5,091,072	211,294,523
More than 90 days (capital or interest)	92,885,501	2,822,333	95,707,834
More than 30 days past due (capital)	6,855,733	0	6,855,733
Total	<u>9,742,229,947</u>	<u>1,026,780,331</u>	<u>10,769,010,278</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The following table analyzes the credit quality of the investments and other financial assets and impairment reserves held by the Bank, excluding corporate shares and mutual funds amounting to B/.43,791,299 (2016: B/.38,800,125), which are not subject to credit risk:

	Investment and Other Financial Assets	
	<u>2017</u>	<u>2016</u>
<u>Maximum exposure</u>		
Carrying amount	<u>4,371,083,917</u>	<u>4,025,243,709</u>
<u>At amortized cost</u>		
AAA	14,313,126	21,509,045
AA+ to A	15,217	98,390
BBB+ to BBB-	28,212,674	28,860,560
BB to B-	7,405,448	8,859,355
NR	<u>127,718</u>	<u>131,452</u>
Gross amount	50,074,183	59,458,802
Impairment amount	<u>91,361</u>	<u>90,421</u>
Net carrying amount	<u>49,982,822</u>	<u>59,368,381</u>
<u>Available for sale</u>		
AAA	1,046,247,857	1,049,852,944
AA+ to A	516,005,602	414,646,715
A-	61,338,711	78,782,567
BBB+ to BBB-	703,928,713	586,905,797
BB+	134,297,700	225,828,105
BB to B-	732,815,797	600,968,354
Less than B-	48,756	68,750
NR	<u>3,885,676</u>	<u>1,860,491</u>
Carrying amount	<u>3,198,568,812</u>	<u>2,958,913,723</u>
<u>At fair value through profit or loss</u>		
AAA	770,283,975	755,044,560
AA+ to A	165,382,953	2,956,114
A-	182,824	50,892,591
BBB+ to BBB-	14,078,969	68,559,189
BB+	0	1,555,863
BB to B-	97,049,755	62,761,762
Less than B-	71,424,859	63,812,401
NR	<u>4,037,587</u>	<u>1,288,704</u>
Carrying amount	<u>1,122,440,922</u>	<u>1,006,871,184</u>

The analysis has been based on the highest ratings assigned amongst Fitch Ratings Inc., Moody's and Standard and Poor's. In the case of local investments that do not have an international rating, the Bank uses an internal rating, which is consistent with international risk ratings.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Time deposits with banks

The time deposits with banks are held with central banks and financial institution counterparties that are rated at least between AAA to BBB-, based on ratings by Standard & Poor's, Moody's and Fitch Ratings Inc., amount to B/.306,273,184 (2016: B/.281,209,278).

Factors of major influence in the credit risk of the Bank and the assumptions used for this disclosure are as follows:

- *Impairment of loans and investments and other financial assets and deposits with banks:*
Impairment of loans, investments and other financial assets and deposits with banks is determined by comparing the carrying value of the asset to its estimated recoverable amount. At December 31, 2016 and 2017 the Bank has no impaired deposits.
- *Past due but not impaired loans and investments and other financial assets:*
Loans and investments and other financial assets that hold enough collateral and/or sources of repayment to cover the carrying value of such loans or investments and other financial assets are considered past due but not impaired, i.e, no losses incurred.
- *Restructured loans:*
Restructured loans are those that due to deterioration in the borrower's financial position, a significant variation in the original terms (balance, term, payment schedule, rate or guarantees) have been formally documented, due to material difficulties in the payment capacity of the debtor, and the result of the assessment of their current condition does not permit their reclassification to Standard.
- *Impairment reserves:*
The Bank has established reserves to cover losses incurred on loans and investments and other financial assets portfolios.

(a) Loans

The allowance for loan losses is calculated on an individual basis for loans that are individually significant; and on a collective basis for loans that are not individually significant, as well as for loans that present no impairment when assessed individually.

(b) Investments and other financial assets

The reserve for prolonged impairment of investments carried at amortized cost is calculated individually based on their fair value as established by the investment and other financial assets policies and credit risk of the Bank. In the case of instruments available for sale, the estimated loss is calculated individually based on its market value and / or individual analysis of the investment based on its estimated cash flows.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

- *Charge-off policy:*

The Bank periodically reviews its impaired corporate loan portfolio to identify credits that are deemed uncollectible and should be charged-off. For unsecured consumer loans, charge-offs are carried out based on the accrued level of delinquency. In the case of mortgage and consumer loans, charge-offs are recognized for the estimated portion of the carrying value that is not covered by loan collateral.

Collateral and other credit enhancements held to reduce credit risk

The Bank holds collateral and other credit enhancements to reduce its exposure to credit risk.

The table below sets out the principal types of collateral held against financial assets.

	% of exposure that is subject to collateral requirements		<u>Type of collateral</u>
	<u>2017</u>	<u>2016</u>	
Loans	79.71%	78.17%	Cash, Properties, Equipment, and Others
Investment and other financial assets	53.28%	52.33%	Cash, Properties, and Equipment

Residential mortgage loans

The table below presents the value of residential mortgage loans held within ranges of loan-to-value (LTV). The LTV is calculated as the ratio of the gross loan balance to the value of the collateral. The gross loan balances exclude any impairment allowance. The value of collateral for residential mortgage loans is based on the collateral value at loan origination, which in certain instances is updated on a periodic basis.

	<u>2017</u>	<u>2016</u>
Residential mortgages loans:		
Less than 50%	642,818,385	571,969,171
51% - 70%	1,004,888,972	860,189,430
71% - 90%	1,979,688,603	1,749,600,611
More than 90%	<u>425,968,877</u>	<u>475,227,105</u>
Total	<u>4,053,364,837</u>	<u>3,656,986,317</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements*Concentration of Credit Risk*

The Bank monitors credit risk concentration by sector and geographic location. The analysis of credit risk concentration is presented below:

	<u>Loans</u>		<u>Investments and other financial assets</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
	(in thousands)		(in thousands)	
<u>Concentration by Sector:</u>				
Corporate	5,351,181	5,186,832	2,562,121	2,237,067
Consumer	5,725,280	5,187,783	0	0
Government and Government Agencies	0	0	1,852,663	1,826,886
Other Sectors	429,600	394,395	0	0
	<u>11,506,061</u>	<u>10,769,010</u>	<u>4,414,784</u>	<u>4,063,953</u>
<u>Geographical Concentration:</u>				
Panama	10,176,210	9,317,246	1,321,154	1,307,941
Latin America and the Caribbean	1,329,437	1,451,733	236,857	309,444
United States of America and Other	414	31	2,856,773	2,446,568
	<u>11,506,061</u>	<u>10,769,010</u>	<u>4,414,784</u>	<u>4,063,953</u>

The geographic concentration of loans is based on the debtor's location, and location of investments is based on the issuer's location.

(b) Counterparty Risk

Counterparty risk is the risk that a counterparty does not comply with the settlement of a purchase or sale of securities or other instruments traded in financial markets.

Risk management policies set counterparty limits that determine, at every moment, the maximum amount of net exposure of unsettled transactions that the Bank can hold with a counterparty. The Assets and Liabilities Committee is responsible for identifying those acceptable counterparties taking into consideration the counterparty's history with respect to the fulfillment of obligations, as well as indications of its capability and position to comply with its obligations.

(c) Market Risk

Market risk is the risk that the value of the Bank's financial assets are reduced as a result of changes in interest rates, foreign currency exchange rates, stock prices, and also the impact of other financial variables that are out of the Bank's control.

Management of market risk:

Policies and global limits of exposure to investments, provided in the Investment Manual, are established and approved by the Bank's Board of Directors based on the Assets and Liabilities Committee's recommendation; which take into consideration the portfolio and the assets that comprise it.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The Bank's investment policies provide for the compliance of limits by total amount of the investment portfolio, individual limits by type of asset, by institution, by issuer and/or issue and maximum term by portfolio; for each portfolio the instruments to be included and their credit risk rating are specified.

In addition, the Bank has established maximum limits for market risk losses in its investment and other financial assets portfolio that may be caused by movements in interest rates, credit risk and fluctuations in the market values of equity investments.

Currently, the investment policy of the Bank does not contemplate investments in commodities.

The Assets and Liabilities Committee approves the use of derivatives as part of its strategy to manage the financial assets and liabilities of the Bank. It is the responsibility of the Treasury Unit of the Bank, to carry out interest rate derivative transactions based on the policies and approvals adopted by the Assets and Liabilities Committee as well as future monitoring of existing positions.

Exposure to market risk:

The portfolio of held for trading securities of the Bank has the sole purpose of maintaining an inventory of securities to meet the demands of investment clients. The Bank's investment policies do not include investment portfolios that seek to generate short-term gains.

The composition and analysis of each type of market risk is presented as follows:

- *Exchange rate risk:*

Exchange rate risk is the risk that the value of a financial instrument fluctuates as a consequence of variations in foreign currency exchange rates, and other financial variables, as well as the market participants' reactions to political and economic events. For accounting standard purposes, this risk does not originate from financial instruments that are non-monetary items, or financial instruments denominated in the functional currency.

Currently, foreign exchange exposures are low considering the Bank's policy is not to hold foreign exchange positions, unless their purpose is to cover clients' needs or those arising from portfolios managed by third parties which have maximum exposure limits, according to those established by Bank's Board of Directors.

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The table below sets out the Bank's maximum exposure to foreign currencies. The assets and liabilities are presented at their carrying amount, except derivatives which are presented at their nominal value within other assets/other liabilities.

	2017							
	Euro, expressed in USD	Costa Rican Colon, expressed in USD	Sterling Pound, expressed in USD	Japanese Yen, expressed in USD	Mexican Peso, expressed in USD	Swiss Franc, expressed in USD	Other currencies, expressed in USD*	Total
Exchange rate	<u>1.20</u>	<u>566.42</u>	<u>1.35</u>	<u>112.64</u>	<u>19.63</u>	<u>0.97</u>		
Assets								
Cash and cash items	670,270	7,335,965	631,450	5,128,886	45,403	1,056,963	257,509	15,126,446
Investments and other financial assets	40,655,488	2,208,128	47,497,815	27,116,208	0	0	78,809	117,556,448
Loans	0	11,648,161	0	0	0	0	0	11,648,161
Other assets	<u>466,143</u>	<u>1,634,198</u>	<u>68,108</u>	<u>1,855,162</u>	<u>1,521,006</u>	<u>187,092,794</u>	<u>0</u>	<u>192,637,411</u>
	<u>41,791,901</u>	<u>22,826,452</u>	<u>48,197,373</u>	<u>34,100,256</u>	<u>1,566,409</u>	<u>188,149,757</u>	<u>336,318</u>	<u>336,968,466</u>
Liabilities								
Deposits	0	17,977,169	0	0	0	0	0	17,977,169
Borrowings and debt securities issued	0	1,679,590	0	0	0	184,710,108	0	186,389,698
Other liabilities	<u>41,714,173</u>	<u>329,965</u>	<u>50,118,797</u>	<u>32,195,632</u>	<u>0</u>	<u>0</u>	<u>5,443,387</u>	<u>129,801,954</u>
	<u>41,714,173</u>	<u>19,986,724</u>	<u>50,118,797</u>	<u>32,195,632</u>	<u>0</u>	<u>184,710,108</u>	<u>5,443,387</u>	<u>334,168,821</u>
Net position	<u>77,728</u>	<u>2,839,728</u>	<u>(1,921,424)</u>	<u>1,904,624</u>	<u>1,566,409</u>	<u>3,439,649</u>	<u>(5,107,069)</u>	<u>2,799,645</u>

	2016							
	Euro, expressed in USD	Costa Rican Colon, expressed in USD	Sterling Pound, expressed in USD	Japanese Yen, expressed in USD	Mexican Peso, expressed in USD	Swiss Franc, expressed in USD	Other currencies, expressed in USD*	Total
Exchange rate	<u>1.05</u>	<u>548.18</u>	<u>1.23</u>	<u>116.96</u>	<u>20.73</u>	<u>1.02</u>		
Assets								
Cash and cash items	521,858	7,911,667	287,808	37,115,056	7,592	1,971,059	126,121	47,941,161
Investments and other financial assets	37,628,603	914,131	14,097,122	13,252,328	50,892,591	0	0	116,784,775
Loans	0	12,695,790	0	0	0	0	0	12,695,790
Other assets	<u>25,627,998</u>	<u>2,351,620</u>	<u>14,853,521</u>	<u>26,022,300</u>	<u>1,269,880</u>	<u>183,595,692</u>	<u>13,289,972</u>	<u>267,010,983</u>
	<u>63,778,459</u>	<u>23,873,208</u>	<u>29,238,451</u>	<u>76,389,684</u>	<u>52,170,063</u>	<u>185,566,751</u>	<u>13,416,093</u>	<u>444,432,709</u>
Liabilities								
Deposits	0	16,554,240	0	0	0	0	0	16,554,240
Borrowings and debt securities issued	0	6,075,920	0	0	0	176,713,136	0	182,789,056
Other liabilities	<u>64,440,382</u>	<u>95,405</u>	<u>29,539,571</u>	<u>76,433,965</u>	<u>51,067,755</u>	<u>0</u>	<u>18,265,845</u>	<u>239,842,923</u>
	<u>64,440,382</u>	<u>22,725,565</u>	<u>29,539,571</u>	<u>76,433,965</u>	<u>51,067,755</u>	<u>176,713,136</u>	<u>18,265,845</u>	<u>439,186,219</u>
Net position	<u>(661,923)</u>	<u>1,147,643</u>	<u>(301,120)</u>	<u>(44,281)</u>	<u>1,102,308</u>	<u>8,853,615</u>	<u>(4,849,752)</u>	<u>5,246,490</u>

*Other currencies include Australian Dollar, Indonesian Rupiah, Korean Won, Chinese Yuan, Taiwanese Dollar, Singapur Dollar, Philippine Peso, South African Rand, Colombian Peso, Canadian Dollar, Guatemalan Quetzal, Russian Ruble and Brazilian Real.

In June 2014, the Bank issued a CHF 180,000,000 bond with a 1.6125% coupon rate and maturity on June 18, 2018. In order to hedge the risk of foreign currency exposure in Swiss Francs ("CHF") related to this issuance, the Bank entered into a futures contract to purchase CHF 180,000,000 with a settlement date on June 18, 2018. This futures contract is measured at its fair value in the consolidated statement of financial position with changes in fair value recognized in the consolidated statement of income.

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

• *Interest rate risk on cash flows and fair value:*

The interest rate risk on cash flows and the interest rate risk on fair value are the risks of fluctuation of both the future cash flows and the value of a financial instrument due to changes in market interest rates.

The net interest margin of the Bank may vary as a result of unanticipated movements in interest rates.

In order to mitigate this risk, the Bank's management has defined exposure limits to the interest rate risk.

The table below summarizes the Bank's exposure based on the re-pricing terms of interest rates on financial assets and liabilities:

	Up to 3 months	From 3 to 6 months	From 6 months to 1 year	2017 From 1 to 5 years	From 5 to 10 years	More than 10 years	Total
Assets:							
Time deposits	194,749,429	50,661,167	61,275,046	0	0	0	306,685,642
Securities and other financial assets	1,273,319,497	155,549,600	201,311,735	1,598,279,179	712,271,703	211,103,801	4,151,835,515
Loans	<u>10,275,720,434</u>	<u>595,586,904</u>	<u>362,142,300</u>	<u>239,199,556</u>	<u>26,219,223</u>	<u>7,192,335</u>	<u>11,506,060,752</u>
Total	<u>11,743,789,360</u>	<u>801,797,671</u>	<u>624,729,081</u>	<u>1,837,478,735</u>	<u>738,490,926</u>	<u>218,296,136</u>	<u>15,964,581,909</u>
Liabilities:							
Deposits	5,258,487,850	752,443,645	1,159,836,096	2,388,434,523	1,050,376	0	9,560,252,490
Securities sold under repurchased agreements	45,814,600	0	0	0	0	0	45,814,600
Borrowings, debt securities issued and perpetual bonds	<u>1,364,015,425</u>	<u>432,050,732</u>	<u>195,799</u>	<u>175,840,571</u>	<u>689,262,681</u>	<u>217,680,000</u>	<u>2,879,045,208</u>
Total	<u>6,668,317,875</u>	<u>1,184,494,377</u>	<u>1,160,031,895</u>	<u>2,564,275,094</u>	<u>690,313,057</u>	<u>217,680,000</u>	<u>12,485,112,298</u>
Total interest sensitivity gap	<u>5,075,471,485</u>	<u>(382,696,706)</u>	<u>(535,302,814)</u>	<u>(726,796,359)</u>	<u>48,177,869</u>	<u>616,136</u>	<u>3,479,469,611</u>
				2016			
	Up to 3 months	From 3 to 6 months	From 6 months to 1 year	From 1 to 5 years	From 5 to 10 years	More than 10 years	Total
Assets:							
Time deposits	183,258,283	20,200,464	78,910,007	0	0	0	282,368,754
Securities and other financial assets	1,155,456,024	276,770,589	378,000,522	1,190,127,608	664,342,902	168,471,516	3,833,169,161
Loans	<u>10,021,972,219</u>	<u>306,192,221</u>	<u>153,972,637</u>	<u>243,614,826</u>	<u>26,190,179</u>	<u>17,068,196</u>	<u>10,769,010,278</u>
Total	<u>11,360,686,526</u>	<u>603,163,274</u>	<u>610,883,166</u>	<u>1,433,742,434</u>	<u>690,533,081</u>	<u>185,539,712</u>	<u>14,884,548,193</u>
Liabilities:							
Deposits	5,110,538,760	716,677,453	1,107,246,313	2,165,177,530	1,578,444	36,470	9,101,254,970
Securities sold under repurchased agreements	273,299,978	0	0	0	0	0	273,299,978
Borrowings, debt securities issued and perpetual bonds	<u>1,221,009,817</u>	<u>307,030,780</u>	<u>10,682,516</u>	<u>299,628,841</u>	<u>112,272,386</u>	<u>217,680,000</u>	<u>2,168,304,340</u>
Total	<u>6,604,848,555</u>	<u>1,023,708,233</u>	<u>1,117,928,829</u>	<u>2,464,806,371</u>	<u>113,850,830</u>	<u>217,716,470</u>	<u>11,542,859,288</u>
Total interest sensitivity gap	<u>4,755,837,971</u>	<u>(420,544,959)</u>	<u>(507,045,663)</u>	<u>(1,031,063,937)</u>	<u>576,682,251</u>	<u>(32,176,758)</u>	<u>3,341,688,905</u>

In order to assess the interest rate risks and their impact on the fair value of financial assets and liabilities, the Bank's management performs simulations to determine the sensitivity on financial assets and liabilities.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The Bank has defined a standard scenario for the management of interest rate risk and to monitor the sensitivity of financial assets and liabilities. Standard scenarios that are considered on a monthly basis include a 100 basis point (bp) parallel fall or rise in all yield curves. The following is an analysis of the Bank's sensitivity to variations in market interest rates:

	Sensitivity of the net interest income			
	100bp increase		100bp decrease	
	2017	2016	2017	2016
At 31 December	9,468,394	6,251,123	(8,525,861)	(3,211,515)
Average for the year	7,692,415	5,464,299	(6,245,325)	(3,003,128)
Maximum for the year	10,547,353	6,351,327	(8,945,854)	(3,647,091)
Minimum for the year	4,905,128	4,589,926	(3,378,858)	(2,174,662)

	Sensitivity in profit or loss for investments at fair value			
	100pb increase		100pb decrease	
	2017	2016	2017	2016
At 31 December	(23,995,728)	(18,705,750)	19,743,192	14,479,150
Average for the year	(21,334,374)	(14,124,829)	17,158,705	8,774,391
Maximum for the year	(23,995,728)	(18,705,750)	19,743,192	14,479,150
Minimum for the year	(19,828,456)	(11,870,686)	15,359,339	5,425,189

	Sensitivity of other comprehensive income			
	100pb increase		100pb decrease	
	2017	2016	2017	2016
At 31 December	(94,586,308)	(84,229,682)	98,643,232	90,278,724
Average for the year	(90,553,743)	(85,689,234)	95,220,350	85,781,225
Maximum for the year	(94,586,308)	(88,331,222)	98,643,232	90,278,724
Minimum for the year	(87,284,104)	(82,423,763)	92,681,697	81,138,205

(d) Liquidity and Financing Risk

Liquidity and financing risk is the risk that the Bank is unable to meet all its obligations as a result of, among other reasons, unexpected withdrawals of funds by depositors, the deterioration of the quality of the loan portfolio, the devaluation of securities, the excessive concentration of liabilities in one particular source, a gap between assets and liabilities, a shortage of asset liquidity and, lastly, the mismatch of long-term asset financing with short-term liabilities.

Liquidity Risk Management:

Risk management policies establish a liquidity limit in order to determine the amount of the Bank's assets that should be maintained in highly liquid instruments. It also sets out; financing limits, leverage limits and maturity limits.

BANCO GENERAL, S. A. AND SUBSIDIARIES
(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The Bank is exposed to daily calls on its available cash resources due to withdrawals of demand and savings deposits, maturity of time deposits and borrowings, and also draw downs on loans and guarantees.

Liquidity is monitored on a daily basis by the Treasury Unit of the Bank and simulations of withdrawals are carried out periodically to determine the capacity of the Bank to deal with crisis scenarios with the available liquidity levels. All policies and procedures for liquidity management are subject to review and approval by the Assets and Liabilities Committee.

The table below summarizes the Bank's assets and liabilities grouped by their residual maturities with respect to the contractual maturity date:

	Up to 3 months	From 3 to 6 months	From 6 months to 1 year	From 1 to 5 years	From 5 to 10 years	More than 10 years	With no maturity	Total
2017								
Assets:								
Cash and cash items	283,199,967	0	0	0	0	0	0	283,199,967
Deposits with banks	450,251,996	31,026,167	80,910,046	0	0	0	0	562,188,209
Securities and other financial assets, net	330,629,024	175,399,776	259,254,845	2,111,254,931	1,076,994,538	417,550,802	65,775,692	4,436,859,608
Loans, net	1,216,877,401	964,402,602	1,293,966,910	6,912,622,458	682,191,795	252,912,527	0	11,322,973,693
Other assets	<u>401,843,951</u>	<u>2,017,506</u>	<u>181,942,522</u>	<u>31,674</u>	<u>69,711</u>	<u>0</u>	<u>380,795,107</u>	<u>966,700,471</u>
Total assets	<u>2,682,802,339</u>	<u>1,172,846,051</u>	<u>1,816,074,323</u>	<u>9,023,909,063</u>	<u>1,759,256,044</u>	<u>670,463,329</u>	<u>446,570,799</u>	<u>17,571,921,948</u>
Liabilities:								
Deposits	7,143,248,409	752,443,645	1,169,177,189	2,392,507,467	1,050,376	0	0	11,458,427,086
Securities sold under repurchased agreements	0	0	0	45,814,600	0	0	0	45,814,600
Borrowings, debt securities issued and perpetual bonds	44,062,160	276,578,857	198,618,109	1,444,900,242	697,205,840	0	217,680,000	2,879,045,208
Other liabilities	<u>737,728,040</u>	<u>3,570,328</u>	<u>144,929,499</u>	<u>8,574,031</u>	<u>0</u>	<u>0</u>	<u>247,990,346</u>	<u>1,142,792,244</u>
Total liabilities	<u>7,925,038,609</u>	<u>1,032,592,830</u>	<u>1,512,724,797</u>	<u>3,891,796,340</u>	<u>698,256,216</u>	<u>0</u>	<u>465,670,346</u>	<u>15,526,079,138</u>
Net liquidity gap	<u>(5,242,236,260)</u>	<u>140,253,221</u>	<u>303,349,526</u>	<u>5,132,112,723</u>	<u>1,060,999,828</u>	<u>670,463,329</u>	<u>(19,099,547)</u>	<u>2,045,842,810</u>
2016								
	Up to 3 months	From 3 to 6 months	From 6 months to 1 year	From 1 to 5 years	From 5 to 10 years	More than 10 years	With no maturity	Total
Assets:								
Cash and cash items	255,676,459	0	0	0	0	0	0	255,676,459
Deposits with banks	464,916,111	25,600,463	72,510,007	0	0	0	0	563,026,581
Securities and other financial assets, net	312,301,582	280,251,079	441,264,787	1,657,589,597	962,076,985	371,759,679	57,300,265	4,082,543,974
Loans, net	1,157,660,477	967,642,600	1,145,203,515	6,524,745,909	566,194,497	243,134,828	0	10,604,581,826
Other assets	<u>415,917,168</u>	<u>5,358,599</u>	<u>140,073,759</u>	<u>139,881</u>	<u>78,076</u>	<u>0</u>	<u>348,427,178</u>	<u>909,994,661</u>
Total assets	<u>2,606,471,797</u>	<u>1,278,852,741</u>	<u>1,799,052,068</u>	<u>8,182,475,387</u>	<u>1,528,349,558</u>	<u>614,894,507</u>	<u>405,727,443</u>	<u>16,415,823,501</u>
Liabilities:								
Deposits	6,428,214,225	715,237,452	1,109,897,905	2,817,721,208	1,578,444	36,470	0	11,072,685,704
Securities sold under repurchased agreements	273,299,978	0	0	0	0	0	0	273,299,978
Borrowings, debt securities issued and perpetual bonds	113,802,126	32,968,281	129,524,471	1,537,818,371	136,511,091	0	217,680,000	2,168,304,340
Other liabilities	<u>704,667,440</u>	<u>2,756,786</u>	<u>113,173,468</u>	<u>14,382,157</u>	<u>0</u>	<u>0</u>	<u>234,367,786</u>	<u>1,069,347,637</u>
Total liabilities	<u>7,519,983,769</u>	<u>750,962,519</u>	<u>1,352,595,844</u>	<u>4,369,921,736</u>	<u>138,089,535</u>	<u>36,470</u>	<u>452,047,786</u>	<u>14,583,637,659</u>
Net liquidity gap	<u>(4,913,511,972)</u>	<u>527,890,222</u>	<u>446,456,224</u>	<u>3,812,553,651</u>	<u>1,390,260,023</u>	<u>614,858,037</u>	<u>(46,320,343)</u>	<u>1,832,185,842</u>

In management's opinion, the Bank's investment portfolio consist of highly liquid investments and other financial assets (with ratings from AAA to BBB-) in the amount of B/.2,869,561,949 (2016: B/.2,630,035,389), which can be readily convertible to cash, in a period of less than a week.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Exposure to Liquidity Risk:

The Bank uses the index of primary liquid assets to total deposits plus borrowings to measure and monitor its targeted liquidity levels. The primary liquid assets are defined as assets that may be exchanged into cash in a term equal or less than 90 days. The Board of Directors has approved that the following assets be classified as primary liquidity: cash, cash items, deposits due from banks, securities purchased under resell agreements in which the underlying value is liquid and highly graded, short-term securities mutual funds, US Government Treasury Bills, foreign commercial paper with minimum credit risk rating of A2/P2/F2, and lastly liquid bonds and syndicated loans with minimum credit risk rating of BBB- and an active secondary market.

The liquidity index of the Bank, that is primary liquid assets to total deposits and borrowings, measured at the consolidated statement of financial position date, is detailed as follows:

	<u>2017</u>	<u>2016</u>
At end of year	26.12%	26.00%
Average for the year	25.87%	26.02%
Maximum for the year	26.54%	26.58%
Minimum for the year	25.43%	25.66%

(e) *Operational Risk*

Operational risk is the risk that losses may occur due to failure or insufficiency of controls in internal processes, persons and systems or external events. This definition includes the legal risk associated with these factors.

The Bank has designed an operational risk management model under a decentralized management structure through risk managers within functional areas.

The Operational Risk Management model, addresses within its key functions the following:

- Definition of strategies and implementation of business continuity plans for the Bank's critical processes
- Identification and assessment of risks
- Reporting of incidents and loss events
- Evaluation and follow-up of risk mitigating actions
- Assessment of operational risks in new initiatives
- Continuous training.

The following areas manage operational risk within their functions:

- Operational Risk Unit
- Risk Management of Information Technology
- Information Security
- Prevention and Fraud Control
- Corporate Security.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

As part of the Corporate Governance Model; strategy, methodology and monitoring of action plans for events and risks measured as critical and high are reported to the Executive Committee of Operational Risk and, on a quarterly basis, to the Board's Risk Committee.

The Internal Audit Department reviews and validates compliance of defined policies and methodologies in accordance with existing regulations, the results of which are presented to the Corporate Audit Committee.

(f) Capital Management

For purposes of calculating the capital adequacy of the Bank, capital is separated into two tiers based on Rulings No.1-2015 and No.3-2016 issued by the Superintendence of Banks of Panama: ordinary and additional primary capital (Tier I), and secondary capital (Tier II). Ordinary primary capital consists of capital stock paid, capital paid in excess, reserves declared, retained earnings, minority interests and other items of accumulated comprehensive income, less regulatory adjustments such as: goodwill from acquisitions and other intangible assets. The additional primary capital consists of instruments issued by the Bank or consolidated subsidiaries that comply with the established characteristics for inclusion, issue premiums, less regulatory adjustments applicable to the additional primary capital. Secondary capital consists of instruments issued by the bank or consolidated subsidiaries that comply with the established characteristics for inclusion, issue premiums and reserves set up for future losses minus regulatory adjustments applicable to the secondary capital.

In the following table, the Bank presents its consolidated regulatory capital to its risk-weighted assets in accordance with the requirements established by the Superintendence of Banks of Panama:

	<u>2017</u>	<u>2016</u>
Regular Primary Capital (Tier 1)		
Common shares	500,000,000	500,000,000
Legal reserve	180,079,610	178,381,264
Other items comprehensive income	35,796,615	32,286,812
Retained earnings	1,329,584,948	1,121,179,809
Less: regulatory adjustments	<u>61,725,358</u>	<u>64,342,750</u>
Total	<u>1,983,735,815</u>	<u>1,767,505,135</u>
Additional Primary Capital (Tier 1)		
Subordinated debt – perpetual bonds	<u>217,680,000</u>	<u>217,680,000</u>
Total	<u>217,680,000</u>	<u>217,680,000</u>
Total primary capital	<u>2,201,415,815</u>	<u>1,985,185,135</u>
Total capital	<u>2,201,415,815</u>	<u>1,985,185,135</u>
Risk-weighted assets	11,521,593,067	10,684,527,402
Capital ratios		
Total capital	19.11%	18.58%
Total primary capital	19.11%	18.58%

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

(31) Critical Accounting Estimates and Judgments in Applying Accounting Policies

The Bank's Management has made a number of estimates and assumptions relating to the reporting of assets, liabilities, results of operations, and commitments and contingencies, based on historical experience and other factors, including expectations of future events that are believed to be reasonable. Changes in assumptions or criteria could significantly affect estimates.

(a) Impairment losses on loans:

The Bank reviews its loan portfolio at each consolidated statement of financial position date to determine if there is objective evidence of impairment in a loan or loan portfolio that should be recognized in the results of the year.

The Bank makes its best judgment as to whether there is any observable data indicating that there is a measurable impairment in a loan portfolio using estimates based on historical loss experience for loans with similar characteristics at the moment of forecasting the future recoverable cash flows of these operations.

(b) Fair value of derivative instruments:

The fair value of derivative instruments that are not quoted in active markets is determined by using valuation techniques to determine their fair value. Models are reviewed before they are used and are calibrated to ensure that outputs reflect actual data and comparative fair values of market prices of similar instruments.

To the extent it is practical, models use only observable data as variables, although certain variables such as counterparty credit risk, volatility measures and correlations require management to make certain estimates.

(c) Impairment of investment securities and other financial assets:

The Bank determines that investment securities and other financial assets are impaired when there has been a significant and prolonged decline in their fair value below their respective cost, if its rating was reduced below B+, or there has been default on payment, bankruptcy, debt restructuring, or similar events that change in a material way the original terms and conditions.

(d) Goodwill impairment:

The Bank reviews the carrying value of goodwill, on an annual basis or when there is an indication of impairment. The estimate of value in use requires management to estimate future cash flows of the related assets or businesses acquired, discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and risks specific to the asset.

(32) Main Applicable Laws and Regulations

(a) Banking Law in the Republic of Panama

Banking operations are regulated and supervised by the Superintendence of Banks of Panama, according to the regulations established by Executive Decree No.52 of April 30, 2008, adopting the single text of Decree Law 9 of February 26, 1998, as amended by Decree Law No. 2 of February 22, 2008, whereby establishing the banking system in Panama and creating the Superintendence of Banks and the rules that govern it.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Liquidity Ratio

The liquidity ratio reported by Banco General S. A. to the regulating body, based on the parameters established in the Agreement No.4-2008, was 38.81% (2016: 38.90%).

Capital Adequacy

The Law mandates general license banks to maintain a minimum paid-in capital or assigned capital of not less than ten million balboas (B/.10,000,000) and a capital adequacy ratio of not less than 8%, including off-balance sheet operations.

The Bank has a ratio of consolidated regulatory capital to its risk-weighted assets of 19.11% (2016: 18.58%) in accordance with Agreements No.1-2015 and No.3-2016, issued by the Superintendence of Banks of Panama.

Agreement No.1-2015 establishes applicable capital adequacy standards for banks and banking groups, which came into effect on January 1, 2016. Agreement No.3-2016, which came into effect on July 1, 2016, establishes standards for the calculation of risk-weighted assets for credit and counterparty risks.

Regulatory Allowances

The accounting treatment for the recognition of losses on loans, investment securities and other real estate owned in conformity with prudential standards enacted by the Superintendence of Banks of Panama, differs in some aspects from the accounting treatment established by International Financial Reporting Standards, specifically IAS 39 and IFRS 5. The Superintendence of Banks of Panama mandates that general license banks apply these prudential standards.

Loans and Loan Allowances

Specific provisions

The Agreement No.4-2013 indicates that specific reserves shall be established when there is objective evidence of impairment. These reserves and their applicable percentages must be established for credit facilities classified under the following risk categories for both individual loans and loan portfolios: special mention 20%, substandard 50%, doubtful 80%, and unrecoverable 100%.

Banks must calculate and maintain, at a minimum, the specific reserves determined by the criteria established in this Agreement at all times. The basis for the reserve calculation is the difference between the balance of the loan classified in any of the categories subject to reserve, and the amount of collateral mitigating any possible loss. The weighted values for collateral are also detailed in this Agreement.

If there is a surplus in the specific reserve with respect to the allowance estimated in accordance with IFRS, such surplus will be recorded as a regulatory reserve within equity and its variations are applied against retained earnings. This regulatory reserve shall not be considered as regulatory capital used in calculations of ratios or any other prudential relationships mentioned in the Agreement.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

The following table summarizes the classification of the loan portfolio and allowance for loan losses of Banco General, S. A., based on Agreement No.4-2013:

	2017 (in thousands)					Total
	Standard	Special mention	Sub- standard	Doubtful	Loss	
Corporate loans	4,730,515	206,224	58,118	36,157	27,533	5,058,547
Consumer loans	<u>5,376,270</u>	<u>116,262</u>	<u>40,916</u>	<u>24,690</u>	<u>21,258</u>	<u>5,579,396</u>
Total	<u>10,106,785</u>	<u>322,486</u>	<u>99,034</u>	<u>60,847</u>	<u>48,791</u>	<u>10,637,943</u>
Specific Reserve	<u>0</u>	<u>22,317</u>	<u>13,164</u>	<u>27,332</u>	<u>16,915</u>	<u>79,728</u>

	2016 (in thousands)					Total
	Standard	Special mention	Sub- standard	Doubtful	Loss	
Corporate loans	4,508,858	192,358	50,712	5,359	24,985	4,782,272
Consumer loans	<u>4,909,824</u>	<u>108,364</u>	<u>38,115</u>	<u>24,110</u>	<u>19,045</u>	<u>5,099,458</u>
Total	<u>9,418,682</u>	<u>300,722</u>	<u>88,827</u>	<u>29,469</u>	<u>44,030</u>	<u>9,881,730</u>
Specific Reserve	<u>0</u>	<u>23,551</u>	<u>12,283</u>	<u>12,288</u>	<u>15,760</u>	<u>63,882</u>

In accordance with Agreement No.4-2013, loans whose payment of principal and/or interest with more than 90 days in arrears from the contractual payment date will be classified as delinquent. Delinquency days are calculated from the date in which payment was required. Single-payment transactions and overdrafts will be considered delinquent when the payment is over 30 days in arrears from the contractual payment date.

The following table presents the balance of delinquent and loans distributed by loan categories pursuant to Agreement No.4-2013:

	2017 (in thousands)			Total
	Current	Past Due	Delinquent	
Corporate loans	4,996,172	36,735	25,640	5,058,547
Consumer loans	<u>5,247,860</u>	<u>243,760</u>	<u>87,776</u>	<u>5,579,396</u>
Total	<u>10,244,032</u>	<u>280,495</u>	<u>113,416</u>	<u>10,637,943</u>

	2016 (in thousands)			Total
	Current	Past Due	Delinquent	
Corporate loans	4,738,540	15,678	28,054	4,782,272
Consumer loans	<u>4,836,329</u>	<u>189,626</u>	<u>73,503</u>	<u>5,099,458</u>
Total	<u>9,574,869</u>	<u>205,304</u>	<u>101,557</u>	<u>9,881,730</u>

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

Furthermore, based on Agreement No.8-2014, recognition of interest income on the basis of days in arrears in the payment of principal and/or interest and the type of credit operations is suspended as per the following:

- a) Consumer and business loans, if more than 90 days overdue, and
- b) Residential mortgage loans, if more than 120 days overdue.

Total loans of Banco General, S. A. in non-accrual status of interest is B/.84,700,213 (2016: B/.75,619,947). Total interest income not recognized on these loans is B/.5,906,963 (2016: B/.4,890,194).

Dynamic Provision

Agreement No.4-2013 indicates that the dynamic provision is a reserve provided to face possible future needs for specific provisions. They are governed by prudential criteria in the banking regulation. Dynamic reserves are established on a quarterly basis, on loans classified as Standard.

The dynamic reserve is an equity account presented as a legal reserve in the consolidated statement of changes in equity and appropriated from retained earnings. The balance of the dynamic reserve is part of the regulatory capital, but cannot be used in satisfying current or future capital adequacy requirements established by this Superintendence. The balance of the Bank's dynamic reserve is detailed as follows:

	<u>2017</u>	<u>2016</u>
Banco General, S. A.	133,877,476	133,877,476
Finanzas Generales, S. A.	2,810,061	2,810,061
Banco General (Overseas), Inc.	9,480,047	9,480,047
Banco General (Costa Rica), S. A.	<u>4,580,865</u>	<u>4,580,865</u>
Total	<u>150,748,449</u>	<u>150,748,449</u>

The current Agreement establishes that the dynamic reserve will not be lower than 1.25%, nor greater than 2.50% of risk-weighted assets applied to the loan facilities classified as standard.

Foreclosed Assets

Agreement No.3-2009 enacted by the Superintendence of Banks of Panama, through which provisions pertaining to the disposal of property are updated, sets a five (5) year period to dispose real estate acquired in settlement of unpaid loans.

Foreclosed assets held for sale are recognized at the lower of the carrying amount of the outstanding loans or the estimated realizable value of the properties. The Agreement establishes that the provision of foreclosed assets shall be progressively applied up to 90% in accordance with the following table:

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

<u>Years</u>	<u>Minimum reserve percentage</u>
First	10%
Second	20%
Third	35%
Fourth	15%
Fifth	10%

Banco General, S. A. holds foreclosed assets held for sale in the amount of B/.5,730,492 (2016: B/.3,368,073) and a provision in the amount of B/.911,969 (2016: B/.572,031). The provision was estimated based on Agreements No.1-2000 and No.3-2009 in the amounts of B/.530,332, and B/.381,637, respectively (2016: B/.234,074 and B/.337,957, respectively).

Off-Balance Sheet Operations

Management has classified off-balance sheet operations and estimated the Bank's reserve requirements in accordance with Agreement No.4-2013, enacted by the Superintendence of Banks of Panama, as presented below:

	<u>Standard</u>	<u>Special Mention</u>	<u>2017</u> (in thousands)			
			<u>Sub- Standard</u>	<u>Doubtful</u>	<u>Loss</u>	<u>Total</u>
Letters of credit	177,502	2,830	1,314	0	0	181,646
Financial guarantees and mortgage disbursement commitments	<u>899,196</u>	<u>2,717</u>	<u>2,323</u>	<u>1,654</u>	<u>752</u>	<u>906,642</u>
Total	<u>1,076,698</u>	<u>5,547</u>	<u>3,637</u>	<u>1,654</u>	<u>752</u>	<u>1,088,288</u>
Reserve required	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>

	<u>Standard</u>	<u>Special Mention</u>	<u>2016</u> (in thousands)			
			<u>Sub- Standard</u>	<u>Doubtful</u>	<u>Loss</u>	<u>Total</u>
Letters of credit	206,313	4,443	1,069	0	0	211,825
Financial guarantees and mortgage disbursement commitments	<u>1,039,039</u>	<u>3,461</u>	<u>1,102</u>	<u>644</u>	<u>360</u>	<u>1,044,606</u>
Total	<u>1,245,352</u>	<u>7,904</u>	<u>2,171</u>	<u>644</u>	<u>360</u>	<u>1,256,431</u>
Reserve required	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>

Investments

Banco General, S. A. classifies its investment portfolio pursuant to Agreement No. 7-2000, enacted by the Superintendence of Banks of Panama. In addition, Agreement No.7-2000 requires the establishment of provisions for possible investment losses based on certain risk elements stipulated therein. The Bank maintains a valuation allowance for its securities and its provisions are recognized as provision expense in the consolidated statement of income.

BANCO GENERAL, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

Notes to the Consolidated Financial Statements

(b) *Banking Law of Costa Rica*

The subsidiary Banco General (Costa Rica), S. A. is regulated by the National Banking System Act, the Costa Rica Central Bank Act, the National Council of Financial System Supervision (CONASSIF), and the General Superintendence of Financial Entities (SUGEF).

(c) *Banking Law of the Cayman Islands*

The operations of Banco General (Overseas), Inc. is regulated by the Bank and Fiduciary Institutions Law of May 15, 1989, which was last revised on October 11, 2013, issued by the Government of the Cayman Islands.

(d) *Financing Companies Law*

The operations of financing companies in the Republic of Panama are regulated by the Office of Financial Entities of the Ministry of Commerce and Industry in accordance with provisions established under Law No.42 of July 23, 2001.

(e) *Financial leases Law*

The operations of financial leases in the Republic of Panama are regulated by the Office of Financial Entities of the Ministry of Commerce and Industry in accordance with provisions established under Law No.7 of July 10, 1990.

(f) *Insurance and Reinsurance Law*

Insurance and reinsurance operations in the Republic of Panama are regulated by the Superintendence of Insurance and Reinsurance of Panama, in accordance with provisions established under the Insurance Law No.12 of April 3, 2012 and Reinsurance Law No.63 of September 19, 1996.

(g) *Insurance Law of the British Virgin Islands*

The operations of Commercial Re Overseas Limited are regulated by the Insurance Law of the February 7, 2008 promulgated by the British Virgin Islands legislature and by statutory instrument 2009 No.62 denominated "2009 Insurance Regulations".

(h) *Securities Law*

Brokerage operations in Panama are regulated by the Superintendence of the Securities Markets in accordance with legislation established in Law Decree No.1 of July 8, 1999 as revised by Law No.67 of September 1, 2011.

The operations of brokerage houses are regulated by Agreement No.4-2011, modified by provisions of Agreement No.8-2013 and Agreement No.3-2015, established by the Superintendence of the Securities Markets, which obliges brokerage operations to comply with capital adequacy regulations.

(i) *Fiduciary Law*

Fiduciary operations in the Republic of Panama are regulated by the Superintendence of Banks in accordance with provisions established under Law No.1 of January 5, 1984 and modified by provisions of Law No.21 of May 10, 2017.