

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

**Consolidated Financial Statements**

December 31, 2016

(With Independent Auditors' Report Thereon)

(FREE ENGLISH LANGUAGE TRANSLATION  
FROM SPANISH VERSION)

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

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## **INDEPENDEND AUDITORS' REPORT**

To the Board of Directors and Stockholders of  
Banco La Hipotecaria, S. A.

### ***Report on the Audit of the Consolidated Financial Statements***

#### *Opinion*

We have audited the consolidated financial statements of Banco La Hipotecaria, S. A. and subsidiaries ("the Bank"), which comprise the consolidated statement of financial position as at December 31, 2016, 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 at December 31, 2016, 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 further described 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 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 and 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 those 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(g), 4 and 9 to the consolidated financial statements*

**Key audit matter**

The allowance for loan losses requires judgment application and use of assumptions made by the management. The loan portfolio represents 82% of the total assets of the Bank. The allowance for loan losses comprises the allowance for loans individually assessed and loan collectively assessed.

The loan impairment allowance individually assessed is determined by an assessment of the exposures case by case based in judgment and estimates of the management when an impairment event has occurred and the present value of the expected cash flows are uncertain.

The collective allowance for impairment is determined in accordance to the grouping of loans with similar credit risk characteristics.

**How the key matter was addressed in our audit**

Our audit procedures included:

- Control tests over the delinquency calculations, customers' internal risk ratings, annual review of loans, customers' risk review and of the models and methodologies used.
- For a sample of loans with individual allowance, a test of the credit files of such customers and review of the allowance estimate assessment prepared by management.
- For individual allowance model, a test of the cash flows calculation considering the value of the collateral in reference to specialists developed valuations.
- Tests of the key inputs used in to calculate the collective impairment allowance model.
- Assessment of the management judgment over the actual economy and credit conditions related assumptions that could change the real loss level, based in our experience and knowledge of the industry.
- Assessment of the delinquency profiles for mortgage and personal loans.
- Assessment with our specialists of the collective allowance model and recalculation of such allowance.

*Investment valuation*

*See notes 3(h), 4 and 8 to the consolidated financial statements*

**Key audit matter**

Investment in securities are 9.7% of the total assets as of December 31, 2016. The Bank uses external price vendors to obtain most of prices of these securities and also uses internal methodologies to evaluate the remaining securities.

The valuation of these securities using valuation models involves management judgment and use of inputs unavailable in active markets. Additionally, the securities valuation whose prices are provided by external price vendors that also uses valuation models, requires additional efforts from auditors to validate.

The judgment is significant involved in estimating the fair value of a security when some valuation inputs are not observable. As of December 31, 2016, securities classified as level 3 represented 79% of total securities measured at fair value and 7.5% of total assets.

*No consolidation of trusts*

*See notes 3(a.6), 3(r) and 26 to the consolidated financial statements*

**Key audit matter**

Trusts under management amounted to B/.246,569,078 as of December 31, 2016. These trusts are unconsolidated vehicles designed by the Bank to securitize loans originated by itself.

**How the key matter was addressed in our audit**

Our audit procedures included:

- Assessment of key control tests on the identification process, measuring and valuation risk management, and assessment of the methodologies, inputs and assumptions used by the Bank in the fair value determination.
- Assessment with our specialists of the fair value models and inputs used in valuation of level 2 instruments; therefore we compared market observable inputs with independent sources and external market available data.
- For a securities' sample with significant unobservable valuation inputs (level 3), assessment with our specialists of the models used and approved by corporate government and independent calculation of such securities prices.
- Obtaining reports of design and operating effectiveness assessment over the internal controls of the price vendor service organizations and assessment of the complementary controls mentioned in such reports over the relevance for it application by the Bank.

Our audit procedures included:

- Assessment of loan sale contracts made and the characteristics in relation to the required by IAS 39 to derecognize a financial asset.

The loans are sold to the trusts which structured the bond issuance placed through the Stock Market of Panama. These loans are in custody of a third party and managed by the Bank.

The Bank must assess whether at the sale could derecognize the loans and whether should consolidate these trusts. The assessment includes determine who retain the main risks and benefits of the securitized loans. These assessments required significant management judgment, an error in this assessment could have a significant impact in the consolidated financial statements of the Bank.

- Assessment of debt issuance prospects of the trusts and contractual covenants that grant the decision making authority to the Bank, bondholders' rights, and the fee obtained by the Bank when providing its management services.
- Assessment of any modification to the debt issuance prospects of the trusts to determine whether the characteristics of scope of decision making authority, rights maintained by bondholders, and fees obtained.
- Obtaining the annual analyses made by management, in which assess and define the no consolidation of the trusts in accordance the guides required by IFRS to consolidate the trusts.

#### *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 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 appropriate audit evidence regarding the financial information of the entities or business activities within the Bank to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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 provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditors' report is Kuldip Singh K.

KPMG (SIGNED)

Panama, Republic of Panama  
March 16, 2017



**BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES**

(Panama, Republic of Panama)

**Consolidated Statement of Financial Position**

December 31, 2016

(Stated in Balboas)

| <b><u>Assets</u></b>   | <b><u>Note</u></b> | <b><u>2016</u></b> | <b><u>2015</u></b> |
|--|--------------------|--------------------|--------------------|
| Cash and cash equivalents                                    |                    | 281,416            | 325,366            |
| Deposits in banks  |                    |                    |                    |
| Demand deposits in local banks                               |                    | 19,798,230         | 10,604,590         |
| Demand deposits in foreign banks                             |                    | 6,483,190          | 4,744,962          |
| Savings deposits in local banks                              |                    | 1,129,056          | 1,123,364          |
| Savings deposits in foreign banks                            |                    | 2,614,741          | 5,185,918          |
| Time deposits in local banks                                 |                    | 1,000,000          | 2,500,000          |
| Time deposits in foreign banks                               |                    | 0                  | 1,251,666          |
| <b>Total deposits in banks</b>                               |                    | <b>31,025,217</b>  | <b>25,410,500</b>  |
| <b>Total of cash, cash equivalents and deposits in banks</b> | 7, 28              | <b>31,306,633</b>  | <b>25,735,866</b>  |
| Investments in securities                                    | 8, 28              | 59,139,149         | 42,894,265         |
| Loans  | 9, 28              | 505,818,303        | 468,103,097        |
| Less: Allowance for loan losses                              | 9, 28              | 300,664            | 261,314            |
| <b>Loans, net</b>  |                    | <b>505,517,639</b> | <b>467,841,783</b> |
| Furniture, equipment and improvements, net                   | 10                 | 1,466,778          | 904,303            |
| Accounts and interests receivable                            | 11                 | 3,217,978          | 3,491,448          |
| Tax credit   | 30                 | 7,247,049          | 6,800,239          |
| Deferred tax assets  | 25                 | 554,811            | 59,663             |
| Other assets   | 12                 | 2,249,448          | 1,605,019          |
| <b>Total assets</b>  |                    | <b>610,699,485</b> | <b>549,332,586</b> |

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

| <b><u>Liabilities and Equity</u></b>            | <b><u>Note</u></b> | <b><u>2016</u></b> | <b><u>2015</u></b> |
|---|--------------------|--------------------|--------------------|
| Liabilities:                                    |                    |                    |                    |
| Deposits from customers:                        |                    |                    |                    |
| Local savings                                   | 6, 28              | 852,461            | 814,076            |
| Foreign savings                                 | 6, 28              | 321,017            | 58,866             |
| Local time deposits                             | 6, 28              | 160,248,249        | 137,079,253        |
| Foreign time deposits                           | 6, 28              | 18,428,733         | 33,389,067         |
| <b>Total deposits from customers:</b>           |                    | <u>179,850,460</u> | <u>171,341,262</u> |
| Negotiable commercial papers                    | 13, 28             | 70,760,884         | 53,791,389         |
| Negotiable commercial notes                     | 14, 28             | 92,861,338         | 72,128,518         |
| Ordinary bonds                                  | 15                 | 16,591,868         | 0                  |
| Investment certificates                         | 16, 28             | 23,072,087         | 19,875,121         |
| Other negotiable debts                          | 17, 28             | 8,988,036          | 6,987,535          |
| Borrowed funds                                  |                    | 141,544,615        | 159,235,027        |
| Deferred tax liabilities                        | 25                 | 0                  | 106,940            |
| Income tax payable                              | 25                 | 791,313            | 1,248,957          |
| Other liabilities                               | 19                 | 9,517,855          | 7,415,145          |
| <b>Total liabilities</b>                        |                    | <u>543,978,456</u> | <u>492,129,894</u> |
| Equity:   |                    |                    |                    |
| Common shares                                   | 20                 | 15,000,000         | 15,000,000         |
| Additional paid-in capital                      |                    | 26,300,000         | 21,300,000         |
| Capital reserve                                 |                    | 1,800,000          | 1,800,000          |
| Fair value reserve                              |                    | 3,410,751          | 3,489,242          |
| Currency translation reserve                    |                    | (4,690,536)        | (5,261,834)        |
| Regulatory reserves                             |                    | 6,593,451          | 5,876,284          |
| Retained earnings                               |                    | 17,605,388         | 14,481,045         |
| <b>Total equity of the controlling interest</b> |                    | <u>66,019,054</u>  | <u>56,684,737</u>  |
| Non-controlling interest                        | 1                  | 701,975            | 517,955            |
| <b>Total equity</b>                             |                    | <u>66,721,029</u>  | <u>57,202,692</u>  |
| Commitments and contingencies                   | 27                 |                    |                    |
| <b>Total liabilities and equity</b>             |                    | <u>610,699,485</u> | <u>549,332,586</u> |

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

**Consolidated Statement of Income**

Year ended December 31, 2016

(Stated in Balboas)

|  | <u>Note</u> | <u>2016</u>       | <u>2015</u>       |
|--|-------------|-------------------|-------------------|
| Interest and commissions income:                           |             |                   |                   |
| Interest on:   |             |                   |                   |
| Loans  |             | 33,587,241        | 28,177,336        |
| Investment securities                                      |             | 2,270,626         | 2,038,682         |
| Deposits in banks  |             | 221,324           | 221,598           |
|  |             | <u>36,079,191</u> | <u>30,437,616</u> |
| Commission on:   |             |                   |                   |
| Management and servicing, net                              | 22          | 4,454,610         | 4,026,663         |
| Loan granting  |             | 2,702,010         | 2,881,246         |
| <b>Total interest and commissions income</b>               |             | <u>43,235,811</u> | <u>37,345,525</u> |
| Interest and commissions expenses:                         |             |                   |                   |
| Deposits   |             | 8,540,115         | 7,598,856         |
| Borrowed funds   |             | 15,426,531        | 10,776,464        |
| Commissions  | 23          | 1,359,550         | 1,152,732         |
| <b>Total interest and commissions expenses</b>             |             | <u>25,326,196</u> | <u>19,528,052</u> |
| <b>Net interest and commissions income</b>                 |             | <u>17,909,615</u> | <u>17,817,473</u> |
| Provision for loan losses                                  | 9           | 345,406           | 344,975           |
| <b>Net interest and commission income, after provision</b> |             | <u>17,564,209</u> | <u>17,472,498</u> |
| <b>Income from banking services and others:</b>            |             |                   |                   |
| (Loss) gain on investments, net                            |             | (12,198)          | 1,016,395         |
| Other income   | 6, 22       | 2,716,433         | 1,590,505         |
| <b>Total income from banking services and others, net</b>  |             | <u>2,704,235</u>  | <u>2,606,900</u>  |
| General and administrative expenses:                       |             |                   |                   |
| Salaries and other personnel expenses                      | 6, 24       | 7,839,241         | 7,400,097         |
| Depreciation and amortization                              | 10          | 541,550           | 493,527           |
| Professional and legal fees                                |             | 1,056,004         | 1,147,601         |
| Taxes  |             | 1,954,447         | 1,450,619         |
| Other expenses   | 6, 24       | 3,906,310         | 3,548,556         |
| <b>Total general and administrative expenses</b>           |             | <u>15,297,552</u> | <u>14,040,400</u> |
| <b>Net income before income tax</b>                        |             | <u>4,970,892</u>  | <u>6,038,998</u>  |
| Income tax   | 25          | 1,033,308         | 2,068,341         |
| <b>Net income</b>  |             | <u>3,937,584</u>  | <u>3,970,657</u>  |
| <b>Income attributable to:</b>                             |             |                   |                   |
| Controlling interest                                       |             | 3,937,359         | 4,015,476         |
| Non-controlling interest                                   |             | 225               | (44,819)          |
|  |             | <u>3,937,584</u>  | <u>3,970,657</u>  |
| <b>Earnings per share</b>                                  |             | <u>262.51</u>     | <u>264.71</u>     |
| <b>Diluted earnings per share</b>                          |             | <u>262.51</u>     | <u>264.71</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 LA HIPOTECARIA, S. A. AND SUBSIDIARIES**

(Panama, Republic of Panama)

**Consolidated Statement of Comprehensive Income**

Year ended December 31, 2016

(Stated in Balboas)

|   | <u>Note</u> | <u>2016</u>      | <u>2015</u>        |
|---|-------------|------------------|--------------------|
| <b>Net income</b>   |             | <u>3,937,584</u> | <u>3,970,657</u>   |
| <b>Other comprehensive income:</b>                                      |             |                  |                    |
| <b>Items that are or may be reclassified to the statement of income</b> |             |                  |                    |
| Fair value reserve:   |             |                  |                    |
| Fair value of loan portfolio acquired:                                  |             |                  |                    |
| Initial record  |             | 0                | 1,361,625          |
| Amortization  |             | (78,440)         | (36,591)           |
| Valuation reserve of available for sale securities:                     |             |                  |                    |
| Trasferred to profit or loss  | 8           | 458,014          | (315,000)          |
| Net change in fair value  |             | (458,065)        | 663,706            |
| Foreign currency translation differences for foreign operations         |             | 597,049          | (2,795,848)        |
|   |             | <u>518,558</u>   | <u>(1,122,108)</u> |
| <b>Total other comprehensive income</b>                                 |             | <u>4,456,142</u> | <u>2,848,549</u>   |
| <b>Comprehensive income attributable to:</b>                            |             |                  |                    |
| Controlling interest  |             | 4,430,166        | 2,983,238          |
| Non-controlling interest  |             | 25,976           | (134,689)          |
| <b>Total comprehensive income</b>                                       |             | <u>4,456,142</u> | <u>2,848,549</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 LA HIPOTECARIA, S. A. AND SUBSIDIARIES**  
(Panama, Republic of Panama)

**Consolidated Statement of Changes in Equity**

Year ended December 31, 2016

(Stated in Balboas)

|   | Note | Attributable to the Controlling Interest |                            |                 |                    |                              |                     |                              |                    |                   |                          | Total equity |
|---|------|--|----------------------------|-----------------|--------------------|------------------------------|---------------------|------------------------------|--------------------|-------------------|--------------------------|--------------|
|   |      | Common Shares                            | Additional paid-in capital | Capital reserve | Fair value reserve | Currency translation reserve | Regulatory reserves |                              |                    | Retained earnings | Non-controlling interest |              |
|   |      |  |                            |                 |                    |                              | Dynamic provision   | Specific provision in excess | Specific provision |                   |                          |              |
| <b>Balance at January 1, 2015</b>                               |      | 15,000,000                               | 18,500,000                 | 1,800,000       | 1,815,502          | (2,555,856)                  | 3,096,884           | 318,317                      | 13,017,085         | 412,690           | 51,404,622               |              |
| Net income  |      | 0  | 0                          | 0               | 0                  | 0                            | 0                   | 0                            | 4,015,476          | (44,819)          | 3,970,657                |              |
| Other comprehensive income (loss)                               |      | 0  | 0                          | 0               | 1,325,034          | 0                            | 0                   | 0                            | 0                  | 0                 | 1,325,034                |              |
| Fair value reserve:   |      | 0  | 0                          | 0               | 348,706            | 0                            | 0                   | 0                            | 0                  | 0                 | 348,706                  |              |
| Net change in fair value  |      | 0  | 0                          | 0               | (2,705,978)        | 0                            | 0                   | 0                            | 0                  | 0                 | (2,705,978)              |              |
| Foreign currency translation differences for foreign operations |      | 0  | 0                          | 0               | 1,673,740          | (2,705,978)                  | 0                   | 0                            | 0                  | 0                 | (99,870)                 |              |
| Total other comprehensive income (loss)                         |      | 0  | 0                          | 0               | 1,673,740          | (2,705,978)                  | 0                   | 0                            | 0                  | 0                 | (1,122,108)              |              |
| Total comprehensive income                                      |      | 0  | 0                          | 0               | 1,673,740          | (2,705,978)                  | 0                   | 0                            | 4,015,476          | (134,689)         | 2,848,549                |              |
| <b>Other changes in equity</b>                                  |      | 0  | 0                          | 0               | 0                  | 0                            | 2,258,453           | 202,630                      | (2,461,083)        | 0                 | 0                        |              |
| Constitution of reserves  |      | 0  | 0                          | 0               | 0                  | 0                            | 2,258,453           | 202,630                      | (2,461,083)        | 0                 | 0                        |              |
| <b>Transactions with the shareholders of the Bank:</b>          |      | 0  | 2,800,000                  | 0               | 0                  | 0                            | 0                   | 0                            | 0                  | 0                 | 2,800,000                |              |
| Contributions, distributions and change in participations:      |      | 0  | 0                          | 0               | 0                  | 0                            | 0                   | 0                            | (90,433)           | 0                 | (90,433)                 |              |
| Additional paid-in capital                                      |      | 0  | 0                          | 0               | 0                  | 0                            | 0                   | 0                            | 0                  | 0                 | 0                        |              |
| Complementary tax   |      | 0  | 0                          | 0               | 0                  | 0                            | 0                   | 0                            | 0                  | 0                 | 0                        |              |
| Non-controlling interest  |      | 0  | 0                          | 0               | 0                  | 0                            | 0                   | 0                            | 239,954            | 239,954           | 239,954                  |              |
| Total of contributions and distributions                        |      | 0  | 2,800,000                  | 0               | 0                  | 0                            | 0                   | 0                            | (90,433)           | 239,954           | 2,949,521                |              |
| <b>Balance at December 31, 2015</b>                             |      | 15,000,000                               | 21,300,000                 | 1,800,000       | 3,489,242          | (5,281,834)                  | 5,355,337           | 520,947                      | 14,481,045         | 517,955           | 57,202,692               |              |
| <b>Net income</b>   |      | 0  | 0                          | 0               | 0                  | 0                            | 0                   | 0                            | 3,937,359          | 225               | 3,937,584                |              |
| Other comprehensive income (loss):                              |      | 0  | 0                          | 0               | (78,440)           | 0                            | 0                   | 0                            | 0                  | 0                 | (78,440)                 |              |
| Fair value reserve:   |      | 0  | 0                          | 0               | (51)               | 0                            | 0                   | 0                            | 0                  | 0                 | (51)                     |              |
| Net change in fair value  |      | 0  | 0                          | 0               | 0                  | 571,298                      | 0                   | 0                            | 0                  | 0                 | 571,298                  |              |
| Foreign currency translation differences for foreign operations |      | 0  | 0                          | 0               | (78,491)           | 571,298                      | 0                   | 0                            | 0                  | 25,751            | 597,049                  |              |
| Total other comprehensive income (loss)                         |      | 0  | 0                          | 0               | (78,491)           | 571,298                      | 0                   | 0                            | 0                  | 25,751            | 518,558                  |              |
| Total comprehensive income                                      |      | 0  | 0                          | 0               | (78,491)           | 571,298                      | 0                   | 0                            | 3,937,359          | 25,976            | 4,456,142                |              |
| <b>Other changes in equity</b>                                  |      | 0  | 0                          | 0               | 0                  | 0                            | 591,457             | 125,710                      | (717,167)          | 0                 | 0                        |              |
| Constitution of reserves  |      | 0  | 0                          | 0               | 0                  | 0                            | 591,457             | 125,710                      | (717,167)          | 0                 | 0                        |              |
| <b>Transactions with the shareholders of the Bank</b>           |      | 0  | 5,000,000                  | 0               | 0                  | 0                            | 0                   | 0                            | 0                  | 0                 | 5,000,000                |              |
| Contributions, distributions and change in participations:      |      | 0  | 0                          | 0               | 0                  | 0                            | 0                   | 0                            | (95,849)           | 0                 | (95,849)                 |              |
| Additional paid-in capital                                      |      | 0  | 0                          | 0               | 0                  | 0                            | 0                   | 0                            | 0                  | 0                 | 0                        |              |
| Complementary tax   |      | 0  | 0                          | 0               | 0                  | 0                            | 0                   | 0                            | 0                  | 0                 | 0                        |              |
| Non-controlling interest  |      | 0  | 0                          | 0               | 0                  | 0                            | 0                   | 0                            | 158,044            | 158,044           | 158,044                  |              |
| Total of contributions and distributions                        |      | 0  | 5,000,000                  | 0               | 0                  | 0                            | 0                   | 0                            | (95,849)           | 158,044           | 5,062,195                |              |
| <b>Balance at December 31, 2016</b>                             |      | 15,000,000                               | 26,300,000                 | 1,800,000       | 3,410,751          | (4,690,536)                  | 5,946,794           | 646,657                      | 17,605,388         | 701,975           | 66,721,029               |              |

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 LA HIPOTECARIA, S. A. AND SUBSIDIARIES**  
(Panama, Republic of Panama)

**Consolidated Statement of Cash Flows**

Year ended December 31, 2016

(Stated in Balboas)

|  | <u>Note</u> | <u>2016</u>         | <u>2015</u>         |
|--|-------------|---------------------|---------------------|
| <b>Operating activities:</b>   |             |                     |                     |
| Net income   |             | 3,937,584           | 3,970,657           |
| <b>Adjustments to reconcile net income and cash from operating activities:</b> |             |                     |                     |
| Provision for loan losses  |             | 345,406             | 344,975             |
| Realized gain on investment at fair value                                      |             | (445,816)           | (701,395)           |
| (Gain) loss from sale of securities  |             | 458,014             | (315,000)           |
| Depreciation and amortization  |             | 541,550             | 493,527             |
| Loss on disposal of fixed assets   |             | 55,466              | 0                   |
| Gain on sale of foreclosed assets  |             | (79,389)            | (72,634)            |
| Interest income  |             | (36,079,191)        | (30,437,616)        |
| Interest expense   |             | 23,966,646          | 18,375,320          |
| Income tax expense   |             | 1,033,308           | 2,068,341           |
| <b>Changes in operating assets and liabilities:</b>                            |             |                     |                     |
| Loans  |             | (38,099,702)        | (105,811,801)       |
| Accounts receivable with related parties                                       |             | 0                   | 183,331             |
| Accounts receivable  |             | (24,683)            | (277,928)           |
| Sale of tax credits  |             | 6,560,778           | 1,397,144           |
| Accrual of tax credits   |             | (7,007,588)         | (5,792,301)         |
| Other assets   |             | (1,514,175)         | 1,312,554           |
| Time deposits  |             | 8,208,662           | 29,488,702          |
| Saving deposits  |             | 300,536             | (4,066,408)         |
| Other liabilities  |             | 1,458,244           | (1,780,130)         |
| <b>Cash generated from operations:</b>   |             |                     |                     |
| Interest received  |             | 36,404,387          | 29,844,912          |
| Interest paid  |             | (23,514,501)        | (17,727,830)        |
| Income tax paid  |             | (950,217)           | (830,024)           |
| <b>Cash flows from operating activities</b>                                    |             | <u>(24,444,681)</u> | <u>(80,333,604)</u> |
| <b>Investing activities:</b>   |             |                     |                     |
| Purchase of investment securities  |             | (26,826,379)        | (3,937,648)         |
| Sale of available for sale securities  |             | 8,255,523           | 7,250,212           |
| Redemption of investment securities  |             | 2,286,681           | 1,634,217           |
| Purchases of furniture and equipments  |             | (1,154,917)         | (374,959)           |
| <b>Cash flows from investing activities</b>                                    |             | <u>(17,439,092)</u> | <u>4,571,822</u>    |
| <b>Financing activities:</b>   |             |                     |                     |
| Proceeds of borrowed funds   |             | 88,800,000          | 111,608,036         |
| Payment of borrowed funds  |             | (106,490,412)       | (48,949,419)        |
| Proceeds from issuance of negotiable commercial papers                         |             | 82,049,000          | 53,215,000          |
| Redemption of negotiable commercial papers                                     |             | (65,079,505)        | (48,342,253)        |
| Proceeds of issuance of negotiable commercial notes                            |             | 47,968,000          | 35,949,000          |
| Redemption of commercial notes   |             | (27,235,180)        | (14,884,867)        |
| Issuance of investment certificate   |             | 13,608,000          | 5,492,000           |
| Redemption of investment certificate   |             | (10,411,034)        | (9,968,998)         |
| Issuance of negotiable debts   |             | 10,070,000          | 10,000,000          |
| Redemption of negotiable debts   |             | (8,069,499)         | (14,971,870)        |
| Proceeds of issuance of ordinary bonds   |             | 16,591,868          | 0                   |
| Additional paid-in capital   |             | 5,000,000           | 2,800,000           |
| Non-controlling interest   |             | 158,044             | 239,954             |
| Complementary tax  |             | (95,849)            | (90,433)            |
| <b>Cash flows from financing activities</b>                                    |             | <u>46,863,433</u>   | <u>82,096,150</u>   |
| Effect on the fluctuation of exchange rates on cash held                       |             | 591,107             | (2,807,690)         |
| Net increase on cash   |             | 4,979,660           | 6,334,368           |
| Cash and cash equivalents at the beginning of the year                         |             | 25,735,866          | 22,209,188          |
| <b>Cash and cash equivalents at the end of the year</b>                        | 7           | <u>31,306,633</u>   | <u>25,735,866</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 LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

## Notes to the Consolidated Financial Statements

December 31, 2016

(Stated in Balboas)

### (1) General information

Banco La Hipotecaria, S. A. and Subsidiaries (formerly La Hipotecaria, S. A.), was incorporated on November 7, 1996 under the law of companies in the Republic of Panama. According to Resolution S. B. P. No. 127-2010 of June 4, 2010, the Superintendence of Banks of Panama granted a General Banking License to start operations as a Bank on June 7, 2010, which allows it to carry out banking transactions in Panama and abroad in addition to any other activity authorized by this Superintendence.

Banco La Hipotecaria, S. A. is a private bank whose shareholder is La Hipotecaria (Holding), Inc. a company incorporated under the laws of the British Virgin Islands whose main shareholder is Grupo Assa, S. A. in 69.01% (2015: 69.01%).

Through Resolution FID No. 3-97 of August 6, 1997, the Superintendence of Banks granted the Bank a fiduciary license that allows it to conduct trust business in or from the Republic of Panama. The Bank is registered with the Superintendence of the Securities Market by means of Resolution No.487-01 of December 14, 2001.

The following table provides the detail of the Bank's significant subsidiaries:

|  | <u>Activity</u>   | <u>Country of Incorporation</u> | <u>Controlling Interest</u> |             |
|--|---|---------------------------------|-----------------------------|-------------|
|  |   |                                 | <u>2016</u>                 | <u>2015</u> |
| La Hipotecaria Compañía de Financiamiento, S. A. | Grant residential mortgage loans, administer residential mortgage loans in the Republic of Colombia.                          | Colombia                        | 94.99%                      | 94.99%      |
| La Hipotecaria, S. A. de C. V.                   | Grant residential and personal mortgage loans, manage residential and personal mortgage loans in the Republic of El Salvador. | El Salvador                     | 99.98%                      | 99.98%      |

The main office is located on Via España, Plaza Regency, floor No. 13, Panama City.

Thereafter, Banco La Hipotecaria, S. A. and its subsidiaries will be referred to as "the Bank".

### (2) Basis of Preparation

#### (a) *Statement of Compliance*

These consolidated financial statements of the Bank have been prepared in conformity with International Financial Reporting Standards (IFRS).

The Audit Committee of the Bank authorized the issuance of these consolidated financial statements on March 13, 2017.

# BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

## Notes to the Consolidated Financial Statements

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### (2) Basis of Preparation, continued

#### (b) *Basis of Measurement*

The consolidated financial statements have been prepared on a historical cost basis, except for the following items:

| <u>Item</u>               | <u>Basis of Measurement</u> |
|---------------------------|-----------------------------|
| Investments in securities | Fair value                  |

#### (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 of America Dollar (US\$). The Republic of Panama does not issue its own paper currency and, instead, the United States of America Dollar is used as a legal tender. The functional currency of the subsidiary in Colombia is the Colombian peso (COP), and the functional currency of the subsidiary in El Salvador is the United States of America Dollar (US\$).

### (3) Summary of Significant Accounting Policies

The accounting policies set out below have been applied by the Bank consistently to all periods presented in these consolidated financial statements.

#### (a) *Consolidation Basis*

##### (a.1) *Subsidiaries*

The subsidiaries are participated entities controlled by the Bank. The Bank controls a subsidiary as it is exposed, or has rights, to variable returns from its involvement in the subsidiary and has the ability to affect those returns through its power over the investee. The Bank reassesses whether it has control over a participated entity if there are changes to one or more of the three elements of control. The financial statements of subsidiaries, as described in Note 1, are included in the consolidated financial statements from the date on which control commences until the date when control ceases.

##### (a.2) *Structured Entities*

A structured entity, is an entity that has been designed so that the rights to vote or similar are not the determinant factor to decide who controls the entity, as when the rights to vote are related only to the administrative tasks and the relevant activities are directed by contractual agreements. In the evaluation to determine if the Bank has sufficient rights to give power on these participated entities, the Bank considers factors of the participated entity; such as, its intention and design; its present aptitude to direct the relevant activities; the nature of its relation with other parts; and the exposition to the implication in the participated entity.



## **BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES**

(Panama, Republic of Panama)

### **Notes to the Consolidated Financial Statements**

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#### **(3) Summary of Significant Accounting Policies, continued**

*(a.3) Non-controlling interests*

Changes in the Bank's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

*(a.4) Loss of Control*

When the Bank loses control over a subsidiary, it derecognizes the assets and liabilities of the subsidiary, any related non-controlling interest, and other components of equity. Any resulting gain or loss is recognized in the statement of income. Whether the Bank retains any interest in the former subsidiary is measured at fair value when control is lost.

*(a.5) Transactions Eliminated on Consolidation*

Intra-group balances and transactions, and any unrealized income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

*(a.6) Funds Administration*

The Bank acts as administrator and trustee of trust contracts at the risk of customers. The financial statements of these entities are not part of these consolidated financial statements except when the Bank has control over the entity.

*(b) Foreign Currency*

*(b.1) Foreign Currency Transactions*

Transactions in foreign currencies are translated into the respective functional currency at the current exchange rates at the date of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into the functional currency at the current exchange rate at that date. Foreign currency differences arising on translation are generally recognized in the statement of income. However, foreign currency differences arising from the translation of available-for-sale equity instruments are recognized in after comprehensive income.

*(b.2) Foreign Operations*

The financial position and the results of any subsidiary in a different functional currency are translated to the presentation currency as follows:

- Assets and liabilities, at the current exchange rate at the end of the year.
- Revenue and expenses, at the monthly average exchange rate of the year.
- Equity accounts are measured at historical cost, at relevant exchange rate at the time of each transaction.

## **BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES**

(Panama, Republic of Panama)

### **Notes to the Consolidated Financial Statements**

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#### **(3) Summary of Significant Accounting Policies, continued**

The resulting adjustments due to translation are recorded in a separate account directly in the consolidated statement of changes in equity, under currency translation reserve.

#### *(c) Financial Assets and Liabilities*

##### *(c.1) Recognition*

The Bank initially recognizes loans, receivables, investments, deposits, debt instruments issued, and borrowing on the date on which they are originated or date of settlement.

##### *(c.2) Offsetting Financial Assets and Liabilities*

Financial assets and liabilities are offset only for purposes of presentation in the consolidated statement of financial position when the Bank has a legally enforceable right to set off the amounts and intends either to settle them on a net basis, or to realize the asset and settle the liability simultaneously. Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions derived from financial instruments held for trading.

#### *(d) Fair Value Measurement*

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When applicable, the Bank measures fair value of an instrument 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 a transaction. The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price.

The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

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

## BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

### Notes to the Consolidated Financial Statements

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#### (3) Summary of Significant Accounting Policies, continued

(e) *Cash and Cash Equivalents*

For purpose of the consolidated statement of cash flows, cash equivalents include demand deposits with banks and term deposits with original maturities of three months or less, excluding restricted deposits.

(f) *Loans*

Loans are non-derivative financial assets with fixed determinable payments that are not quoted in the active market, and are generally originated by providing funds to debtors and the Bank does not intend to sell immediately or in the near term. Loans are reported at their principal amounts outstanding, less unearned interest and commissions and the allowance for impairment. Unearned interest and commissions on loans are accrued to income under the effective interest method.

(g) *Allowance for Impairment*

The Bank assesses at each date of the consolidated statement of financial position whether there is objective evidence of impairment in a loan or loan portfolio. The amount of losses on certain loans during the period is recognized as an allowance for loan's impairment in the consolidated statement of income and increases an account allowance for impairment. The allowance is presented deducted from loans receivable in the consolidated statement of financial position. When a loan is determined to be uncollectible, the recoverable amount is deducted from the allowance account.

Impairment losses are determined using two methodologies to determine whether an objective evidence of impairment exists, individually for the loans that are significant individually and collective for loans that are not individually significant.

(g.1) *Individually Assessed Loans*

Impairment losses on individually assessed loans are determined on an evaluation of the exposures on a case by case basis. If it is determined that no objective evidence of impairment exists for an individually significant loan, it is included in a group of loans with similar characteristics and are collectively assessed for impairment. The impairment loss is calculated by comparing the current value of the expected future cash flows, discounted at the original effective interest rate of the loan, against its current carrying value. Any loss is recognized as an allowance for impairment in the consolidated statement of income. The carrying amount of impaired loans is reduced through the use of an allowance account.

(g.2) *Collectively Evaluated Loans*

For purposes of a collective assessment of impairment, the Bank uses statistical models of historical trends of probability of default, the timing of recoveries and the amount of the loss incurred, and makes an, adjustment if current economic and credit conditions are such that the real losses are likely to be greater or less than those suggested by historical trends. Default rates, loss rates and expected time for future recoveries are regularly compared with the real results to ensure they still appropriate.

# BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

## Notes to the Consolidated Financial Statements

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### (3) Summary of Significant Accounting Policies, continued

#### *(g.3) 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 allowance for impairment account. The amount of any reversal is recognized in the consolidated statement of income.

#### *(g.4) Provision for Contingent Credit Risk*

The Bank uses the allowance method to provide for possible losses over contingencies with credit nature. The allowance is increased based on a provision that is recognized as a provision expense in the consolidated statement of income and is reduced by write-offs related to these contingencies of a credit nature.

#### *(g.5) Renegotiated or Restructured Loans*

Loans that have been renegotiated or restructured are the ones that a renegotiation or restructuration has been made because of impairment in the borrower's financial condition, and when the Bank considers granting a change in the terms of the credit.

#### *(h) Investment Securities*

Investment securities are initially measured at fair value plus, incremental costs related to the transaction, except for securities at fair value through profit or loss, and subsequently accounted based on the maintained classifications according to the characteristics of the instrument and purpose for which its acquisition was determined. The classifications used by the Bank are detailed below:

#### *(h.1) Held-to-Maturity*

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank's has the positive intent and ability to hold to maturity.

Held-to-maturity investments owned by the Bank consist of debt instruments, which are carried at amortized cost using the effective interest method, less any impairment losses. A sale or reclassification that is not insignificant in relation to the amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available-for-sale, and would prevent the Bank from classifying investment securities as held-to-maturity for the current and the following two financial years. However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:

- Sales or reclassifications that are close to the maturity date or the redemption date of the financial asset because changes in the market interest rate would not have a significant effect on the financial asset's fair value.
- Sales or reclassifications after the Bank has collected substantially all of the asset's original principal.

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

**Notes to the Consolidated Financial Statements**

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**(3) Summary of Significant Accounting Policies, continued**

- Sales or reclassifications that are attributable to non-recurring isolated events beyond the Bank's control that could not have been reasonably anticipated.

*(h.2) Securities at Fair Value through Profit or Loss*

This category includes those investments securities acquired mainly for the purpose of generating a profit from short - term fluctuations in the price of the instrument. These securities are measured at fair value and changes in fair value are recognized in the consolidated statement of income in the period in which they are generated.

*(h.3) Securities Available-for-Sale*

This category includes those investments securities acquired with the intention to be held for an indefinite period of time, which may be sold in response to the needs of liquidity or changes in interest rates, exchange rates or equity prices. These securities are measured at fair value and changes in fair value are recognized in consolidated statement of changes in equity and presented in the fair value reserve within equity, until these securities are sold, redeemed, or impaired, in which case, the accumulated gain or loss in other comprehensive income is reclassified the consolidated statement of income.

When the fair value of investments in equity instruments cannot be reliable, investments remain at cost.

*Impairment of Securities Available for Sale*

The Bank assesses at each consolidated statement of financial position date whether there is objective evidence that investment securities are impaired. In the case, of securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired.

If any such evidence exists for securities available-for-sale, the losses accumulated is reclassified from equity to the consolidated statement of income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognized then the impairment loss is reversed through the consolidated statement of income.

*(i) Furniture, Equipment and Improvements*

Furniture, equipment and improvements include buildings, furniture and equipment used by branches and offices of the Bank. All furniture, equipment and improvements are measured at cost less accumulated depreciation and amortization. The historic cost includes the expense that is directly attributable to the acquisition of the asset.

## BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

### Notes to the Consolidated Financial Statements

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#### (3) Summary of Significant Accounting Policies, continued

Subsequent expenditure is capitalized only when it is probable that the future economic benefits of the expenditure will flow to the Bank. Cost considered as repairs and maintenance is charged to the consolidated income statement during the financial period that they are incurred.

The depreciation expense of furniture and equipment, and amortization of improvements to the leased property is charged to current period using the straight-line method over the estimated useful life. The estimated useful life of assets is summarized as follows:

|                         |              |
|-------------------------|--------------|
| Furniture and equipment | 3 - 10 years |
| Vehicles                | 5 years      |
| Improvements            | 3 - 10 years |

The assets' useful lives and residual value are reviewed, and adjusted, if appropriate, at each consolidated statement of financial position date. Furniture and equipment are subject to review for impairment when there are events or changes in the circumstances that indicate that the carrying value may not be recoverable. An asset's carrying amount is written-down immediately to its recoverable amount, if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

#### (j) *Assets Classified as Held for Sale*

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale.

Immediately before classification as held for sale, the assets, or components of a disposal group, are remeasured in accordance with the Bank's accounting policies. Thereafter generally the assets, or disposal group, are measured at the lower of their carrying amount and fair value less cost to sell. An impairment loss is recognized due to reductions in the initial value of such assets. Impairment losses on initial and subsequent classification as held for sale are recognized in the consolidated statement of income.

#### (k) *Deposits, Borrowed Funds and Debt Securities Issued*

These financial liabilities correspond to the Bank's main sources of debt funding. They are initially measured at fair value less incremental direct transaction costs, and subsequently are measured at amortized cost using the method of effective interest rate.

#### (l) *Share based payments*

The fair value at the date of granting options of the Holding's share purchase plan of Bank employees is recognized as a personnel expense, with the corresponding increase in the account payable to the Holding, within the vesting period in which employees acquire unconditional rights over the shares. The amount recognized as an expense is adjusted to reflect the amount of concessions, which will effectively meet the conditions of service.

# BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

## Notes to the Consolidated Financial Statements

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### (3) Summary of Significant Accounting Policies, continued

#### (m) *Employee Benefits*

##### (m.1) *Termination Benefits*

Termination benefits are recognized as expenses between whichever occurs first when the Bank can no longer withdraw the offer of those benefits and when the Bank recognizes costs for a restructuring. If benefits are not expected to be wholly settled within twelve months of the consolidated statement of financial position, then such benefits are discounted to determine their present value.

##### (m.2) *Short-term Employee Benefits*

Short-term employee benefits are expensed as the related service is provided. A liability is recognized for the amount expected to be paid if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

#### (n) *Earnings per Share*

Basic earnings per share is calculated by dividing the profit or loss that is attributable to ordinary shareholders of the Bank by the weighted-average number of ordinary shares outstanding during the period.

#### (o) *Segment Reporting*

A business segment is a main component of the Bank, whose operating results are regularly reviewed by management for decision making about resources to be allocated to the segment and evaluate its performance, and for which we have available financial information for this purpose.

The business segments presented in the consolidated financial statements correspond to a main component of the Bank responsible for providing a single product or service or a group of related products or services within a particular economic environment and that is subject to risks and returns that are different from the other business segments.

#### (p) *Interest Income and Expense*

Interest income and expense are recognized in the consolidated statement of income 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 asset or financial liability to the carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

# BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

## Notes to the Consolidated Financial Statements

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### (3) Summary of Significant Accounting Policies, continued

Interest income and expense presented in the consolidated statement of income and include:

- Interest on financial assets and financial liabilities measured at amortized cost calculated on an effective interest basis.
- Interest on available-for-sale investment securities calculated on an effective interest basis.

#### (q) *Fees and Commission*

Income and expenses from fees and commissions, both paid and received, other than those included in determining the effective interest rate, include banking services, premium and other service fees, administration and management of accounts which are recognized as the related services are performed or received.

The Bank receives recurrent income related to management services of trusts. These incomes are registered under the accrual method. Its obligation of the Bank to manage the resources of the trusts in conformity with the contracts and independent of its equity.

#### (r) *Trust Operations*

Assets held on trusts or in function of the trustee are not considered part of the Bank and therefore, those assets and its corresponding income are not included in the consolidated financial statements presented. Its obligation of the Bank to manage the resources of the trusts in conformity with the contracts and independent of its equity.

The Bank charges a commission for the trust management of the funds in the trusts, which is paid by the trustees under the basis of the balance that the trusts have or with an agreement between the parties. These commissions are recognized to income under the terms of the trusts contracts monthly, quarterly, or annually under the accrual basis.

#### (s) *Net Income from as Financial Instruments at Fair Value through Profit or Loss*

Net income from other financial instruments at fair value through profit or loss relates to non-trading derivatives held for risk management purposes that do not form part of qualifying hedge relationships and financial assets and financial liabilities designated at fair value through profit or loss. It includes all realized and unrealized fair value changes, interest, dividends and foreign exchange differences.

#### (t) *Income tax*

Current income tax is the expected tax payable on the taxable income for the year using tax rates enacted at the consolidated statement of financial position date, and any adjustment to the tax payable in respect of previous years.



# BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

## Notes to the Consolidated Financial Statements

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### (3) Summary of Significant Accounting Policies, continued

Deferred income tax represents the amount of income tax payable and/or receivable in future years resulting from temporary differences between the carrying accounts 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. If it is determined that the deferred tax would not be realized in future years, the deferred tax will be totally or partially reduced.

#### (u) *New IFRS and Interpretations that have not been yet adopted*

There are standards that have not been yet applied in the preparation of the consolidated financial statements:

- The final version of IFRS 9 “Financial Instruments” (2014) will replace all previous versions of IFRS 9 issued (2009, 2010, and 2013) and complete the project to replace IAS 39. The most significant impact of this standard are:
  - New requirements for classification and measurement of financial assets. Among other things, the standard contains two primary measurement categories for financial assets: amortized cost and fair value. IFRS 9 eliminates the existing categories in IAS 39 of held to maturity, securities available for sale, loans and receivables values.
  - Eliminates the volatility in results caused by changes in the credit risk liabilities measured at fair value, which means that the profits produced by the impairment of the own credit risk of the entity in such obligations are not recognized in the operating results.
  - A substantially reformed approach to hedge accounting, with improved activity on risk management disclosures.
  - A new impairment model based on “expected loss” that will require greater timely recognition of credit losses.

The effective date for the application of IFRS 9 is for annual periods beginning on or after January 1, 2018. However, this standard may be adopted in advance.

- IFRS 15 “Income from Contracts with Customers”. It sets out a comprehensive framework to determine how much and the time when revenue should be recognized. This standard replaces the existing guidelines, including IAS 18 “Revenue”, IAS 11 “Construction Contracts” and interpretation by International Financial Reporting Interpretations Committee (“IFRIC”) 13 “Customer Loyalty Programs”. IFRS 15 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

## **BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES**

(Panama, Republic of Panama)

### **Notes to the Consolidated Financial Statements**

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#### **(3) Summary of Significant Accounting Policies, continued**

- IFRS 16 "Leases". On January 13, 2016, IFRS 16 "Leases", which replaces the current, IAS 17 "Leases" was issued. IFRS 16 eliminates classification of leases either as operating leases or finance leases for the lessee. Instead, all leases are recognized similarly to finance leases under IAS 17. Leases are measured at the present value of future lease payments and are presented as either leased assets (right of use assets) or along with property, furniture and equipment. 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".

By the nature of the Bank's operations, the adoption of these standards could have an impact on the consolidated financial statements, something that is currently being evaluated by management.

#### **(4) Financial Risk Management**

A financial instrument is any contract that originates a financial asset in one entity and a financial liability or equity instrument in another entity. The Bank's activities are mainly related to the use of derivative financial instruments and therefore, the consolidated statement of financial position is comprised mainly of financial instruments. These instruments expose the Bank to various types of risk, for which the Bank Board has established certain committees for administration and regular monitoring of risks to which the Bank is exposed. To manage and monitor these risk, the Board has established the following committees:

- Credit Committee
- Collections Committee
- Audit Committee
- Compliance Committee
- Risk Committee
- Asset and Liability Committee (ALCO)

The Audit Committee of the Bank supervises the way in which Management monitors the compliance of the policies and procedures of risk management and reviews if the risk management framework is appropriate in respect of the risks that the Bank confronts.

This Committee is assisted by Internal Audit in its supervision role. Internal Audit makes periodic revisions of the controls and procedures of risk management. These results are reported to the Audit Committee.

The Bank's Risk Committee main responsibilities are the following:

1. Oversight of the performance and independence of the Risk Department of the Bank, according to its role.
2. To monitor the risk expositions and compare those expositions to the risk limits approved by the Board of Directors; as to bring to the Board of Directors the presented results.

## **BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES**

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#### **(4) Financial Risk Management, continued**

3. To develop and to propose methodologies, procedures, limits and strategies for the administration of the risks; as well as to propose improvements to the risk management policies.
4. Issue recommendations to support the maintenance and/or improvement of the risk qualification of the Bank.
5. Periodically, as well as prior to performing assets and liabilities operations with large entities, to help management quantify the possible losses which the Bank might incur, in case of an operation is carried out.
6. To propose contingency plans on the risks subject, which will be submitted to the approval of the Board of Directors and to recommend courses of action or mechanisms which can normalize any situation in which the Bank has left of the established limits.
7. To watch that the management of the Bank promotes the culture of risk management.

The main risks identified by the Bank are credit, liquidity, market and operational risk, which are described as follows:

##### *(a) Credit Risk:*

Is the risk that the debtor, issuer or counterpart of a financial asset owned by the Bank does not fully and timely comply with any payment due to the Bank, in conformity with the agreed upon terms and conditions, when the financial asset was acquired or originated by the Bank. Also this risk is conceived as an impairment in the credit quality of the counterpart, of the collateral and/or of the guarantee agreed initially.

To mitigate the credit risk, the risk management policies establish processes and controls to follow for loans approvals or credit facilities. The Bank structures the levels of credit risk acceptable by the establishment of limits over the quantity of accepted risk in relation to only one borrower, or group of borrowers, and geographic segment. These credits are controlled constantly and subject to a periodic revision.

Exposure to credit risk is also managed through a periodic analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits when appropriate. The exposure to credit risk is also mitigated through collaterals, corporate, and personals obtained by the Bank.

Risk management is carried out under policies approved by the Board of Directors; these policies are reviewed and modified to reflect changes in markets, regulations, and other factors to consider in the formulation of these policies.

The Bank has several risk assessment reports to evaluate the performance of their credit portfolio, allowance requirements, and especially to anticipate the circumstances that can affect the repayment ability of their borrowers.

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**Notes to the Consolidated Financial Statements**

**(4) Financial Risk Management, continued**

The Board of Directors has delegated the responsibility for the management of the credit risk in the Credit Committee, Administration of Credit Committee, Risk Committee, Collections Committee which watch periodically the financial condition of the debtors and respective issuers, who involve a credit risk for the Bank.

Credit Quality Analysis

The following table analyzes the credit quality of financial assets and the impairment / loss reserves maintained by the Bank for this assets:

|   | <u>Loans</u>       |                    | <u>Investments securities (1)</u> |                   |
|---|--------------------|--------------------|-----------------------------------|-------------------|
|   | <u>2016</u>        | <u>2015</u>        | <u>2016</u>                       | <u>2015</u>       |
| <b>Maximum exposure</b>                     |                    |                    |                                   |                   |
| Carrying amount                             | <u>505,517,639</u> | <u>467,841,783</u> | <u>59,104,134</u>                 | <u>42,840,608</u> |
| <b>At amortized cost</b>                    |                    |                    |                                   |                   |
| Low-fair risk                               | 491,378,401        | 456,335,037        | 1,537,501                         | 726,092           |
| Watch list                                  | 10,244,902         | 7,919,832          | 0                                 | 0                 |
| Substandard                                 | 774,808            | 842,497            | 0                                 | 0                 |
| Doubtful                                    | 779,304            | 899,324            | 0                                 | 0                 |
| Loss  | <u>2,640,888</u>   | <u>2,106,407</u>   | <u>0</u>                          | <u>0</u>          |
| <b>Gross amount</b>                         | <u>505,818,303</u> | <u>468,103,097</u> | <u>1,537,501</u>                  | <u>726,092</u>    |
| Allowance for impairment                    | <u>300,664</u>     | <u>261,314</u>     | <u>0</u>                          | <u>0</u>          |
| <b>Net carrying amount</b>                  | <u>505,517,639</u> | <u>467,841,783</u> | <u>1,537,501</u>                  | <u>726,092</u>    |
| <b>Available for sale</b>                   |                    |                    |                                   |                   |
| Low-fair risk                               | <u>0</u>           | <u>0</u>           | <u>44,762,589</u>                 | <u>34,615,778</u> |
| <b>Carrying amount</b>                      | <u>0</u>           | <u>0</u>           | <u>44,762,589</u>                 | <u>34,615,778</u> |
| <b>At fair value through profit or loss</b> |                    |                    |                                   |                   |
| Low-fair risk                               | <u>0</u>           | <u>0</u>           | <u>12,804,044</u>                 | <u>7,498,738</u>  |
| <b>Carrying amount</b>                      | <u>0</u>           | <u>0</u>           | <u>12,804,044</u>                 | <u>7,498,738</u>  |
| <b>Neither past due nor impair</b>          |                    |                    |                                   |                   |
| Low-fair risk                               | <u>491,378,401</u> | <u>456,335,037</u> | <u>0</u>                          | <u>0</u>          |
| <b>Total</b>                                | <u>491,378,401</u> | <u>456,335,037</u> | <u>0</u>                          | <u>0</u>          |
| <b>Past due but not impaired</b>            |                    |                    |                                   |                   |
| 31 to 60 days                               | 7,040,165          | 5,554,993          | 0                                 | 0                 |
| 61 to 90 days                               | 3,204,737          | 2,364,839          | 0                                 | 0                 |
| 91 to 180 days                              | <u>1,554,112</u>   | <u>1,741,821</u>   | <u>0</u>                          | <u>0</u>          |
| <b>Total</b>                                | <u>11,799,014</u>  | <u>9,661,653</u>   | <u>0</u>                          | <u>0</u>          |
| <b>Individually impaired</b>                |                    |                    |                                   |                   |
| Watch list                                  | 0                  | 0                  | 0                                 | 0                 |
| Substandard                                 | 0                  | 0                  | 0                                 | 0                 |
| Doubtful                                    | 0                  | 0                  | 0                                 | 0                 |
| Loss  | <u>2,640,888</u>   | <u>2,106,407</u>   | <u>0</u>                          | <u>0</u>          |
| <b>Total</b>                                | <u>2,640,888</u>   | <u>2,106,407</u>   | <u>0</u>                          | <u>0</u>          |
| <b>Allowance for impairment:</b>            |                    |                    |                                   |                   |
| Individual allowance                        | 206,519            | 173,275            | 0                                 | 0                 |
| Collective allowance                        | <u>94,145</u>      | <u>88,039</u>      | <u>0</u>                          | <u>0</u>          |
| <b>Total</b>                                | <u>300,664</u>     | <u>261,314</u>     | <u>0</u>                          | <u>0</u>          |

(1) Excludes equity shares

At December 31, 2016, the Bank made the analysis based on the requirements of the Agreement No.4-2013 which regulates off-balance accounts. Of the total off-balance accounts, 100% correspond to revocable promise of payment cards. The total of the promise of payment cards are classified in the normal category.

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**(4) Financial Risk Management, continued**

Renegotiated and restructured loans are presented as follows:

|  | <u>2016</u>    | <u>2015</u>    |
|--|----------------|----------------|
| <b>Renegotiated and restructured loans</b> |                |                |
| Carrying amount                            | 186,998        | 157,662        |
| Impaired amount                            | 154,684        | 147,019        |
| Allowance for impairment                   | (9,230)        | (24,309)       |
| Net carrying amount                        | <u>145,454</u> | <u>122,710</u> |

The factors of major risk exposure, information on the impaired assets, and the premises used for these disclosures are the following:

- Impaired loans and investment debt securities:  
Management assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired, based on the following criteria established by the Bank:
  - Contractual non-payment of principal or interest;
  - borrowers' cash flow difficulties;
  - non-compliance with covenants and conditions;
  - borrower or issuer will enter bankruptcy;
  - impairment of the competitive position of the borrower; or
  - impairment of warranty
- Past due but not impaired:  
Loans that hold enough level of guarantees and/or sources of payment to cover the carrying value of such loans are considered in arrears with no impairment.
- Renegotiated or restructured loans:  
Renegotiated loans are those loans for which a significant variation in the original credit terms (balance, term, payment plan, rate and guarantees) have been formally documented, due to material difficulties in the payment capacity of the debtor. The objective of a restructuration is to obtain a more favorable situation, so that the Bank recovers the debt.
- Write-off policy:  
The Bank determines the write-off a group of loans that demonstrate non-recoverability. This determination is made after performing an analysis of the borrower's financial conditions since the last payment of an obligation, and when the amount of collateral are not enough for the payment of the facility. For loans of lower amounts, write-offs are generally based on the expired time of the credit granted.
- Allowance for impairment:  
The Bank has established reserves to cover losses incurred in the loans portfolio. These reserves are calculated on an individual basis for the loans that are individually significant and collectively for the loans that are not individually significant. The loans that are evaluated on an individual basis and are not impaired, are evaluated on a collective basis.

# BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

## Notes to the Consolidated Financial Statements

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### (4) Financial Risk Management, continued

#### *Deposits placed with Banks*

At December 31, 2016, the Bank held deposits placed with banks for B/.31,025,217 (2015: B/.25,410,500). These deposits are held with financial institutions that are rated at least BBB- and BBB+, based on Fitch Ratings Inc., Moodys, and Standard & Poors.

#### *Collateral held and Other Credit improvement and their Financial Effect*

The Bank held collateral and other credit enhancements to secure the of its financial assets exposed to credit risk improvements. The table below presents the main types of collateral held by different types of financial assets.

|                       | % of exposure subject to requirements<br>of Collaterals |             |                           |
|-----------------------|---|-------------|---------------------------|
|                       | <u>2016</u>   | <u>2015</u> | <u>Type of Collateral</u> |
| Loans                 | 92%   | 92%         | Properties                |
| Investment securities | 78%   | 76%         | Mortgage loans            |

#### *Residential mortgage loans*

The tables below stratify credit exposures from mortgage loans and advances to retail customers by ranges of loan-to-value (LTV) ratio. LTV is calculated as the ratio of the gross amount of the loan – or the amount committed for loan commitments – to the value of the collateral. The gross amounts exclude any impairment allowance. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for residential mortgage loans is based on the collateral value at origination and generally is not updated.

| <u>LTV ranges</u> | <u>2016</u>        | <u>2015</u>        |
|-------------------|--------------------|--------------------|
| 0-20%             | 391,022            | 316,875            |
| 20-40%            | 3,440,419          | 3,018,603          |
| 40-60%            | 21,475,393         | 20,331,857         |
| 60-80%            | 151,826,428        | 124,488,202        |
| 80-100%           | <u>287,919,741</u> | <u>281,509,689</u> |
| Total             | <u>465,053,003</u> | <u>429,665,226</u> |

The Bank does not update its collateral valuation routinely. The appraisals on the collaterals are updated for consumer loans when the credit risk of a loan becomes significantly impaired and the loan is under close supervision. For loans that are doubtful to recover, the Bank obtains appraisals for collaterals because it is an input for measuring impairment.

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**Notes to the Consolidated Financial Statements**

**(4) Financial Risk Management, continued**

*Assets obtained by taking possession of collateral*

Details of financial and non-financial assets obtained by the Bank during the year by taking possession of collateral held as security against loans and advances as well as calls made on credit enhancements and held at year end are shown below:

|            | <u>2016</u>    | <u>2015</u>    |
|------------|----------------|----------------|
| Properties | <u>291,885</u> | <u>254,281</u> |

*Concentration of Credit Risk*

The Bank monitors concentrations of credit risk by sector and by geographic location. An analysis of concentrations of credit risk at the date of the consolidated financial statements is as follows:

|                          | <u>Loans</u>       |                    | <u>Investment Securities</u> |                   |
|--------------------------|--------------------|--------------------|------------------------------|-------------------|
|                          | <u>2016</u>        | <u>2015</u>        | <u>2016</u>                  | <u>2015</u>       |
| <b>Concentration by:</b> |                    |                    |                              |                   |
| <b>Sector:</b>           |                    |                    |                              |                   |
| Mortgage banking         | 465,053,003        | 429,665,226        | 44,556,529                   | 37,011,388        |
| Personal banking         | 40,765,300         | 38,437,871         | 0                            | 0                 |
| Other sectors            | <u>0</u>           | <u>0</u>           | <u>14,582,620</u>            | <u>5,882,877</u>  |
|                          | <u>505,818,303</u> | <u>468,103,097</u> | <u>59,139,149</u>            | <u>42,894,265</u> |
| <b>Geographic:</b>       |                    |                    |                              |                   |
| Panama                   | 364,220,041        | 307,619,589        | 52,549,864                   | 39,288,706        |
| Central America          | 98,069,243         | 126,629,172        | 0                            | 0                 |
| Colombia                 | <u>43,529,019</u>  | <u>33,854,336</u>  | <u>6,589,285</u>             | <u>3,605,559</u>  |
|                          | <u>505,818,303</u> | <u>468,103,097</u> | <u>59,139,149</u>            | <u>42,894,265</u> |

Concentration by location for loans is based on the customer's country of domicile. Concentration by location for investment securities is based on the country of domicile of the issuer of the security.

**(b) Liquidity Risk**

The liquidity risk consists of two definitions and depends on its origination:

*Funding Liquidity Risk*

It represents the difficulty of an entity to obtain the resources necessary to comply with all its obligations, through the income generated by their assets or by the acquisition of new liabilities. This type of risk, generally, is occasioned by a drastic and sudden deterioration of the quality of the assets which originates an extreme difficulty to turn them into liquid resources.

*Market Liquidity Risk*

It is the probability of economic loss due to the difficulty of disposing assets without a significant reduction in its price. It is incurred in this class of risk as a result of changes in the market (prices, rates, etc.), or when investments realized are in markets or instruments for which does not exist an ample offer and demand.

# BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

## Notes to the Consolidated Financial Statements

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### (4) Financial Risk Management continued

#### *Liquidity Risk Management*

The Bank monitors this risk with sufficient and appropriate liquid funds and assets that can easily be liquidated, usually at level required by the regulator and maintains an adequate gap between maturities of assets and liabilities which is reviewed regularly.

The ALCO Committee is in charge of the management of the liquidity risk in order to assure the Bank can respond in case of unexpected cash withdrawals of deposits or unscheduled loans commitments.

Bank's management and the ALCO Committee is responsible to monitor the liquidity position through an analysis of the contractual maturity are structure, stability of deposits by type of customer, and the compliance with regulations and corporate policies..

#### *Exposure to Liquidity Risk*

The key measure used by the Bank for managing liquidity risk is the index of net liquid assets to deposits from customers. The net liquid assets include cash and cash equivalents and debt securities for which there is an active and liquid market, less any deposit from banks, debt securities issued and other borrowings.

The table below shows the Bank's index of net liquid assets on deposits from customers reported to the Superintendence of Banks of Panama; this index should not be less than 30%:

|                     | <u>2016</u> | <u>2015</u> |
|---------------------|-------------|-------------|
| At December 31      | 86.11%      | 39.31%      |
| Average of the year | 77.64%      | 55.93%      |
| Maximum of the year | 136.42%     | 80.90%      |
| Minimum of the year | 45.94%      | 39.31%      |



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**Notes to the Consolidated Financial Statements**

**(4) Financial Risk Management, continued**

The table below set out the undiscounted cash flows of the financial assets and liabilities of the Bank and its loan commitments not recognized.

| <u>2016</u>                          | <u>Carrying amount</u>        | <u>Gross nominal (outflow)/inflow</u>        | <u>Up to 1 year</u>        | <u>From 1 to 5 years</u>        | <u>From 5 to 10 years</u>        | <u>More than 10 years</u>        |
|--------------------------------------|-------------------------------|--|----------------------------|---------------------------------|----------------------------------|----------------------------------|
| <b>Financial Liabilities:</b>        |                               |  |                            |                                 |                                  |                                  |
| Saving deposits                      | 1,173,478                     | (1,173,478)                                  | (1,173,478)                | 0                               | 0                                | 0                                |
| Time deposits                        | 178,676,982                   | (184,006,462)                                | (52,574,452)               | (131,432,010)                   | 0                                | 0                                |
| Negotiable commercial papers         | 70,760,884                    | (72,038,452)                                 | (72,038,452)               | 0                               | 0                                | 0                                |
| Negotiable commercial notes          | 92,861,338                    | (99,615,302)                                 | (34,376,487)               | (65,238,815)                    | 0                                | 0                                |
| Ordinary bonds                       | 16,591,868                    | (20,069,247)                                 | (841,116)                  | (19,228,131)                    | 0                                | 0                                |
| Investment certificates              | 23,072,087                    | (25,279,123)                                 | (9,893,297)                | (15,385,826)                    | 0                                | 0                                |
| Other negotiable debts               | 8,988,036                     | (9,128,639)                                  | (9,128,639)                | 0                               | 0                                | 0                                |
| Borrowed funds                       | <u>141,544,615</u>            | <u>(160,436,696)</u>                         | <u>(23,785,492)</u>        | <u>(110,979,852)</u>            | <u>(25,671,352)</u>              | <u>0</u>                         |
| <b>Total financial liabilities</b>   | <u>533,669,288</u>            | <u>(571,747,399)</u>                         | <u>(203,811,413)</u>       | <u>(342,264,634)</u>            | <u>(25,671,352)</u>              | <u>0</u>                         |
| <b>Financial Assets:</b>             |                               |  |                            |                                 |                                  |                                  |
| Cash                                 | 281,416                       | 281,416                                      | 281,416                    | 0                               | 0                                | 0                                |
| Demand deposits                      | 31,025,217                    | 31,025,217                                   | 31,025,217                 | 0                               | 0                                | 0                                |
| Investment securities                | 59,139,149                    | 107,775,178                                  | 3,152,336                  | 12,293,081                      | 12,400,300                       | 79,929,461                       |
| Loans                                | <u>505,818,303</u>            | <u>999,008,868</u>                           | <u>49,656,575</u>          | <u>192,680,134</u>              | <u>222,342,374</u>               | <u>534,329,785</u>               |
| <b>Total financial assets</b>        | <u>596,264,086</u>            | <u>1,138,090,679</u>                         | <u>84,115,545</u>          | <u>204,973,215</u>              | <u>234,272,674</u>               | <u>614,259,246</u>               |
| <b>Commitments and contingencies</b> |                               |  |                            |                                 |                                  |                                  |
| Loan commitments                     | <u>0</u>                      | <u>(66,490,092)</u>                          | <u>(66,490,092)</u>        | <u>0</u>                        | <u>0</u>                         | <u>0</u>                         |
| <b>2015</b>                          | <b><u>Carrying amount</u></b> | <b><u>Gross nominal (outflow)/inflow</u></b> | <b><u>Up to 1 year</u></b> | <b><u>From 1 to 5 years</u></b> | <b><u>From 5 to 10 years</u></b> | <b><u>More than 10 years</u></b> |
| <b>Financial Liabilities:</b>        |                               |  |                            |                                 |                                  |                                  |
| Saving deposits                      | 872,942                       | (872,942)                                    | (872,942)                  | 0                               | 0                                | 0                                |
| Time deposits                        | 170,468,320                   | (182,420,858)                                | (86,672,386)               | (95,748,472)                    | 0                                | 0                                |
| Negotiable commercial papers         | 53,791,389                    | (54,688,948)                                 | (54,688,948)               | 0                               | 0                                | 0                                |
| Negotiable commercial notes          | 72,128,518                    | (76,468,391)                                 | (24,239,832)               | (52,228,559)                    | 0                                | 0                                |
| Investment certificates              | 19,875,121                    | (21,226,639)                                 | (10,796,646)               | (10,429,993)                    | 0                                | 0                                |
| Other negotiable debts               | 6,987,535                     | (7,087,125)                                  | (7,087,125)                | 0                               | 0                                | 0                                |
| Borrowed funds                       | <u>159,235,027</u>            | <u>(179,852,948)</u>                         | <u>(15,346,875)</u>        | <u>(117,021,166)</u>            | <u>(47,484,907)</u>              | <u>0</u>                         |
| <b>Total financial liabilities</b>   | <u>483,358,852</u>            | <u>(522,617,851)</u>                         | <u>(199,704,754)</u>       | <u>(275,428,190)</u>            | <u>(47,484,907)</u>              | <u>0</u>                         |
| <b>Financial Assets:</b>             |                               |  |                            |                                 |                                  |                                  |
| Cash                                 | 325,366                       | 325,366                                      | 325,366                    | 0                               | 0                                | 0                                |
| Demand deposits                      | 25,410,500                    | 25,410,500                                   | 25,410,500                 | 0                               | 0                                | 0                                |
| Investment securities                | 42,894,265                    | 76,579,107                                   | 4,590,492                  | 12,688,215                      | 12,602,531                       | 46,697,869                       |
| Loans                                | <u>468,103,097</u>            | <u>928,852,124</u>                           | <u>45,321,301</u>          | <u>175,919,633</u>              | <u>201,479,000</u>               | <u>506,132,190</u>               |
| <b>Total financial assets</b>        | <u>536,733,228</u>            | <u>1,031,167,097</u>                         | <u>75,64,659</u>           | <u>188,607,848</u>              | <u>214,081,531</u>               | <u>552,830,059</u>               |
| <b>Commitments and contingencies</b> |                               |  |                            |                                 |                                  |                                  |
| Loan commitments                     | <u>0</u>                      | <u>(64,534,809)</u>                          | <u>(64,534,809)</u>        | <u>0</u>                        | <u>0</u>                         | <u>0</u>                         |

For financial assets and liabilities that are non-derivatives, the gross nominal amount is measured based on the undiscounted cash flows which include estimated interest payable and receivable.

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**Notes to the Consolidated Financial Statements**

**(4) Financial Risk Management, continued**

The table below sets out the carrying amounts of financial liabilities expected to be settled more than twelve months after the reporting date:

|                               | <u>2016</u>        | <u>2015</u>        |
|-------------------------------|--------------------|--------------------|
| <b>Financial Liabilities:</b> |                    |                    |
| Time deposits                 | <u>116,632,993</u> | <u>85,381,491</u>  |
| Borrowed funds                | <u>119,637,121</u> | <u>145,564,967</u> |
| Negotiable commercial notes   | <u>59,287,000</u>  | <u>46,760,000</u>  |
| Ordinary bonds                | <u>16,591,868</u>  | <u>0</u>           |
| Investment certificates       | <u>13,600,000</u>  | <u>9,492,000</u>   |

The Bank is dedicated to generate mortgage and personal loans and is capable of securitize part of its loans in accordance with its liquidity needs. Mortgage loans reflect a monthly flow in capital subscriptions and interest payments which are not listed in the table above.

The table below shows the Bank's commitment and available assets as collateral in connection with any financial liability or other compromise, and represent those financial assets available to support future commitments or borrowed funds:

| <u>2016</u>              | <u>Pledged as<br/>Collateral</u> | <u>Available as<br/>Collateral</u> | <u>Total</u>       |
|--------------------------|----------------------------------|------------------------------------|--------------------|
| Cash and cash equivalent | 0                                | 31,306,633                         | 31,306,633         |
| Investment securities    | 0                                | 59,139,149                         | 59,139,149         |
| Loans, net               | 119,701,728                      | 385,815,911                        | 505,517,639        |
| Non-financial assets     | <u>0</u>                         | <u>14,360,064</u>                  | <u>14,360,064</u>  |
|                          | <u>119,701,728</u>               | <u>490,997,757</u>                 | <u>610,699,485</u> |
|                          |                                  |                                    |                    |
| <u>2015</u>              | <u>Pledged as<br/>Collateral</u> | <u>Available as<br/>Collateral</u> | <u>Total</u>       |
| Cash and cash equivalent | 0                                | 25,735,866                         | 25,735,866         |
| Investment securities    | 0                                | 42,894,265                         | 42,894,265         |
| Loans, net               | 182,091,674                      | 285,750,109                        | 467,841,783        |
| Non-financial assets     | <u>0</u>                         | <u>12,860,672</u>                  | <u>12,860,672</u>  |
|                          | <u>182,091,674</u>               | <u>367,240,912</u>                 | <u>549,332,586</u> |

**(c) Market Risk:**

It is the risk that the value of a financial asset is reduced as a result of changes in interest rates, in monetary exchange rates, stock prices and other financial variables, as well as the reaction of market participants to political and economic events. These elements cause that the Bank is subject to latent losses as to potential profit. The objective of market risk management is to manage and control market risk exposures within acceptable parameters to ensure the Bank's solvency while optimizing the risk return.

# BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

## Notes to the Consolidated Financial Statements

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### (4) Financial Risk Management, continued

#### *Market Risk Management:*

The management of this risk is supervised constantly by the General Management. To mitigate this risk, the Bank has documented in its control policies related to investment limits, classification and valuation of investments, qualification of portfolio, cross-check of interest payments, sensibility and stress tests.

Below are detailed the composition and analysis of each of the types of market risk:

#### *Exchange Rate Risk*

Is the risk that the value of a financial instrument fluctuates as a consequence of changes in exchange rates of foreign currencies and other financial variables, and the reaction of market participants to political and economic events. For purposes of IFRS 7, this risk does not derive from financial instruments that are not monetary items, nor for financial instruments denominated in the functional currency.

The Bank holds and makes loans in Colombian Pesos, the national currency of Colombia. The value of positions fluctuates as a result of changes in the prices of the exchange rate.

The sensibility analysis for the risk of exchange rate, is mainly considered in the measurement of the position inside a specific currency. The analysis consists of verifying how much would represent the position in the functional currency on the currency to which it would be converting and therefore the mix of the exchange rate risk.

The currency position is presented in its equivalent in dollars as follows:

| <u>Colombian Pesos</u>   | <u>2016</u>       | <u>2015</u>       |
|--------------------------|-------------------|-------------------|
| <b>Assets</b>            |                   |                   |
| Cash and cash equivalent | 5,575,212         | 6,468,882         |
| Loans, net               | 43,498,692        | 33,854,336        |
| Other assets             | <u>7,703,987</u>  | <u>4,044,622</u>  |
| <b>Total assets</b>      | <u>56,777,891</u> | <u>44,367,840</u> |
| <b>Liabilities</b>       |                   |                   |
| Time deposits            | 10,673,991        | 18,227,161        |
| Ordinary bonds           | 16,591,868        | 0                 |
| Borrowed funds           | 9,692,151         | 12,383,036        |
| Other liabilities        | <u>1,459,470</u>  | <u>491,254</u>    |
| <b>Total liabilities</b> | <u>38,417,480</u> | <u>31,101,451</u> |
| <b>Net position</b>      | <u>18,360,411</u> | <u>13,266,389</u> |

#### *Interest Rate Risk*

Interest rate risk is the Bank's financial exposure (net margin and equity market value) to possible losses in the event of unexpected movement in the interest rates.

**BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES**

(Panama, Republic of Panama)

**Notes to the Consolidated Financial Statements****(4) Financial Risk Management, continued**

The Board of Directors establishes that the ALCO Committee has the responsibility to analyze the sensibility to interest rate fluctuations, statement of financial position structure, transaction terms and investment strategies.

The basic analysis carried out every month by management consists in determining the impact caused on financial assets and liabilities by increases or decreases of 25 and 50 basis points in interest rates, considering as a premise, the minimum rate of 0.005% in cases that their results yield negative values to raise the actual values. The impact is summarized as follows:

|   | <b>Increase of<br/>25 bp</b> | <b>Decrease of<br/>25 bp</b> | <b>Increase of<br/>50 bp</b> | <b>Decrease of<br/>50 bp</b> |
|---|------------------------------|------------------------------|------------------------------|------------------------------|
| <b>Sensitivity of projected net interest income</b> |                              |                              |                              |                              |
| 2016  | 122,776                      | (125,058)                    | 247,903                      | (243,567)                    |
| 2015  | 43,825                       | (44,657)                     | 87,651                       | (85,986)                     |
| <b>Sensitivity of projected net equity</b>          |                              |                              |                              |                              |
| 2016  | (1,069,372)                  | 1,071,654                    | (2,138,743)                  | 2,134,407                    |
| 2015  | (967,494)                    | 968,326                      | (1,934,988)                  | 1,933,323                    |

The table below summarizes the Bank's exposure to interest rate risk. It includes the Bank's assets and liabilities at carrying value, categorized by the earlier of contractual repricing rate or maturity:

| <b>2016</b>                                      | <b>Up to<br/>1 year</b>   | <b>From 1 to 5<br/>years</b> | <b>From 5 to 10<br/>years</b> | <b>More than 10<br/>years</b> | <b>Total</b>              |
|--|---------------------------|------------------------------|-------------------------------|-------------------------------|---------------------------|
| <b>Assets:</b>                                   |                           |                              |                               |                               |                           |
| Demand deposits                                  | 20,319,978                | 0                            | 0                             | 0                             | 20,319,978                |
| Time deposits                                    | 1,000,000                 | 0                            | 0                             | 0                             | 1,000,000                 |
| Investments available for sale                   | 31,787,500                | 0                            | 4,073,403                     | 7,705,280                     | 43,566,183                |
| Investments held to maturity                     | 1,319,477                 | 0                            | 0                             | 218,024                       | 1,537,501                 |
| Investments at fair value through profit or loss | 0                         | 0                            | 0                             | 12,804,044                    | 12,804,044                |
| Loans  | <u>505,818,303</u>        | <u>0</u>                     | <u>0</u>                      | <u>0</u>                      | <u>505,818,303</u>        |
| <b>Total assets</b>                              | <b><u>560,245,258</u></b> | <b><u>0</u></b>              | <b><u>4,073,403</u></b>       | <b><u>20,727,348</u></b>      | <b><u>585,046,009</u></b> |
| <b>Liabilities:</b>                              |                           |                              |                               |                               |                           |
| Saving deposits                                  | 1,173,478                 | 0                            | 0                             | 0                             | 1,173,478                 |
| Time deposits                                    | 62,043,988                | 116,632,994                  | 0                             | 0                             | 178,676,982               |
| Borrowed funds                                   | 141,544,615               | 0                            | 0                             | 0                             | 141,544,615               |
| Issued debt                                      | <u>123,079,920</u>        | <u>89,194,293</u>            | <u>0</u>                      | <u>0</u>                      | <u>212,274,213</u>        |
| <b>Total liabilities</b>                         | <b><u>327,842,001</u></b> | <b><u>205,827,287</u></b>    | <b><u>0</u></b>               | <b><u>0</u></b>               | <b><u>533,669,288</u></b> |
| <b>Interest rate sensitivity, net</b>            | <b><u>232,403,257</u></b> | <b><u>(205,827,287)</u></b>  | <b><u>4,073,403</u></b>       | <b><u>20,727,348</u></b>      | <b><u>51,376,721</u></b>  |

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**Notes to the Consolidated Financial Statements**

**(4) Financial Risk Management, continued**

| <u>2015</u>                                      | <u>Up to<br/>1 year</u> | <u>From 1 to 5<br/>years</u> | <u>From 5 to 10<br/>years</u> | <u>More than 10<br/>years</u> | <u>Total</u>       |
|--|-------------------------|------------------------------|-------------------------------|-------------------------------|--------------------|
| <b>Assets:</b>                                   |                         |                              |                               |                               |                    |
| Demand deposits                                  | 21,658,834              | 0                            | 0                             | 0                             | 21,658,834         |
| Time deposits                                    | 3,751,666               | 0                            | 0                             | 0                             | 3,751,666          |
| Investments available for sale                   | 29,537,949              | 0                            | 2,361,875                     | 2,034,945                     | 33,934,769         |
| Investments held to maturity                     | 0                       | 0                            | 509,018                       | 217,074                       | 726,092            |
| Investments at fair value through profit or loss | 0                       | 0                            | 0                             | 7,498,438                     | 7,498,438          |
| Loans  | <u>468,103,097</u>      | <u>0</u>                     | <u>0</u>                      | <u>0</u>                      | <u>468,103,097</u> |
| <b>Total assets</b>                              | <u>523,051,546</u>      | <u>0</u>                     | <u>2,870,893</u>              | <u>9,750,457</u>              | <u>535,672,896</u> |
| <b>Liabilities:</b>                              |                         |                              |                               |                               |                    |
| Saving deposits                                  | 872,942                 | 0                            | 0                             | 0                             | 872,942            |
| Time deposits                                    | 85,086,829              | 85,381,491                   | 0                             | 0                             | 170,468,320        |
| Borrowed funds                                   | 159,235,027             | 0                            | 0                             | 0                             | 159,235,027        |
| Issued debt                                      | <u>96,530,563</u>       | <u>56,252,000</u>            | <u>0</u>                      | <u>0</u>                      | <u>152,782,563</u> |
| <b>Total liabilities</b>                         | <u>341,725,361</u>      | <u>141,633,491</u>           | <u>0</u>                      | <u>0</u>                      | <u>483,358,852</u> |
| <b>Interest rate sensitivity, net</b>            | <u>181,326,185</u>      | <u>(141,633,491)</u>         | <u>2,870,893</u>              | <u>9,750,457</u>              | <u>52,314,044</u>  |

To evaluate the interest rate risk and its impact in the fair value of financial assets and liabilities, management of the Bank prepares stress tests to determine the sensibility of financial assets and liabilities.

*Price Risk*

Is the risk that the value of a financial instrument fluctuates due to changes in market prices, independently that they are caused by specific factors related to the particular instrument or its issuer, or factors that affect all securities traded on the market.

The Bank is exposed to price risk of equity instruments classified as available for sale or securities at fair value through profit or loss. To mitigate the price risk in equity or debt instruments, the Bank diversifies its portfolio according to the established limits.

(d) *Operational Risk*

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks, such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviors.

The model of Operative Risk Management covers as principal points:

- Identification and evaluation of the risks.
- Report of events of losses and incidents.
- Definition of mitigating actions.

## **BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES**

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### **Notes to the Consolidated Financial Statements**

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#### **(4) Financial Risk Management, continued**

- Proper follow up to the execution of plans of actions defined by new initiatives of the Bank, products and/or services and significant improvements to the processes.
- To evaluate the operative risk level in the Bank's initiatives products and/or services and significant progress to the processes.
- Development of trainings.
- Participation in the design of policies and procedures.

The different areas that manage the operative risk are:

- Unit of Administration of Risk.
- Technology of Information.
- Unit of Computer Security.
- Monitoring and Prevention of Frauds.
- Unit of Internal control.

As part of the model of Corporate Government, the strategy, methodology of work and follow up to the plans of actions defined for the events and risks valued as critical and high are brought to the Top Management and in turn to the Risk Committee of the Board of Directors every three months.

The Department of Internal Audit checks and validates the compliance of the policies and defined methodologies and that these are in compliance with existing regulation; the results of this review are presented to the Audit Committee.

#### *(e) Capital Management:*

One of the Bank's policies is to maintain a level of capital to accompanying credit business and investment growth in the market, maintaining a balance between the return on investments, and the adequacy of capital required by regulators.

The Bank is subject to the Panamanian Banking Law, which states that the total capital adequacy ratio shall not be less than 8% of its total weighted assets and off-balance accounts which represent an irrevocable contingency, weighted based on their risks.

Based in the Agreement No. 1-2015 and its amendments and No. 3-2016, issued by the Superintendence of Banks of Panama, as of December 31, 2016, the Bank held a regulatory capital position that is comprised as follows:

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**Notes to the Consolidated Financial Statements**

**(4) Financial Risk Management, continued**

|  | <u>2016</u>        |                          |
|--|--------------------|--------------------------|
| <b>Primary Ordinary Capital</b>            |                    |                          |
| Common shares                              | 15,000,000         |                          |
| Additional paid in capital                 | 26,300,000         |                          |
| Capital reserves                           | 1,800,000          |                          |
| Other items of comprehensive income (1)    |                    |                          |
| Gain in available for sale securities      | 2,164,157          |                          |
| Adjust for translation of foreign currency | (4,690,536)        |                          |
| Retained earnings                          | 17,605,388         |                          |
| Non-controlling interests                  | 701,975            |                          |
| Less: Deferred tax                         | <u>(554,811)</u>   |                          |
| <b>Total Primary Ordinary Capital</b>      | <u>58,326,173</u>  |                          |
| <b>Dynamic provision</b>                   | <u>6,058,625</u>   |                          |
| <b>Total Regulatory Capital</b>            | <u>64,384,798</u>  |                          |
| <b>Total of Risk weighed assets</b>        | <u>392,702,907</u> |                          |
| <b>Ratios:</b>                             |                    | <b>Minimum requested</b> |
| Capital Adequacy ratio                     | <u>16.40%</u>      | <u>8%</u>                |
| Primary Ordinary Capital Ratio             | <u>14.85%</u>      | <u>3.75%</u>             |
| Primary Capital Ratio                      | <u>14.85%</u>      | <u>5.25%</u>             |

(1) Excludes the fair value of the portfolio acquired

The Bank, as of December 31, 2015 stated its regulatory capital position applying the standards of the Superintendence of Banks of Panama established for general license banks, based on the Agreement No. 5-2008 of October 1, 2008 and amended by the Agreement No. 4-2009 of July 9, 2009, as follows:

|  | <u>2015</u>        |
|--|--------------------|
| <b>Primary Capital (Pillar 1)</b>  |                    |
| Common shares  | 15,000,000         |
| Additional paid in capital   | 21,300,000         |
| Non-controlling interests  | 517,955            |
| Retained earnings  | 14,481,045         |
| Regulatory reserves  | 5,876,284          |
| Other items of comprehensive income  | 0                  |
| Deferred tax   | 0                  |
| Capital reserves   | <u>1,800,000</u>   |
| <b>Total</b>   | <u>58,975,284</u>  |
| <b>Risk weighed assets</b>   | <u>357,649,284</u> |
| <b>Capital Index</b>   |                    |
| Total of regulatory capital stated as a percentage of risk-based weighted assets | <u>16.49%</u>      |

**(5) Use of Estimates and Judgments in Applying Accounting Policies**

The Bank's management prepares the consolidated financial statements in accordance with International Financial Reporting Standards. They have applied judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses during the period. Actual results may differ from these estimates.

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**Notes to the Consolidated Financial Statements**

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**(5) Use of Estimates and Judgments in Applying Accounting Policies, continued**

The assumptions and decisions are continuously evaluated and are based on the historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Bank's management evaluates the selection, disclosures and application of critical accounting policies in the mayor uncertain estimates. The information related to the presumptions and estimates that affect the reported amounts of assets and liabilities under the next fiscal year and critical judgments in the selection and application of the accounting policies detailed as follows:

*(a) Impairment losses on Loans*

At cash reporting date, the Bank reviews its loan portfolios to determine whether there is objective evidence of impairment of a loan or portfolio of loans that must be recognized in the consolidated statement of income for the year. The Bank uses its best judgment to determine whether there is observable data that may indicate a measurable deterioration in a group of loans using estimates based on historical loss experience for loans with similar when predicting recoverable future cash flows of the following features.

This evidence may include observable data indicating that there has been and adverse change in payment status of borrowers or economic conditions that correlate with defaults on loans in the Bank. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between estimated losses and actual loss experience.

*(b) Impairment of Investments Securities*

The Bank determines that investments securities are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires the management judgment. Additionally, impairment may be appropriate when there is evidence of impairment in the financial condition of the issuer, industry and sector performance, changes in technology, and operational and financing cash flows.

*(c) Income tax*

The Bank is subject to income taxes under the jurisdictions of the Republic of Panama, Colombia, and El Salvador. Significant estimates are required in determining the provision for income taxes and deferred tax product of temporary differences. There are many transactions and calculations for which the final tax determination is uncertain during the ordinary course of business. The Bank recognizes liabilities based on estimates that if there is an obligation to pay additional taxes. When the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the provision for income taxes in the period in which such determination was made.



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**Notes to the Consolidated Financial Statements**

**(5) Use of Estimates and Judgments in Applying Accounting Policies, continued**

*(d) Non-consolidated structured entities:*

The Bank's management conducted an analysis of their structured entities, and in turn concluded that the same should not be consolidated because the Bank performs the function of an agent and not principal. An agent act on behalf and for the benefit of another party or parties (the principal or principals) and therefore does not control an investee when exercising its authority to make decisions. Therefore, sometimes the power of a principal can be maintained and exercised by an agent, but on behalf of the principal.

**(6) 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:

|                                   | <b><u>2016</u></b> | <b><u>2015</u></b> |
|-----------------------------------|--------------------|--------------------|
| <b>Assets:</b>                    |                    |                    |
| Demand deposits                   | <u>105,500</u>     | <u>91,656</u>      |
| <b>Liabilities:</b>               |                    |                    |
| Savings deposits                  | <u>894,407</u>     | <u>327,313</u>     |
| Time deposits                     | <u>5,748,401</u>   | <u>6,948,653</u>   |
| <b>Other income (expenses):</b>   |                    |                    |
| Interest expense on deposits      | <u>(225,075)</u>   | <u>(257,974)</u>   |
| Short-term benefits to executives | <u>(1,203,510)</u> | <u>(973,098)</u>   |

Transactions with Directors and Executives

As of December 31, 2016, the Bank has paid fees for B/.39,919 (2015: B/.23,330) to Directors that attend the meetings of the Board of Directors and Committees.

The Bank has paid salaries and other benefits such as life insurance, bonus, and salaries in species to the executives for B/.1,203,510 (2015: B/.973,098).

As of December 31, 2015 a related Company was liquidated and all of its assets were transferred to a subsidiary of the Bank.

**(7) Cash and Cash Equivalents**

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

|  | <b><u>2016</u></b> | <b><u>2015</u></b> |
|--|--------------------|--------------------|
| Cash and cash effects  | 281,416            | 325,366            |
| Demand deposits  | 26,281,420         | 15,349,552         |
| Saving deposits  | 3,743,797          | 6,309,282          |
| Time deposits  | <u>1,000,000</u>   | <u>3,751,666</u>   |
| <b>Cash and cash equivalents in the consolidated statement of cash flows</b> | <u>31,306,633</u>  | <u>25,735,866</u>  |

# BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

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### (8) Investment in Securities

The investment securities and other financial assets are classified as follows:

|   | <u>2016</u>              | <u>2015</u>              |
|---|--------------------------|--------------------------|
| Securities available for sale                   | 44,797,604               | 34,669,435               |
| Securities at fair value through profit or loss | 12,804,044               | 7,498,738                |
| Securities held to maturity                     | <u>1,537,501</u>         | <u>726,092</u>           |
| <b>Total investments in securities</b>          | <b><u>59,139,149</u></b> | <b><u>42,894,265</u></b> |

#### Securities Available-for-Sale

These securities are detailed as follow:

|                                     | <u>2016</u>              | <u>2015</u>              |
|-------------------------------------|--------------------------|--------------------------|
| Mortgage bonds                      | 31,752,485               | 29,537,949               |
| Republic of Panama bonds            | 7,740,295                | 1,981,288                |
| Republic of Colombia treasury bonds | 4,073,403                | 2,361,875                |
| Mutual funds                        | 1,196,406                | 734,666                  |
| Shares                              | <u>35,015</u>            | <u>53,657</u>            |
| <b>Total</b>                        | <b><u>44,797,604</u></b> | <b><u>34,669,435</u></b> |

The Bank holds a share investment amounted on B/.35,015 (2015: B/.53,657), which the Bank could not assess a reliable fair value.

The Bank made sales of investments available for sale of B/.8,255,523 (2015: B/.7,250,212), these sales generate a loss of B/.458,014 (2015: gain B/.458,014).

#### Securities at Fair Value through Profit or Loss

These securities consist of residual interests that the Bank has retained as part of the securitization of their portfolios, and are detailed as follows:

|                                       | <u>Maturity</u> | <u>2016</u>              | <u>2015</u>             |
|---------------------------------------|-----------------|--------------------------|-------------------------|
| Residual interest of eighth trust     | December 2036   | 3,236,077                | 3,482,255               |
| Residual interest of ninth trust      | December 2022   | 619,407                  | 797,621                 |
| Residual interest of tenth trust      | September 2039  | 3,961,893                | 0                       |
| Residual interest of eleventh trust   | October 2041    | 2,440,936                | 2,241,153               |
| Residual interest of twelfth trust    | November 2042   | 1,464,727                | 977,409                 |
| Residual interest of thirteenth trust | December 2045   | <u>1,081,004</u>         | <u>0</u>                |
| <b>Total</b>                          |                 | <b><u>12,804,044</u></b> | <b><u>7,498,738</u></b> |

The trust's residual interests were determined by discounting the future cash flows as trustee commissions and incentives that will receive the Bank of these trusts. At the time of creation of these trusts, it was estimated that the realization of values was 30 years for the Eighth, Ninth, Tenth, Eleventh, Twelfth, and Thirteenth Mortgage Bonds Trust: (maturing in 2036, 2022, 2039, 2041, 2042 and 2045 respectively).

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**(8) Investment in Securities, continued**

As of December 31, 2016, the Bank made a purchase of residual bonds to a related one for the sum of B/.3,805,685 (2015: sale B/.3,634,182) this transaction did not generate profit or loss (2015: B/.0).

**Securities Held-to-Maturity**

The Bank maintains bonds of the Republic of Panama with a nominal value of B/.225,000, which are recorded at amortized cost of B/.218,024 (2015: B/.217,374) with a fair value of B/.308,813 (2015: B/.324,000). These bonds have an interest rate of 8.875% (2016: 8.875%) and maturity date on December 31, 2027. These bonds are held in the Banco Nacional de Panama and are at the disposition of the Superintendencia of Banks of Panama, in order to guarantee proper compliance with the fiduciary obligations of the Bank. Similarly the Bank maintain Colombian agricultural development securities (TDA and TDB) with a carrying amount of B/.470,143 (2016: B/.508,718) a fair value of B/.470,143 (2016: B/.508,718) with maturity on October 27, 2017 and Time Deposit Certificate amounted on B/.849,334 (2015: B/.0) with maturity on January 4, 2017.

**(9) Loans, Net**

The composition of the loans portfolio is summarized as follows:

|                       | <u>2016</u>        | <u>2015</u>        |
|-----------------------|--------------------|--------------------|
| <b>Local loans:</b>   |                    |                    |
| Personal              | 30,986,955         | 28,337,519         |
| Residential mortgages | 333,233,086        | 279,282,070        |
| Total local loans     | <u>364,220,041</u> | <u>307,619,589</u> |
| <b>Foreign loans:</b> |                    |                    |
| Personal              | 9,778,345          | 10,100,352         |
| Residential mortgages | 131,819,917        | 150,383,156        |
| Total foreign loans   | <u>141,598,262</u> | <u>160,483,508</u> |
| Total loans           | <u>505,818,303</u> | <u>468,103,097</u> |

The movements of the allowance for loan losses are detailed as follows:

|                               | <u>2016</u>      | <u>2015</u>      |
|-------------------------------|------------------|------------------|
| Balance at beginning of year  | 261,314          | 255,292          |
| Provision charged to expenses | 345,406          | 344,975          |
| Loans charged-off             | <u>(306,056)</u> | <u>(338,953)</u> |
| Balance at end of year        | <u>300,664</u>   | <u>261,314</u>   |

In the months of June and September 2015, the Bank has made purchases of residential mortgage loan portfolios from Sixth and Seventh Trust of Mortgage loans bonds with a fair value of B/.4,517,878 and B/.4,773,715, respectively. The difference between the amount paid and the fair value of these purchased loans of B/.1,325,034 was recorded in fair value reserve account in the consolidated statement of changes in equity. The amount pending amortization at the date is B/.1,246,594.

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**Notes to the Consolidated Financial Statements**

**(10) Furniture, Equipment and Improvements, net**

Furniture, equipment and improvements are summarized as follows:

| <u>2016</u>                      | <u>Furniture</u> | <u>Office<br/>Equipment</u> | <u>Vehicles</u> | <u>Leasehold<br/>Improvements</u> | <u>Total</u>     |
|----------------------------------|------------------|-----------------------------|-----------------|-----------------------------------|------------------|
| <b>Cost:</b>                     |                  |                             |                 |                                   |                  |
| At the beginning of the year     | 565,221          | 2,076,029                   | 355,828         | 901,567                           | 3,898,645        |
| Purchases                        | 132,037          | 455,981                     | 32,921          | 533,978                           | 1,154,917        |
| Sales and disposals              | <u>(6,288)</u>   | <u>(5,349)</u>              | <u>(3,076)</u>  | <u>(299,385)</u>                  | <u>(314,098)</u> |
| <b>At the end of the year</b>    | <u>690,970</u>   | <u>2,526,661</u>            | <u>385,673</u>  | <u>1,136,160</u>                  | <u>4,739,464</u> |
| <b>Accumulated depreciation:</b> |                  |                             |                 |                                   |                  |
| At the beginning of the year     | 462,153          | 1,561,220                   | 204,620         | 766,349                           | 2,994,342        |
| Expense for the year             | 50,759           | 341,299                     | 63,444          | 86,048                            | 541,550          |
| Sales and disposals              | <u>(6,049)</u>   | <u>(5,350)</u>              | <u>(3,076)</u>  | <u>(244,158)</u>                  | <u>(258,632)</u> |
| Adjustment for conversion        | <u>(534)</u>     | <u>(4,041)</u>              | <u>0</u>        | <u>0</u>                          | <u>(4,575)</u>   |
| <b>At the end of the year</b>    | <u>506,329</u>   | <u>1,893,130</u>            | <u>264,988</u>  | <u>608,239</u>                    | <u>3,272,686</u> |
| <b>Net balances</b>              | <u>184,641</u>   | <u>633,531</u>              | <u>120,685</u>  | <u>527,921</u>                    | <u>1,466,778</u> |
| <br>                             |                  |                             |                 |                                   |                  |
| <u>2015</u>                      | <u>Furniture</u> | <u>Office<br/>Equipment</u> | <u>Vehicles</u> | <u>Leasehold<br/>Improvements</u> | <u>Total</u>     |
| <b>Cost:</b>                     |                  |                             |                 |                                   |                  |
| At the beginning of the year     | 550,305          | 1,776,252                   | 354,505         | 858,098                           | 3,539,160        |
| Purchases                        | 14,992           | 299,777                     | 16,721          | 43,469                            | 374,959          |
| Sales and disposals              | <u>(76)</u>      | <u>0</u>                    | <u>(15,398)</u> | <u>0</u>                          | <u>(15,474)</u>  |
| <b>At the end of the year</b>    | <u>565,221</u>   | <u>2,076,029</u>            | <u>355,828</u>  | <u>901,567</u>                    | <u>3,898,645</u> |
| <b>Accumulated depreciation:</b> |                  |                             |                 |                                   |                  |
| At the beginning of the year     | 403,211          | 1,284,092                   | 158,232         | 682,596                           | 2,528,131        |
| Expense for the year             | 61,187           | 286,801                     | 61,786          | 83,753                            | 493,527          |
| Sales and disposals              | <u>(76)</u>      | <u>0</u>                    | <u>(15,398)</u> | <u>0</u>                          | <u>(15,474)</u>  |
| Adjustment for conversion        | <u>(2,169)</u>   | <u>(9,673)</u>              | <u>0</u>        | <u>0</u>                          | <u>(11,842)</u>  |
| <b>At the end of the year</b>    | <u>462,153</u>   | <u>1,561,220</u>            | <u>204,620</u>  | <u>766,349</u>                    | <u>2,994,342</u> |
| <b>Net balances</b>              | <u>103,068</u>   | <u>514,809</u>              | <u>151,208</u>  | <u>135,218</u>                    | <u>904,303</u>   |

**(11) Accounts and Interests Receivable**

The following is a detail of accounts and interests receivable:

|                       | <u>2016</u>      | <u>2015</u>      |
|-----------------------|------------------|------------------|
| Accounts receivable:  |                  |                  |
| Clients               | 880,276          | 786,940          |
| Employees             | 4,596            | 16,405           |
| Insurance             | 552,248          | 467,738          |
| Others                | <u>142,272</u>   | <u>283,626</u>   |
|                       | <u>1,579,392</u> | <u>1,554,709</u> |
| Interests receivable: |                  |                  |
| Loans                 | 1,222,962        | 1,072,174        |
| Bonds                 | <u>415,624</u>   | <u>864,565</u>   |
|                       | <u>1,638,586</u> | <u>1,936,739</u> |
|                       | <u>3,217,978</u> | <u>3,491,448</u> |

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**(12) Other Assets**

The other assets are detailed as follows:

|                            | <u>2016</u>      | <u>2015</u>      |
|----------------------------|------------------|------------------|
| Guarantee deposits         | 55,369           | 36,252           |
| Bond of trust license      | 25,000           | 25,000           |
| Severance fund             | 541,485          | 473,674          |
| Various prepaid            | 852,824          | 727,716          |
| Advance to assets purchase | 408,837          | 26,326           |
| Foreclosed assets          | 291,885          | 254,281          |
| Other                      | <u>74,048</u>    | <u>61,770</u>    |
| Total                      | <u>2,249,448</u> | <u>1,605,019</u> |

**(13) Negotiable Commercial Papers**

The Bank maintain five rotating programs for up to B/.150,000,000 in negotiable commercial papers which are backed up by the general credit of the Bank; these programs are authorized by the Superintendence of the Securities Market of the Republic of Panama. Of these programs two for the amount of B/.40,000,000 are backed by Grupo ASSA, S. A. as solidary Surety. At this date those two programs has no papers issued.

| <u>Type</u>         | <u>Interest rate</u> | <u>2016</u><br><u>Maturity</u> | <u>Amount</u>     |
|---------------------|----------------------|--------------------------------|-------------------|
| Series CCH          | 3.5000%              | January, 2017                  | 1,775,000         |
| Series CCI          | 3.5000%              | January, 2017                  | 3,000,000         |
| Series CCJ          | 3.5000%              | January, 2017                  | 2,000,000         |
| Series CCK          | 3.5000%              | January, 2017                  | 1,000,000         |
| Series CCL          | 3.5000%              | February, 2017                 | 1,527,000         |
| Series CCM          | 3.5000%              | February, 2017                 | 3,600,000         |
| Series CCN          | 3.5000%              | March, 2017                    | 1,225,000         |
| Series CCP          | 3.7500%              | April, 2017                    | 1,250,000         |
| Series CCO          | 3.7500%              | March, 2017                    | 1,000,000         |
| Series CCQ          | 3.7500%              | April, 2017                    | 2,990,000         |
| Series CCR          | 3.7500%              | April, 2017                    | 1,684,000         |
| Series CCS          | 3.7500%              | May, 2017                      | 2,472,000         |
| Series CCT          | 3.7500%              | May, 2017                      | 2,140,000         |
| Series CCU          | 3.7500%              | June, 2017                     | 1,000,000         |
| Series CCV          | 3.7500%              | June, 2017                     | 558,000           |
| Series DBM          | 3.5000%              | January, 2017                  | 2,420,000         |
| Series DBN          | 3.5000%              | February, 2017                 | 379,000           |
| Series DBO          | 3.5000%              | March, 2017                    | 2,723,000         |
| Series DBP          | 3.7500%              | April, 2017                    | 2,858,000         |
| Series DBR          | 3.8750%              | August, 2017                   | 1,629,000         |
| Series DBS          | 3.8750%              | October, 2017                  | 2,505,000         |
| Series DBT          | 3.8750%              | October, 2017                  | 300,000           |
| Series DBU          | 3.8750%              | October, 2017                  | 2,000,000         |
| Series DBV          | 3.8750%              | November, 2017                 | 1,390,000         |
| Series BBQ          | 3.7500%              | May, 2017                      | 1,300,000         |
| Series BBS          | 3.8750%              | June, 2017                     | 4,000,000         |
| Series BBT          | 3.8750%              | July, 2017                     | 2,000,000         |
| Series BBU          | 3.8750%              | July, 2017                     | 3,000,000         |
| Series BBV          | 3.8750%              | July, 2017                     | 2,500,000         |
| Series BBW          | 3.0000%              | February, 2017                 | 360,000           |
| Series BBX          | 3.8750%              | August, 2017                   | 1,000,000         |
| Series BBY          | 3.8750%              | September, 2017                | 1,590,000         |
| Series BBZ          | 3.8750%              | August, 2017                   | 5,410,000         |
| Series BCA          | 3.8750%              | September, 2017                | 2,770,000         |
| Series BCB          | 3.8750%              | December, 2017                 | <u>3,515,000</u>  |
|                     |                      |                                | 70,870,000        |
|                     |                      |                                | (109,116)         |
|                     |                      |                                | <u>70,760,884</u> |
| Less issuance costs |                      |                                |                   |

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**(13) Negotiable Commercial Papers, continued**

| <u>Type</u>         | <u>Interest rate</u> | <u>2015</u><br><u>Maturity</u> | <u>Amount</u>     |
|---------------------|----------------------|--------------------------------|-------------------|
| Series CBS          | 3.5000%              | January,2016                   | 1,000,000         |
| Series CBT          | 3.5000%              | January,2016                   | 3,000,000         |
| Series CBU          | 3.5000%              | January,2016                   | 1,000,000         |
| Series CBV          | 3.5000%              | February,2016                  | 2,000,000         |
| Series CBX          | 3.5000%              | February,2016                  | 3,690,000         |
| Series DBC          | 3.5000%              | February,2016                  | 2,500,000         |
| Series DBD          | 3.5000%              | February,2016                  | 1,000,000         |
| Series CBY          | 3.5000%              | March,2016                     | 1,500,000         |
| Series CBZ          | 3.5000%              | April,2016                     | 1,000,000         |
| Series CCA          | 3.5000%              | April,2016                     | 1,000,000         |
| Series CCB          | 3.5000%              | May,2016                       | 3,000,000         |
| Series CCC          | 3.5000%              | May,2016                       | 2,500,000         |
| Series CCD          | 3.5000%              | May,2016                       | 2,500,000         |
| Series CCE          | 3.5000%              | June,2016                      | 2,500,000         |
| Series CCF          | 3.5000%              | June,2016                      | 1,000,000         |
| Series CCG          | 3.5000%              | June,2016                      | 1,000,000         |
| Series DBE          | 3.5000%              | July,2016                      | 2,500,000         |
| Series DBF          | 3.5000%              | August,2016                    | 2,000,000         |
| Series DBG          | 3.5000%              | September,2016                 | 5,305,000         |
| Series DBH          | 3.5000%              | September,2016                 | 2,770,000         |
| Series DBI          | 3.5000%              | October,2016                   | 2,505,000         |
| Series DBJ          | 3.5000%              | October,2016                   | 7,000,000         |
| Series DBK          | 3.5000%              | October,2016                   | 300,000           |
| Series DBL          | 3.5000%              | October,2016                   | <u>1,315,000</u>  |
|                     |                      |                                | 53,885,000        |
| Less issuance costs |                      |                                | <u>(93,611)</u>   |
|                     |                      |                                | <u>53,791,389</u> |

**(14) Negotiable Commercial Notes**

The Bank has been authorized by the Superintendence of the Securities Market of the Republic of Panama of three programs totaling B/.190,000,000 in Negotiable Commercial Notes (NCN). The placements of the first issuance by B/.40,000,000 are supported by the general credit of the Bank, a trust mortgage loan guarantee and Grupo ASSA, S. A. solidary Surety that will cover any difference not covered with the proceeds of the mortgage loans' sale.

The placements of the other two programs of B/.50,000,000 and B/.100,000,000, respectively, are only supported by the general credit of the Bank.

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**(14) Negotiable Commercial Notes, continued**

| <u>Type</u> | <u>Interest rate</u> | <u>Maturity</u>     | <u>2016</u>       | <u>2015</u>       |
|-------------|----------------------|---------------------|-------------------|-------------------|
| SERIES K    | 4.25%                | March 15, 2016      | 0                 | 7,046,000         |
| SERIES B    | 4.00%                | March 15, 2016      | 0                 | 15,000            |
| SERIES L    | 3.88%                | April 15, 2016      | 0                 | 500,000           |
| SERIES N    | 5.00%                | April 15, 2016      | 0                 | 2,500,000         |
| SERIES C    | 4.00%                | May 12, 2016        | 0                 | 1,000,000         |
| SERIES M    | 5.00%                | May 15, 2016        | 0                 | 5,000,000         |
| SERIES D    | 4.00%                | May 15, 2016        | 0                 | 1,000,000         |
| SERIES E    | 4.25%                | May 18, 2016        | 0                 | 1,000,000         |
| SERIES F    | 4.75%                | June 5, 2016        | 0                 | 1,000,000         |
| SERIES G    | 4.75%                | June 15, 2016       | 0                 | 1,000,000         |
| SERIES H    | 3.88%                | June 16, 2016       | 0                 | 2,000,000         |
| SERIES Y    | 4.25%                | August 15, 2016     | 0                 | 1,800,000         |
| SERIES T    | 4.75%                | December 5, 2016    | 0                 | 1,657,000         |
| SERIES J    | 4.13%                | January 20, 2017    | 4,000,000         | 4,000,000         |
| SERIES V    | 4.75%                | February 15, 2017   | 1,761,000         | 1,761,000         |
| SERIES L    | 4.00%                | March 1, 2017       | 3,090,000         | 3,090,000         |
| SERIES A    | 4.25%                | March 10, 2017      | 1,500,000         | 1,500,000         |
| SERIES O    | 4.25%                | April 19, 2017      | 2,000,000         | 2,000,000         |
| SERIES P    | 4.25%                | May 10, 2017        | 3,000,000         | 3,000,000         |
| SERIES S    | 4.00%                | June 21, 2017       | 10,000,000        | 10,000,000        |
| SERIES I    | 4.75%                | July 2, 2017        | 1,500,000         | 1,500,000         |
| SERIES Z    | 4.75%                | July 17, 2017       | 1,200,000         | 1,200,000         |
| SERIES K    | 4.25%                | July 26, 2017       | 3,000,000         | 3,000,000         |
| SERIES T    | 4.00%                | August 15, 2017     | 750,000           | 750,000           |
| SERIES F    | 3.75%                | September 22, 2017  | 30,000            | 0                 |
| SERIES Q    | 4.00%                | December 14, 2017   | 2,000,000         | 0                 |
| SERIES S    | 4.00%                | January 20, 2018    | 2,060,000         | 0                 |
| SERIES D    | 4.00%                | February 27, 2018   | 355,000           | 0                 |
| SERIES I    | 4.25%                | March 21, 2018      | 2,880,000         | 0                 |
| SERIES H    | 4.25%                | April 5, 2018       | 2,996,000         | 0                 |
| SERIES K    | 4.25%                | April 20, 2018      | 4,341,000         | 0                 |
| SERIES J    | 5.00%                | May 1, 2018         | 2,661,000         | 0                 |
| SERIES L    | 4.25%                | May 6, 2018         | 780,000           | 0                 |
| SERIES M    | 4.25%                | May 8, 2018         | 1,000,000         | 0                 |
| SERIES Q    | 4.25%                | May 16, 2018        | 5,000,000         | 5,000,000         |
| SERIES R    | 4.25%                | May 24, 2018        | 1,000,000         | 1,000,000         |
| SERIES N    | 4.25%                | May 27, 2018        | 75,000            | 0                 |
| SERIES O    | 4.25%                | June 5, 2018        | 952,000           | 0                 |
| SERIES P    | 4.25%                | June 6, 2018        | 2,870,000         | 0                 |
| SERIES R    | 4.25%                | July 1, 2018        | 2,000,000         | 0                 |
| SERIES Y    | 4.25%                | November 14, 2018   | 600,000           | 0                 |
| SERIES AB   | 4.50%                | January 9, 2019     | 3,451,000         | 0                 |
| SERIES A    | 4.50%                | January 13, 2019    | 2,500,000         | 0                 |
| SERIES C    | 4.50%                | January 30, 2019    | 2,000,000         | 0                 |
| SERIES V    | 4.38%                | February 26, 2019   | 4,239,000         | 4,239,000         |
| SERIES M    | 4.25%                | March 25, 2019      | 2,150,000         | 2,150,000         |
| SERIES N    | 4.25%                | April 1, 2019       | 500,000           | 500,000           |
| SERIES U    | 4.50%                | August 25, 2019     | 1,250,000         | 1,250,000         |
| SERIES AA   | 4.50%                | September 24, 2019  | 720,000           | 820,000           |
| SERIES W    | 4.50%                | October 4, 2019     | 1,990,000         | 0                 |
| SERIES T    | 4.50%                | July 25, 2020       | 1,800,000         | 0                 |
| SERIES E    | 5.00%                | February 17, 2021   | 6,417,000         | 0                 |
| SERIES U    | 5.00%                | September 9, 2021   | 1,858,000         | 0                 |
| SERIES X    | 5.00%                | November 19, 2021   | 842,000           | 0                 |
|             |                      |                     | <u>93,118,000</u> | <u>72,278,000</u> |
|             |                      | Less issuance costs | <u>(256,662)</u>  | <u>(149,482)</u>  |
|             |                      |                     | <u>92,861,338</u> | <u>72,128,518</u> |

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**(15) Ordinary Bonds**

The Financial Superintendence of Colombia through Resolution 015094871-006-000 of October 8, 2015 authorized the incorporation of Ordinary Bonds in the National Registration of Securities and Issuers and its public offer.

As of December 31, 2016, the subsidiary in Colombia has issued medium-term ordinary bonds by B/.16,591,868 at a rate of 10.05% for 5 years term, its maturity are December 10, 2020.

**(16) Investment Certificates**

The Bank is authorized by the Superintendence of Securities Market of El Salvador to issue B/.30,000,000 in Investment Certificates (IC) of which B/.1,000,000 are supported by a joint guarantee from Grupo ASSA, S. A.

| <u>Type</u> | <u>Interest Rate</u> | <u>Maturity</u>     | <u>2016</u>       | <u>2015</u>       |
|-------------|----------------------|---------------------|-------------------|-------------------|
| Tranche 1   | 5.00%                | June, 2016          | 0                 | 5,000,000         |
| Tranche 2   | 5.00%                | July, 2016          | 0                 | 1,900,000         |
| Tranche 4   | 5.25%                | September, 2016     | 0                 | 1,000,000         |
| Tranche 5   | 5.25%                | September, 2016     | 0                 | 1,000,000         |
| Tranche 7   | 5.25%                | October, 2016       | 0                 | 1,500,000         |
| Tranche 5   | 5.25%                | September, 2017     | 3,500,000         | 3,500,000         |
| Tranche 6   | 5.30%                | October, 2017       | 2,000,000         | 1,992,000         |
| Tranche 3   | 5.25%                | October, 2017       | 1,000,000         | 1,000,000         |
| Tranche 4   | 5.25%                | November, 2017      | 3,000,000         | 3,000,000         |
| Tranche 7   | 6.00%                | June 2018           | 2,000,000         | 0                 |
| Tranche 8   | 6.00%                | June 2018           | 2,000,000         | 0                 |
| Tranche 9   | 6.25%                | June 2019           | 3,000,000         | 0                 |
| Tranche 10  | 6.25%                | July, 2018          | 2,000,000         | 0                 |
| Tranche 11  | 6.25%                | August, 2019        | 3,000,000         | 0                 |
| Tranche 12  | 6.25%                | August, 2019        | <u>1,600,000</u>  | <u>0</u>          |
|             |                      |                     | 23,100,000        | 19,892,000        |
|             |                      | Less issuance costs | <u>(27,913)</u>   | <u>(16,879)</u>   |
|             |                      |                     | <u>23,072,087</u> | <u>19,875,121</u> |

**(17) Other Negotiable Debts**

The Bank was authorized by the Superintendence of Securities of El Salvador for one revolving plan of up to B/.35,000,000 of Negotiable Debt (stock market paper).

| <u>Type</u> | <u>Interest Rate</u> | <u>2016</u><br><u>Maturity</u> | <u>Amount</u>    |
|-------------|----------------------|--------------------------------|------------------|
| Tranche 14  | 5.00%                | January, 2017                  | 3,000,000        |
| Tranche 15  | 5.00%                | February, 2017                 | 2,000,000        |
| Tranche 17  | 5.00%                | June, 2017                     | 2,000,000        |
| Tranche 18  | 5.75%                | August, 2017                   | <u>2,000,000</u> |
|             |                      |                                | 9,000,000        |
|             |                      | Less issuance costs            | <u>(11,964)</u>  |
|             |                      |                                | <u>8,988,036</u> |

  

| <u>Type</u> | <u>Interest Rate</u> | <u>2015</u><br><u>Maturity</u> | <u>Amount</u>    |
|-------------|----------------------|--------------------------------|------------------|
| Tranche 10  | 4.50%                | January, 2016                  | 3,000,000        |
| Tranche 11  | 4.50%                | February, 2016                 | 2,000,000        |
| Tranche 13  | 5.00%                | October, 2016                  | <u>2,000,000</u> |
|             |                      |                                | 7,000,000        |
|             |                      | Less issuance costs            | <u>(12,465)</u>  |
|             |                      |                                | <u>6,987,535</u> |



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

**Notes to the Consolidated Financial Statements**

**(18) Borrowed Funds**

Borrowed funds are summarized as follows:

|   | <u>2016</u>       | <u>2015</u>        |
|---|-------------------|--------------------|
| Line of credit for working capital for B/.4,000,000, with maturity in the year 2018 renewable at the parties' option and annual Libor interest rate plus a margin, backed by a portfolio of residential mortgage loans.           | 2,500,000         | 1,000,000          |
| Line of credit for working capital for B/.30,000,000, with maturity in the year 2021 and annual Libor interest rate plus a margin, backed by a portfolio of residential mortgage loans.   | 7,000,000         | 18,000,000         |
| Revolving line of credit for working capital for B/.6,000,000, with maturity in the year 2017 renewable at the parties option and annual Libor interest rate plus a margin, backed by a portfolio of residential mortgage loans.  | 1,000,000         | 5,000,000          |
| Revolving line of credit for working capital for B/.10,000,000, with maturity in the year 2017 renewable at the parties option and annual Libor interest rate plus a margin, backed by a portfolio of residential mortgage loans. | 7,500,000         | 10,000,000         |
| Line of credit for working capital for B/.15,000,000, with maturity in the year 2018, renewable at the parties' option and fixed annual interest rate backed by a portfolio of residential mortgage loans.                        | 5,500,000         | 11,000,000         |
| Line of credit for working capital for B/.10,000,000, with maturity in the year 2018 and annual Libor interest rate plus a margin, backed by a portfolio of residential mortgage loans.   | 5,000,000         | 7,500,000          |
| Line of credit for working capital for B/.12,000,000, with maturity in the year 2017 renewable at the parties option and annual Libor interest rate plus a margin, backed by a portfolio of residential mortgage loans.           | 1,450,000         | 4,200,000          |
| Line of credit for working capital for B/.15,000,000, with maturity in the year 2016 and annual Libor interest rate plus a margin backed by a portfolio of residential mortgage loans.  | 0                 | 1,666,672          |
| Line of credit for working capital for B/.10,000,000, with maturity in the year 2017 renewable at the parties' option and annual Libor interest rate plus a margin, backed by a portfolio of residential mortgage loans.          | 0                 | 9,000,000          |
| Line of credit for working capital for B/.13,000,000, with maturity in the year 2022 and annual Libor interest rate plus a margin backed by a portfolio of residential mortgage loans.  | 12,384,615        | 8,000,000          |
| Line of credit for working capital for B/.25,000,000, with maturity in the year 2019 and annual Libor interest rate plus a margin, backed by a portfolio of residential mortgage loans.   | <u>6,880,561</u>  | <u>25,000,000</u>  |
| <b>Sub - total going to next page</b>   | <u>49,215,176</u> | <u>100,366,672</u> |

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

**Notes to the Consolidated Financial Statements**

**(18) Borrowed Funds, continued**

|  | <u>2016</u>        | <u>2015</u>        |
|--|--------------------|--------------------|
| <b>Sub - total coming from previous page</b>   | <u>49,215,176</u>  | <u>100,366,672</u> |
| Line of credit for working capital for B/.25,000,000, with maturity in the year 2019 and annual Libor interest rate plus a margin, backed by a portfolio of residential mortgage loans.                                      | 20,000,000         | 15,000,000         |
| Line of credit for working capital for B/.20,000,000, with maturity in the year 2018 and fixed rate.   | 20,000,000         | 0                  |
| Line of credit for working capital for B/.15,000,000, with maturity in the year 2019 and annual Libor interest rate plus a margin, backed by a portfolio of residential mortgage loans.                                      | 6,250,000          | 7,666,667          |
| Line of credit for working capital for B/.25,000,000, with maturity in the year 2022 and annual Libor interest rate plus a margin, backed by a portfolio of residential mortgage loans.                                      | 21,428,572         | 25,000,000         |
| Line of credit for working capital for B/.16,000,000, with maturity in the year 2024 and annual Libor interest rate plus a margin, backed by a portfolio of residential mortgage loans.                                      | 16,000,000         | 0                  |
| Revolving line of credit for working capital up to approximately B/.10,000,000 (COP 30 thousand millions), with maturity in the year 2017 renewable at the parties' option and annual interest rate DTF o IBR plus a margin. | 4,665,563          | 6,032,761          |
| Revolving line of credit for working capital up to approximately B/.4,000,000 (COP 12 thousand millions), with maturity in the year 2019 renewable at the parties' option and annual interest rate DTF plus a margin.        | 1,194,162          | 635,027            |
| Revolving line of credit for working capital up to approximately B/.4,000,000 (COP 12 thousand millions), with maturity in the year 2018 renewable at the parties' option and annual interest rate DTF plus a margin.        | 2,499,408          | 3,810,165          |
| Revolving line of credit for working capital up to approximately B/.2,000,000 (COP 6 thousand millions), with maturity in the year 2018 renewable at the parties' option and annual interest rate DTF plus a margin.         | <u>1,333,018</u>   | <u>1,905,082</u>   |
| Total  | 142,585,899        | 160,416,374        |
| Less issuance costs  | <u>(1,041,284)</u> | <u>(1,181,347)</u> |
| Total of borrowed funds  | <u>141,544,615</u> | <u>159,235,027</u> |

As at December 31, 2017 and 2016, there has not been noncompliance in the payment of capital and interest in relation to the borrowings.

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

**Notes to the Consolidated Financial Statements**

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**(19) Other Liabilities**

The other liabilities are detailed as follows:

|  | <u>2016</u>      | <u>2015</u>      |
|--|------------------|------------------|
| Accrued interest payable of deposits, borrowed funds and other obligations | 2,767,990        | 2,315,845        |
| Allowance for employee benefits and other benefits                         | 919,546          | 785,224          |
| Cashier's checks   | 1,579,875        | 933,888          |
| Others   | 4,250,444        | 3,380,188        |
|  | <u>9,517,855</u> | <u>7,415,145</u> |

**(20) Capital and Reserves**

The composition of common shares is detailed as follows:

|  | <u>2016</u>       | <u>2015</u>       |
|--|-------------------|-------------------|
| Authorized shares with nominal value of B/.1,000                               | <u>15,000</u>     | <u>15,000</u>     |
| Shares issued and paid on January 1 <sup>st</sup> and at the end of the period | <u>15,000</u>     | <u>15,000</u>     |
| Carrying amount of the shares at the end of the period                         | <u>15,000,000</u> | <u>15,000,000</u> |

**Reserves**

Nature and purpose of reserves:

**Capital Reserve**

One of the subsidiaries constitutes a reserve to support any loans portfolio's impairment loss considering the country risks in which the debtors are located. This reserve is established from the retained earnings.

**Fair Value Reserve**

Comprises the cumulative net change in the fair value of available-for-sale financial assets, until the assets is derecognized, redeemed, or impaired. In addition, includes the net amount of the loan portfolio acquired fair value, which will be amortized during the remaining life of the loans or until been cancelled.

**Currency Conversion Reserve**

Comprises all foreign exchange differences arising on foreign currency translation to the currency presented in the financial statements of foreign subsidiaries with a functional currency different from the presentation currency for purposes of presentation of the consolidated financial statements.

**Dynamic Provision**

Is constituted according to prudential criteria on all credit facilities that lack specific provision allocated, i.e. on credit facilities classified in the Normal category, as defined in the Agreement No. 004-2013 issued by the Superintendence of Banks of Panama. It corresponds to an equity account presented under the heading of regulatory reserve in the statement of changes in equity and appropriates retained earnings.

# BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

## Notes to the Consolidated Financial Statements

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### (20) Capital and Reserves, continued, Specific Provision in Excess

Provisions that are to be constituted on the basis of the classification of credit facilities in the risk categories Watch list, Substandard, Doubtful or Loss, as provided in the Agreement No. 004-2013 issued by the Superintendence of Banks of Panama. They are for individual credit facilities as for a group of these. For a group corresponds to circumstances indicating the existence of deterioration in credit quality, although it is not yet possible the individual identification. It corresponds to an equity account that is presented under the heading of regulatory reserve in the statement of changes in equity and appropriates retained earnings.

### (21) Earning per Share

The calculation of basic earning per share is based on net income attributable to common shareholders by the weighted average number of common shares outstanding.

Attributable income to common shareholders:

|  | <u>2016</u>      | <u>2015</u>      |
|--|------------------|------------------|
| Net income for the year                            | 3,937,584        | 3,970,657        |
| Attributable net income to the common shareholders | <u>3,937,584</u> | <u>3,970,657</u> |

Weighted average of common shares:

|                                   | <u>2016</u>   | <u>2015</u>   |
|-----------------------------------|---------------|---------------|
| Issued shares at January 1st      | <u>15,000</u> | <u>15,000</u> |
| Weighted average of common shares | <u>15,000</u> | <u>15,000</u> |

Net income attributable to common stockholders is as follows:

|  | <u>2016</u>   | <u>2015</u>   |
|--|---------------|---------------|
| Attributable income to common shareholders | 3,937,584     | 3,970,657     |
| Weighted average of common share (basics)  | <u>15,000</u> | <u>15,000</u> |
| Earning per share basic and diluted        | <u>262.51</u> | <u>264.71</u> |

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

**Notes to the Consolidated Financial Statements**

**(22) Service Commissions, Net and Other Income**

The breakdown of service commissions and other income are detailed as follows:

|   | <u>2016</u>      | <u>2015</u>      |
|---|------------------|------------------|
| <b>Commissions for administration and management:</b> |                  |                  |
| Trusts administration                                 | 1,354,740        | 1,334,295        |
| Management collection                                 | 1,891,930        | 1,770,296        |
| Insurance management                                  | 670,691          | 596,424          |
| Others  | <u>537,249</u>   | <u>325,648</u>   |
|   | <u>4,454,610</u> | <u>4,026,663</u> |
| <b>Other income:</b>                                  |                  |                  |
| Income on sale of tax credit                          | 92,045           | 20,957           |
| Trusts  | 1,097,028        | 221,397          |
| Insurance   | 148,939          | 440,252          |
| Sale of foreclosed assets                             | 79,389           | 72,634           |
| Other income  | <u>1,299,032</u> | <u>835,265</u>   |
|   | <u>2,716,433</u> | <u>1,590,505</u> |

**(23) Commission Expenses**

The detail of commission expenses are detailed as follows:

|                              | <u>2016</u>      | <u>2015</u>      |
|------------------------------|------------------|------------------|
| <b>Commissions expenses:</b> |                  |                  |
| Negotiable commercial papers | 256,346          | 308,077          |
| Negotiable commercial rates  | 245,464          | 259,427          |
| Line of credit commissions   | 465,769          | 469,870          |
| Other commissions            | <u>391,971</u>   | <u>115,358</u>   |
|                              | <u>1,359,550</u> | <u>1,152,732</u> |

**(24) Salaries, Other Personnel Expenses, and Other Operating Expenses**

Salaries, other personnel expenses, and other operating expenses are detailed as follows:

|   | <u>2016</u>      | <u>2015</u>      |
|---|------------------|------------------|
| <b>Salaries and other personnel expenses:</b> |                  |                  |
| Wages, thirteenth month and vacations         | 4,604,106        | 4,231,327        |
| Representation expenses                       | 854,021          | 777,726          |
| Bonuses                                       | 425,564          | 442,194          |
| Social security costs                         | 685,472          | 680,453          |
| Severance costs                               | 230,824          | 236,205          |
| Travel, allowances and fuel                   | 163,784          | 174,495          |
| Others  | <u>875,470</u>   | <u>857,697</u>   |
|   | <u>7,839,241</u> | <u>7,400,097</u> |
| <b>Other operational expenses:</b>            |                  |                  |
| Rent  | 545,493          | 485,513          |
| Advertising                                   | 678,270          | 563,505          |
| Equipment maintenance                         | 736,713          | 503,646          |
| Office supplies                               | 122,309          | 137,982          |
| Utilities expenses                            | 275,514          | 305,301          |
| Bank charges                                  | 123,211          | 150,926          |
| Other expenses                                | <u>1,424,800</u> | <u>1,401,683</u> |
|   | <u>3,906,310</u> | <u>3,548,556</u> |

# BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

## Notes to the Consolidated Financial Statements

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### (24) Salaries, Other Personnel Expenses and Other Operating Expenses, continued

#### *Options Plan of Purchase of Shares*

In 2014 and 2012, the Board of La Hipotecaria (Holding), Inc. approved plans to grant options to executives of the Bank for 15,200 options with a unit fair value of B/.8.591 and 19,290 options with a unit fair value of B/.3.694, respectively, with exercise maturity in 10 years for each plan. As of December 31, 2016, there are 29,491 options outstanding (2015: 29,491), has not been cancelled options (2015: 0) and at the reporting date no options has been exercised. These options has a weighted-average price of exercise of B/.27.13 (2015: B/.27.13). The plans gives the executive the right to exercise the options over La Hipotecaria (Holding), Inc. shares, at the time of the first anniversary of both plans. In 2016 the Bank has not recorded any expense for options issuance (2015: B/.0).

### (25) Income Tax

The income tax returns of the Bank incorporated in the Republic of Panama, are subject to review by tax authorities for up to three (3) years according to current tax regulations. According to current tax regulations, companies incorporated in Panama are exempt of income tax for earnings from foreign operations, interest earned on deposits in local banks, Panama government securities and of securities listed in the Superintendence of stock market securities and traded on the Bolsa de Valores de Panama, S. A. (Stock Exchange of Panama).

According as required by Article 699 of the Tax Code, as amended by Article 9 of Law 8 of March 15, 2010 with effect from January 1, 2010, the income tax for legal entities engaged in the banking business in the Republic of Panama, should calculate the tax according to the rate of 25%.

Additionally, legal entities whose taxable income exceeds one million five hundred thousand dollars (B/.1,500,000) annually, will pay tax by the applicable income tax rate to the taxable net income according to current legislation in the Republic of Panama or the alternative calculation, which results higher.

Act 52 of August 28, 2012, restored the payment of estimated income tax from September 2012. According to this law, the estimated income tax payable in three equal amounts over June, September and December each year.

The Bank's subsidiaries shall calculate the income tax according the following rates:

|               | <u>Colombia</u> | <u>El Salvador</u> |
|---------------|-----------------|--------------------|
| Current rates | 34%             | 30%                |

## BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

### Notes to the Consolidated Financial Statements

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#### (25) Income Tax, continued

The Congress of the Republic of Colombia, enacted the 1607 Act on December 26, 2012, introducing major reforms to the Colombian tax system, mainly the following:

- The income tax rate is reduced from 33% to 25 % from 2013 and the income tax for equity (CREE) is created, with rate of 9% between 2013 and 2015 and 8% from 2016. A review is made for determining the tax differences with respect to the amount used for income tax purposes, calculated by the ordinary income.
- Taxpayers of income tax for equity are not required to pay contributions to SENA and ICBF for employees earning less than 10 minimum monthly wages; this exemption will be extended for the contributions to the contributory health scheme from the first of January 2014.
- The concept of permanent establishment is defined, which is identified as a fixed place through which a foreign Bank develops business in the country.
- The method on how to calculate the taxable and non-taxable profits for companies that distribute profits to its partners or shareholders is amended.
- New rules are introduced on the transfer pricing regime. Among others, the scope of the transactions with related parties located in free zones is increased and some operations from taxpayers with foreign entities related to a permanent establishment in Colombia or abroad are regulated.

For this purpose, the Technical Board of Public Accountancy of Colombia, through the strategic management directions classified the companies in groups according to our analysis with cutoff date of December 31, 2013, the subsidiaries in Colombia belong to Group 2, classified as SMEs, in which transition period begins on January 1, 2015 and the issuance of the financial statements under International financial Reporting Standards in 2016.

The total expense on income tax as at December 31, 2016 is detailed is follows:

|                                    | <u>2016</u>      | <u>2015</u>      |
|------------------------------------|------------------|------------------|
| Estimated income tax               | 1,634,029        | 1,954,496        |
| Deferred tax temporary differences | <u>(600,721)</u> | <u>113,845</u>   |
| Total income tax costs             | <u>1,033,308</u> | <u>2,068,341</u> |

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

**Notes to the Consolidated Financial Statements**

**(25) Income Tax, continued**

The effective rate of the estimated income tax is detailed as follows:

|                              | <u>2016</u>   | <u>2015</u>   |
|------------------------------|---------------|---------------|
| Profit before income taxes   | 4,970,892     | 6,038,998     |
| Income tax expense           | 1,033,308     | 2,068,341     |
| Effective rate of income tax | <u>20.79%</u> | <u>34.25%</u> |

The deferred income tax arises from temporary differences relating to the provision for loan losses and the operative losses carry forward. Deferred tax asset is included as part of other assets in the consolidated statement of financial position.

Deferred income tax is comprised as follows:

|  | <u>2016</u>                  |                     | <u>2015</u>                  |                     |
|--|------------------------------|---------------------|------------------------------|---------------------|
|  | <u>Temporary differences</u> | <u>Deferred tax</u> | <u>Temporary differences</u> | <u>Deferred tax</u> |
| <b><u>Deferred tax assets</u></b>      |                              |                     |                              |                     |
| Allowance for loan losses              | 300,664                      | 88,255              | 261,314                      | 59,663              |
| Operative losses carry forward (1)     | 1,372,223                    | 466,556             | 0                            | 0                   |
|  | <u>1,672,887</u>             | <u>554,811</u>      | <u>261,314</u>               | <u>59,663</u>       |
| <b><u>Deferred tax liabilities</u></b> |                              |                     |                              |                     |
| Valuation of residuals bonds           | 0                            | 0                   | 427,760                      | 106,940             |
|  | <u>0</u>                     | <u>0</u>            | <u>427,760</u>               | <u>106,940</u>      |

(1) Correspond to losses carry forward in Colombia, without expiration date.

Deferred tax movement is as follows:

|                                     | <u>2016</u>    | <u>2015</u>     |
|-------------------------------------|----------------|-----------------|
| Beginning balance                   | (47,277)       | 66,568          |
| Provision for loan losses           | 28,592         | (31,077)        |
| Operative losses carry forward      | 466,556        | 0               |
| Valuation of residual bond of trust | 106,940        | (82,768)        |
| Deferred income tax at year end     | <u>554,811</u> | <u>(47,277)</u> |



## BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

### Notes to the Consolidated Financial Statements

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#### (25) Income Tax, continued

The conciliation between financial income before income tax and net income tax as at December 31, 2016, is as follows:

|   | <u>2016</u>      | <u>2015</u>      |
|---|------------------|------------------|
| Net financial income before income tax                  | 4,970,892        | 6,038,998        |
| Calculation of "expected" income tax expense            | 1,242,723        | 1,509,750        |
| Non-deductible expenses                                 | 613,049          | 403,407          |
| Income and expense from foreign and exempt sources, net | (613,495)        | (666,082)        |
| Change for temporary differences                        | (600,721)        | 113,845          |
| Difference in foreign tax rates                         | 391,752          | 707,421          |
| <b>Total income tax</b>                                 | <u>1,033,308</u> | <u>2,068,341</u> |

As of December 31, 2016, the Bank has not recognized a liability for deferred income tax of approximately B/.403,526 for the retained earnings of its operations abroad, due to the Bank considers that approximately B/.8,070,512 of its earnings will be reinvested indefinitely.

#### (26) Trust under Management

The Bank held in trust management contracts at customer risk amounted to B/.246,569,078 (2015: B/.213,283,930). Considering the nature of these services, management believes that there are not significant risks for the Bank.

#### (27) Commitments and Contingencies

The Bank has subscribed lease contracts, for terms of up to five (5) years, related to the use of properties where its offices operate. A detail of annual lease payments that the Bank have to pay for the next five years according the lease contracts is as follows:

| <u>Year</u> | <u>Amount</u> |
|-------------|---------------|
| 2017        | 566,250       |
| 2018        | 566,250       |
| 2019        | 566,250       |
| 2020        | 566,250       |
| 2021        | 566,250       |

As at December 31, 2016, there is an ongoing complaint filed against the subsidiary of El Salvador by the Consumer Advocacy. The Bank's management and its legal counsel believe it is not expected that the result of this process have a material adverse effect on the financial position of the Bank.

In the normal course of business, the Bank held off financial instruments without-balance sheet to cover financial needs of its customers. As of December 31, 2016, the Bank has issued promise letters of payments for B/.66,490,092 (2016: B/.64,534,809).

**Notes to the Consolidated Financial Statements**

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**(28) Fair Value of Financial Instruments**

The fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the Bank determines fair value using other valuation techniques.

For financial instruments that are traded on a low frequency and have few availability of pricing information, the fair value is less objective, and its determination requires the use of varying degrees of judgment that depend on liquidity, geographical concentration, uncertainty of market assumptions factors in determining prices and other risks affecting the specific instrument.

The Bank establishes a fair value hierarchy that categorizes into three levels the input data valuation techniques used in measure fair value:

- Level 1: inputs that are quoted market prices (unadjusted) in active markets 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: 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.

Other valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which observable market prices exist and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premise used in estimating discount rates.

The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

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(Panama, Republic of Panama)

**Notes to the Consolidated Financial Statements**

**(28) Fair Value of Financial Instruments, continued**

The following table presents the carrying value and fair value of financial assets and liabilities, by the level in the fair value hierarchy into which the fair value measurement is categorized. This table does not include information on the fair value of financial assets and liabilities not measured at fair value when its carrying approximates their fair value.

| <u>2016</u>  | <u>Carrying amount</u> | <u>Fair Value</u> |                | <u>Total</u> |
|--|------------------------|-------------------|----------------|--------------|
|  |                        | <u>Level 2</u>    | <u>Level 3</u> |              |
| <b>Assets:</b>   |                        |                   |                |              |
| <b>Financial assets measured at fair value:</b>          |                        |                   |                |              |
| Securities available for sale                            | 44,762,589             | 11,813,698        | 32,948,891     | 44,762,589   |
| Securities at fair value through profit or loss          | 12,804,044             | 0                 | 12,804,044     | 12,804,044   |
| <b>Financial assets not measured at fair value:</b>      |                        |                   |                |              |
| Loans  | 505,818,303            | 0                 | 563,627,942    | 563,627,942  |
| Securities held to maturity                              | 1,537,500              | 788,955           | 849,334        | 1,638,289    |
| <b>Liabilities:</b>                                      |                        |                   |                |              |
| <b>Financial liabilities not measured at fair value:</b> |                        |                   |                |              |
| Deposits from customers – time                           | 178,676,982            | 0                 | 180,406,168    | 180,406,168  |
| Negotiable commercial paper                              | 70,760,884             | 0                 | 69,733,845     | 69,733,845   |
| Negotiable commercial notes                              | 92,861,338             | 0                 | 93,257,301     | 93,257,301   |
| Ordinary bonds   | 16,591,868             | 0                 | 16,591,868     | 16,591,868   |
| Investment certificate                                   | 23,072,087             | 0                 | 23,034,048     | 23,034,048   |
| Other negotiable debt                                    | 8,988,036              | 0                 | 8,996,072      | 8,996,072    |
| Borrowed funds   | 141,544,615            | 0                 | 141,721,454    | 141,721,454  |

| <u>2015</u>  | <u>Carrying amount</u> | <u>Fair Value</u> |                | <u>Total</u> |
|--|------------------------|-------------------|----------------|--------------|
|  |                        | <u>Level 2</u>    | <u>Level 3</u> |              |
| <b>Assets:</b>   |                        |                   |                |              |
| <b>Financial assets measured at fair value:</b>          |                        |                   |                |              |
| Securities available for sale                            | 34,615,778             | 4,343,163         | 30,272,615     | 34,615,778   |
| Securities at fair value through profit or loss          | 7,498,438              | 0                 | 7,498,438      | 7,498,438    |
| <b>Financial assets not measured at fair value:</b>      |                        |                   |                |              |
| Loans  | 468,103,097            | 0                 | 513,519,069    | 513,519,069  |
| Securities held to maturity                              | 726,392                | 820,080           | 0              | 820,080      |
| <b>Liabilities:</b>                                      |                        |                   |                |              |
| <b>Financial liabilities not measured at fair value:</b> |                        |                   |                |              |
| Deposits from customers – time                           | 170,468,320            | 0                 | 172,707,004    | 172,707,004  |
| Negotiable commercial paper                              | 53,791,389             | 0                 | 53,110,264     | 53,110,264   |
| Negotiable commercial notes                              | 72,128,518             | 0                 | 68,668,455     | 68,668,455   |
| Investment certificate                                   | 19,875,121             | 0                 | 18,652,867     | 18,652,867   |
| Other negotiable debt                                    | 6,987,535              | 0                 | 6,916,869      | 6,916,869    |
| Borrowed funds   | 159,235,027            | 0                 | 159,277,863    | 159,277,863  |

As of December 31, 2016, there were not transfers of fair value hierarchy on securities available for sale and securities at fair value through profit or loss.

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

**Notes to the Consolidated Financial Statements**

**(28) Fair Value of Financial Instruments, continued**

The following table shows the valuation technique, the input data used, and significant unobservable inputs when measuring the fair value of the instruments classified in Level 2 and Level 3 as at December 31, 2016 and 2015:

|                             |  | <u>Quantitative information Level 3 fair values</u>              |                                 |                          |
|-----------------------------|--|--|---------------------------------|--------------------------|
|                             | <u>Valuation technique</u>   | <u>Unobservable inputs</u>                                       | <u>Range (weighted average)</u> |                          |
|                             |  |  | <u>2016</u>                     | <u>2015</u>              |
| Mortgage bonds              | Discounted cash flows  | Cumulative Default Assumptions ("SDA")                           | 7.46% - 0.26% (2.78%)           | 2.64% - 0.37% (1.24%)    |
|                             |  | Cumulative Speed Assumptions and Prepayment rate ("PSA" y "CPR") | 42.18% - 33.77% (38.49%)        | 39.08% - 33.78% (37.39%) |
|                             |  | Recoveries percentage  | 90%                             | 90%                      |
|                             |  | Estimated time to perform the recoveries                         | 12 months                       | 12 months                |
|                             |  |  |                                 |                          |
| Residual interests of trust | Discounted cash flows  | Cumulative Default Assumptions ("SDA")                           | 7.46% - 0.26% (1.52%)           | 2.64% - 0.37% (1.19%)    |
|                             |  | Cumulative Speed Assumptions and Prepayment rate ("PSA" y "CPR") | 42.18% - 33.77% (36.80%)        | 39.08% - 33.78% (35.96%) |
|                             |  | Recoveries percentage  | 90%                             | 90%                      |
|                             |  | Estimated time to perform the recoveries                         | 12 months                       | 12 months                |
|                             |  |  |                                 |                          |
| Government Bonds            | The valuation model is based on different prices of observable references on an active market. Present value of the flows of a title, discounting them with the reference rate and the corresponding margin. | N/A  | N/A                             | N/A                      |

**BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES**  
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**Notes to the Consolidated Financial Statements**

**(28) Fair Value of Financial Instruments, continued**

| Financial Instrument                                   | Valuation Technique and<br>Observable Input Used  |
|--|---|
| <b>Not measured at fair value:</b>                     |   |
| Deposits from customers                                | For saving deposits its fair value represents the outstanding amount expected to receive/pay at reporting date. For time deposits its fair value is determined using discounted cash flows at market interest rate. |
| Securities held to maturity                            | Fair value represents the amount receivable / payable at the reporting date   |
| Loans  | The fair value of loans represent the discounted expected cash flow to receive. The cash flows are discounted at market interest rates to assess its fair value.  |
| Repurchase agreements                                  | The value of the future cash flows is discounted using a discount rate that represents the present interest rate of market for financings of new debts with maturity similar surplus.                               |
| Borrowed funds   | The fair value for loans payable in semiannual interest rate adjustments are determined using the future cash flows discounted at the current market interest rate.   |
| Ordinary bonds   | The fair value for ordinary bonds are determined using the future cash flows discounted at the current market interest rate.  |
| Negotiable commercial papers                           | The fair value for negotiable commercial papers are determined using the future cash flows discounted at the current market interest rate.  |
| Other negotiable debts                                 | The fair value for other negotiable debt are determined using the future cash flows discounted at the current market interest rate.   |
| Negotiable commercial notes and investment certificate | Fair value for the negotiable commercial notes is determined using future cash flows discounted at the current interest rate of the market.   |

The table below presents the reconciliation as at December 31, 2017 for financial instruments categorized as Level 3 in the hierarchy of levels of fair value:

|   | <u>2016</u>         | <u>2015</u>        |
|---|---------------------|--------------------|
| Balance at the beginning of the year                  | 37,771,053          | 44,559,163         |
| Total income or (loss):                               |                     |                    |
| In the consolidated statement of income               | 622,320             | 701,395            |
| In the consolidated statement of comprehensive income | (590,616)           | (1,288,958)        |
| Purchases   | 18,610,403          | 734,666            |
| Liquidations  | <u>(10,660,225)</u> | <u>(6,935,213)</u> |
| Balance at the end of the year                        | <u>45,752,935</u>   | <u>37,771,053</u>  |

# BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

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## Notes to the Consolidated Financial Statements

### (28) Fair Value of Financial Instruments, continued

Although the Bank management believes their estimates of fair value are appropriate, the use of different methodologies or assumptions could lead to different measurements of fair value. For fair value measurements in Level 3, changing one or more assumptions to reflect reasonable alternative assumptions would have the following effects:

|  | <u>2016</u>                   |                      | <u>Effect on Other Comprehensive</u> |                      |
|--|-------------------------------|----------------------|--------------------------------------|----------------------|
|  | <u>Effect on Consolidated</u> |                      | <u>Income (Loss)</u>                 |                      |
|  | <u>Favorable</u>              | <u>(Unfavorable)</u> | <u>Favorable</u>                     | <u>(Unfavorable)</u> |
| Investments at fair value through profit or loss | 914,898                       | (839,874)            | 0                                    | 0                    |
| Securities available for sale                    | <u>0</u>                      | <u>0</u>             | <u>1,183,883</u>                     | <u>(1,117,282)</u>   |
|  | <u>914,898</u>                | <u>(839,874)</u>     | <u>1,183,883</u>                     | <u>(1,117,282)</u>   |

  

|  | <u>2015</u>                   |                      | <u>Effect on Other Comprehensive</u> |                      |
|--|-------------------------------|----------------------|--------------------------------------|----------------------|
|  | <u>Effect on Consolidated</u> |                      | <u>Income (Loss)</u>                 |                      |
|  | <u>Favorable</u>              | <u>(Unfavorable)</u> | <u>Favorable</u>                     | <u>(Unfavorable)</u> |
| Investments at fair value through profit or loss | 528,766                       | (337,217)            | 0                                    | 0                    |
| Securities available for sale                    | <u>0</u>                      | <u>0</u>             | <u>1,053,785</u>                     | <u>(1,103,002)</u>   |
|  | <u>528,766</u>                | <u>(337,217)</u>     | <u>1,053,785</u>                     | <u>(1,103,002)</u>   |

Favorable and unfavorable effects of using reasonably possible alternative assumptions for the valuation of mortgage bonds and bonds of residual interests in securitizations are calculated recalibrating the values of the models, using methods based on possible estimates of unobservable inputs of the Bank.

The most important unobservable data inputs refer to the risk discount rates. The reasonable alternative assumptions are 0.5% below and 0.5% higher, respectively, of discount rates used in the models.

The Bank has established a control framework with respect to the measurement of fair values. This control framework includes a separate management unit reporting directly to the Executive Vice President of Finance, and has independent responsibility to verify the results of the operations of investment and significant fair value measurements.

Specific controls include:

- Checking the quoted prices;
- Validation or "re-performance" of valuation models;
- Review and approval of the processes for new models and changes to existing valuation models;
- Review of significant unobservable data; adjustments and significant changes in fair value of Level 3 compared with the previous month.

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

**Notes to the Consolidated Financial Statements**

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**(28) Fair Value of Financial Instruments, continued**

The Bank uses a third party, as a service provider for this control unit evaluates and documents the evidence obtained from such third parties that support the conclusion that such assessments meet the requirements of IFRS. This review includes:

- Verify that the vendor price is approved by the Bank;
- Obtain an understanding of how the fair value has been determining and whether it reflects current market transactions;
- When similar instruments are used to determine fair value, how these prices have been adjusted to reflect the characteristics of the instrument being measured.

This process is also monitored by the Audit Committee through Internal Audit.

**(29) Segment Information**

The segment information of the Bank is presented regarding its business lines and has been determined by management based on reports by senior management for decision making.

The composition of the business segments is described as follows:

- *Trust Administration:* This segment includes commissions earned by management and collection of mortgage and personal loans belonging to third parties, which hires the Bank under management contracts to carry out such function.
- *Mortgages as assets:* Within this concept interest income is recognized minus costs generated by financing mortgages loans that Bank hold as assets, plus commissions for disbursements and the proportional share of the commissions from collections and reinsurance services from the insurance Bank to which it provides the service of reinsurance.
- *Personal loans as assets:* Within this concept interest income is recognized minus costs generated by financing personal loans that Bank hold as assets, plus commissions for granted and the proportional share of the commissions from collections and reinsurance services from the insurance Bank to which it provides the service of reinsurance.
- *Other investments:* This concept includes the income generated by other investments of the Bank.

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

**Notes to the Consolidated Financial Statements**

**(29) Segment Information, continued**

| <u>2016</u>                                 | <u>Trust<br/>administration</u> | <u>Mortgage as<br/>assets</u> | <u>Personal<br/>loans as<br/>assets</u> | <u>Other<br/>investments</u> | <u>Total</u>        |
|---|---------------------------------|-------------------------------|---|------------------------------|---------------------|
| Interest income                             | 0                               | 29,358,783                    | 4,227,424                               | 2,492,984                    | 36,079,191          |
| Commission on management and servicing, net | 2,114,050                       | 2,125,608                     | 214,952                                 | 0                            | 4,454,610           |
| Commission on loan granting                 | 0                               | 2,213,072                     | 488,938                                 | 0                            | 2,702,010           |
| Interest and commission expense             | 0                               | (22,320,338)                  | (1,300,806)                             | (1,705,052)                  | (25,326,196)        |
| Provision for loan losses                   | 0                               | (266,836)                     | (78,570)                                | 0                            | (345,406)           |
| Gain on investments, net                    | 0                               | 0                             | 0                                       | (12,198)                     | (12,198)            |
| Other income                                | 0                               | 2,394,031                     | 139,522                                 | 182,880                      | 2,716,433           |
| Operating expenses                          | <u>(1,602,933)</u>              | <u>(10,175,137)</u>           | <u>(2,822,555)</u>                      | <u>(696,927)</u>             | <u>(15,297,552)</u> |
| <b>Profit by segment before tax</b>         | <u>511,117</u>                  | <u>3,329,183</u>              | <u>868,905</u>                          | <u>261,687</u>               | <u>4,970,892</u>    |
| Segment assets                              | <u>0</u>                        | <u>506,618,127</u>            | <u>45,041,937</u>                       | <u>59,039,421</u>            | <u>610,699,485</u>  |
| Segment liabilities                         | <u>0</u>                        | <u>479,415,986</u>            | <u>27,939,861</u>                       | <u>36,622,609</u>            | <u>543,978,456</u>  |
|   |                                 |                               |   |                              |                     |
| <u>2015</u>                                 | <u>Trust<br/>administration</u> | <u>Mortgage as<br/>assets</u> | <u>Personal<br/>loans as<br/>assets</u> | <u>Other<br/>investments</u> | <u>Total</u>        |
| Interest income                             | 0                               | 25,178,882                    | 3,684,258                               | 1,574,476                    | 30,437,616          |
| Commission on management and servicing, net | 2,141,790                       | 1,681,912                     | 202,961                                 | 0                            | 4,026,663           |
| Commission on loan granting                 | 0                               | 2,461,142                     | 420,104                                 | 0                            | 2,881,246           |
| Interest and commission expense             | 0                               | (17,522,760)                  | (1,051,163)                             | (954,129)                    | (19,528,052)        |
| Provision for loan losses                   | 0                               | (235,222)                     | (109,753)                               | 0                            | (344,975)           |
| Gain on investments, net                    | 0                               | 0                             | 0                                       | 1,016,395                    | 1,016,395           |
| Other income                                | 0                               | 1,427,180                     | 85,614                                  | 77,711                       | 1,590,505           |
| Operating expenses                          | <u>(1,578,312)</u>              | <u>(9,436,991)</u>            | <u>(2,400,349)</u>                      | <u>(624,748)</u>             | <u>(14,040,400)</u> |
| <b>Profit by segment before tax</b>         | <u>563,478</u>                  | <u>3,554,143</u>              | <u>831,672</u>                          | <u>1,089,705</u>             | <u>6,038,998</u>    |
| Segment assets                              | <u>0</u>                        | <u>468,688,643</u>            | <u>42,273,112</u>                       | <u>38,370,831</u>            | <u>549,332,586</u>  |
| Segment liabilities                         | <u>0</u>                        | <u>441,594,178</u>            | <u>26,490,545</u>                       | <u>24,045,171</u>            | <u>492,129,894</u>  |



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**Notes to the Consolidated Financial Statements**

**(29) Segment Information, continued**

The composition of the geographic segments is described as follows:

| <u>2016</u>                                 | <u>Panama</u>           | <u>El Salvador</u>      | <u>Colombia</u>         | <u>Total</u>            |
|---|-------------------------|-------------------------|-------------------------|-------------------------|
| Interest income                             | 22,034,704              | 9,378,119               | 4,666,368               | 36,079,191              |
| Commission on management and servicing, net | 3,674,055               | 661,227                 | 119,328                 | 4,454,610               |
| Commission on loan granting                 | 2,257,189               | 444,821                 | 0                       | 2,702,010               |
| Interest and commission expense             | (16,914,889)            | (5,102,125)             | (3,309,182)             | (25,326,196)            |
| Provision for loan losses                   | (163,687)               | (156,096)               | (25,623)                | (345,406)               |
| Gain on investments, net                    | 162,526                 | (174,724)               | 0                       | (12,198)                |
| Other income                                | 2,271,280               | 397,430                 | 47,723                  | 2,716,433               |
| Operating expenses                          | <u>(10,341,656)</u>     | <u>(2,973,241)</u>      | <u>(1,982,655)</u>      | <u>(15,297,552)</u>     |
| <b>Profit by segment before tax</b>         | <u><b>2,979,522</b></u> | <u><b>2,475,411</b></u> | <u><b>(484,041)</b></u> | <u><b>4,970,892</b></u> |
| Segment assets                              | <u>447,142,792</u>      | <u>106,778,802</u>      | <u>56,777,891</u>       | <u>610,699,485</u>      |
| Segment liabilities                         | <u>415,849,803</u>      | <u>89,711,173</u>       | <u>38,417,480</u>       | <u>543,978,456</u>      |

| <u>2015</u>                                 | <u>Panamá</u>           | <u>El Salvador</u>      | <u>Colombia</u>           | <u>Total</u>            |
|---|-------------------------|-------------------------|---------------------------|-------------------------|
| Interest income                             | 18,814,965              | 8,883,414               | 2,739,237                 | 30,437,616              |
| Commission on management and servicing, net | 3,353,990               | 547,729                 | 124,944                   | 4,026,663               |
| Commission on loan granting                 | 2,419,880               | 461,366                 | 0                         | 2,881,246               |
| Interest and commission expense             | (13,513,269)            | (4,537,008)             | (1,477,775)               | (19,528,052)            |
| Provision for loan losses                   | (132,829)               | (170,710)               | (41,436)                  | (344,975)               |
| Gain on investments, net                    | 1,006,144               | 10,251                  | 0                         | 1,016,395               |
| Other income                                | 903,857                 | 652,348                 | 34,300                    | 1,590,505               |
| Operating expenses                          | <u>(9,094,768)</u>      | <u>(2,524,566)</u>      | <u>(2,421,066)</u>        | <u>(14,040,400)</u>     |
| <b>Profit by segment before tax</b>         | <u><b>3,757,970</b></u> | <u><b>3,322,824</b></u> | <u><b>(1,041,796)</b></u> | <u><b>6,038,998</b></u> |
| Segment assets                              | <u>367,173,853</u>      | <u>137,790,893</u>      | <u>44,367,840</u>         | <u>549,332,586</u>      |
| Segment liabilities                         | <u>338,394,489</u>      | <u>122,657,748</u>      | <u>31,077,657</u>         | <u>492,129,894</u>      |

**(30) Preferential Interests on Mortgage Loans**

According to current fiscal regulations in Panama, the financial institutions that grant mortgage loans not exceeding B/.120,000 with preferential interest, receive the benefit of an annual fiscal credit. From July 2010 according to the law 8 of 15 March, 2010 repealing Article 6 of Act 3 of 1985, it increases the benefit of a tax credit of ten (10) years, to, the first (15) years for new loans for the purpose of new houses in the amount equal to the difference between the income that the lender would have received if you have taken the benchmark interest rate market, which has been in effect during that year and the actual income received in interest in relation to each preferential mortgage loans.

## BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

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### Notes to the Consolidated Financial Statements

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#### (30) Preferential Interests on Mortgage Loans, continued

Law No. 3 of May, 1985 in the Republic of Panama establishes that fiscal credit can be used for payment of national taxes, including income tax. The fiscal credit, under Law No. 11 of September, 1990, which extends the previous law, and Law No. 28 of June, 1995, establishes that it can be used only for payment of income tax. If in any fiscal year the financial institution cannot effectively use the entire fiscal credits to which it is entitled, then it can use the excess credit over the next three years, at their convenience, or transfer, in whole or in part, to another taxpayer.

At December 31, 2016, the Bank recorded, net of reserve, B/.6,894,527 (2015: B/.5,492,427), as preferential interest income on the portfolio of residential mortgage loans. During the same period, a subsidiary of the Bank sold to third parties prior years' fiscal credits for B/.6,560,778 (2015: B/.1,397,144), which generated an income of B/.92,045 (2015: B/.20,957).

As at December 31, 2016, the accumulated fiscal credit is included in the consolidated statement of financial position for the amount of B/.7,247,049 (2015: B/.6,800,239).

#### (31) Participations in Non-Consolidated Structured Entities

The following table describes the types of structured entities in which the Bank holds a participation and acts as an agent thereof. (See Note 3 a5).

| <u>Type</u>                | <u>Nature and purpose</u>   | <u>Participation maintained by the Bank</u>            |
|----------------------------|---|--|
| Loan Securitization Trusts | Generate: <ul style="list-style-type: none"><li>• Fund for lending activities of the Bank</li><li>• Commission for administration and management of loan portfolio</li></ul> <p>This trusts are financed by the sale of debt instruments.</p> | Investments in the mortgage bonds issued by the trusts |

The participation maintained by the Bank in the non-consolidated structured entities represents 10%, 3% and 5% (2015: 10%, 10% y 3%) in three trusts.

#### (32) Main Applicable Laws and Regulations

The principal laws and regulations applicable in the Republic of Panama are:

##### (a) *Banking Law*

Banking operations in the Republic of Panama, are regulated and supervised by the Superintendence of Banks of the Republic of Panama, according to the laws established by Executive Decree No.52 of April 30, 2008, which adopts the only text Decree Law 9 of February 26, 1998, as amended by Decree Law 2 of 22 February 2008, by which the banking system in Panama is established and the Superintendence of Banks and the rules that govern it is created.

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(Panama, Republic of Panama)

### **Notes to the Consolidated Financial Statements**

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#### **(32) Main Applicable Laws and Regulations**

*(b) Trust Law*

Trust operations in Panama are regulated by the Superintendence of Banks of Panama in accordance with the legislation established in Law No. 1 of January 5, 1984.

*(c) Securities Law*

The operations brokerage firm in Panama are regulated by the Superintendence of the share market in accordance with the legislation established in Decree Law No.1 of July 8, 1999, reformed by Act No. 67 of September 1, 2011.

The operations of brokerage houses are in the process of adaptation to the Agreement No.4-2011, amended certain provisions by Agreement 8-2013, established by the Superintendence of the share market, which indicate that they have to comply with the capital adequacy rules and modalities.

The main regulations or norms in the Republic of Panama, which have an effect on the preparation of these consolidated financial statements are described below:

*(a) General Board Resolution SBP-GJD-0003-2013 issued by the Superintendence of Banks of Panama on July 9, 2013*

This resolution establishes the accounting treatment for those differences arising between prudential standards issued by the Superintendence of Banks and International Financial Reporting Standards (IFRS), such that 1) the accounting records and financial statements are prepared in accordance with IFRS as required by the Agreement No.006-2012 December 18, 2012 and 2) in the event that the calculation of a provision or reserve under prudential rules applicable to banks to submit additional accounting specific aspects required IFRS, is greater than the respective calculation under IFRS oversupply or under prudential reserves is recognized in a regulatory reserve in equity.

Prior authorization of the Superintendence of Banks, banks shall be able to partially or totally reverse the provision established, after submitting due justification before the Superintendence of Bank.

*(b) Agreement No. 003 – 2009 Dispositions on Acquired Foreclosed Assets, issued by the Superintendence of Banks of Panama on May 12, 2009*

For regulatory purposes, the Superintendence sets a term of five (5) years, effective the date of registration before the Public Registry to sell immovable goods acquired for the payment of past due credits. If after that term the Bank has not sold the property acquired, it shall conduct an independent appraisal to determine if its value has decreased, by applying in such case the provisions of IFRS.

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**Notes to the Consolidated Financial Statements**

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**(32) Main Applicable Laws and Regulations, continued**

Likewise, the Bank shall create a reserve in equity, through the appropriation in the following order of: a) undistributed earnings; b) profits for the period, to which the following value of the foreclosed asset will be transferred:

|              |     |
|--------------|-----|
| First year:  | 10% |
| Second year: | 20% |
| Third year:  | 35% |
| Fourth year: | 15% |
| Fifth year:  | 10% |

The aforementioned reserves shall maintain until the acquired asset is actually transferred, and it shall not be considered a regulatory reserve for purposes of calculating the equity ratio.

- (c) *Agreement No. 004-2013, "Whereby provisions on credit risk management inherent of in credit portfolio and off-balance sheet transactions are established", issued by the Superintendence of Banks of Panama on May 28, 2013*

Sets forth general classification criteria for credit facilities in order to determine the specific and dynamic provisions to cover the Bank's credit risk. Additionally, this Agreement establishes certain required minimum disclosures, in line with IFRS disclosure requirements about credit risk management and administration.

This Agreement is effective as of June 30, 2014 and repeals all parts of the Agreement No. 6-2000 of June 28, 2000 and all amendments, Agreement No. 6-2002 of August 12, 2002 and Article 7 of Agreement No. 2-2003 of March 12, 2003.

**Specific Provisions**

Agreement No.004-2013 sets forth that specific provisions are generated by any objective and concrete evidence of impairment. These provisions shall be recorded for credit facilities classified in the risk categories named: special-mention, substandard, doubtful or loss, both for individual or collective credit facilities.

Banks shall calculate and maintain the amount of the specific provisions determined through the methodology explained in this Agreement, which takes into consideration the balance owed by each credit facility classified in any of the categories subjected to provision, mentioned in the preceding paragraph; the present value of each collateral available as risk mitigating, as established per type of collateral in this Agreement, and a table of estimates applied to the net balance exposed to losses for such credit facilities.

In case of a surplus in the specific provision, calculated in conformity with this Agreement, over the provision calculated in conformity to IFRS; this surplus shall be accounted for in a regulatory reserve in equity increasing or decreasing through allocations from or to retained earnings. The balance of the regulatory reserve shall not be considered as capital funds for purposes of calculating certain indices or ratios mentioned in this Agreement.

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**Notes to the Consolidated Financial Statements**

**(32) Main Applicable Laws and Regulations, continued**

The table below summarizes the loans at amortized cost of the Panamanian Bank classified according this Agreement and the specific provision:

| <u>Classification</u>                        | <u>2016</u>        |                  | <u>2015</u>        |                  |
|--|--------------------|------------------|--------------------|------------------|
|  | <u>Portfolio</u>   | <u>Allowance</u> | <u>Portfolio</u>   | <u>Allowance</u> |
| Normal                                       | 360,100,986        | 0                | 303,291,791        | 0                |
| Watch list                                   | 2,317,680          | 152,219          | 1,526,608          | 87,151           |
| Substandard                                  | 444,011            | 72,511           | 533,709            | 83,692           |
| Doubtful                                     | 506,235            | 100,360          | 333,191            | 91,365           |
| Loss   | <u>851,129</u>     | <u>209,736</u>   | <u>609,256</u>     | <u>112,197</u>   |
| Total of portfolio exposed to amortized cost | <u>364,220,041</u> | <u>534,826</u>   | <u>306,294,555</u> | <u>374,405</u>   |

The table below summarizes the balances of past due and default loans for the principal categories:

|                    | <u>2016</u> | <u>Current</u>     | <u>Past due</u>  | <u>Default</u>   | <u>Total</u>       |
|--------------------|-------------|--------------------|------------------|------------------|--------------------|
| Loans to customers |             | <u>357,070,211</u> | <u>5,519,307</u> | <u>1,630,523</u> | <u>364,220,041</u> |
|                    | <u>2015</u> | <u>Current</u>     | <u>Past due</u>  | <u>Default</u>   | <u>Total</u>       |
| Loans to customers |             | <u>300,392,686</u> | <u>4,509,950</u> | <u>1,391,919</u> | <u>306,294,555</u> |

At December 31, 2016, the balances of the loans which accumulation of interests has been suspended due to an impairment in the quality of the credit or for the nonperformance of payment in accordance with the indicated in the Agreement No. 4-2013 was of B/.1,813,097 (2015: B/.1,470,468).

**Dynamic Provision**

Agreement No. 004 - 2013 indicates that the dynamic provision is a reserve established to meet possible future needs for establishment of specific provisions, which is governed by its own prudential bank regulation criteria. The dynamic provision constitutes at quarterly basis on credit facilities that lack specific provision allocated, i.e. on credit facilities normally classified category.

The dynamic provisioning is a equity item that increases or decreases with assignments to or from retained earnings. The credit balance of this provision is part of dynamic regulatory capital but does not replace or offset the capital adequacy requirements established by the Superintendence.

## BANCO LA HIPOTECARIA, S. A. AND SUBSIDIARIES

(Panama, Republic of Panama)

### Notes to the Consolidated Financial Statements

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#### (32) Main Applicable Laws and Regulations, continued

The balance of dynamic provision of the Bank is as follows:

|                               | <u>2016</u>      | <u>2015</u>      |
|-------------------------------|------------------|------------------|
| Banco La Hipotecaria, S. A.   | 3,928,190        | 3,555,076        |
| La Hipotecaria, S. A. de C.V. | 1,416,926        | 1,416,926        |
| La Hipotecaria C. F., S. A.   | <u>601,678</u>   | <u>383,335</u>   |
| Total                         | <u>5,946,794</u> | <u>5,355,337</u> |

With this Agreement is established a dynamic provision which will not be less of 1.25%, nor higher to 2.50% of the risk weighed assets corresponding to credit facilities classified as normal.

By requirements of Agreement No.004-2013, is constituted a regulatory provision of B/.646,657 (2015: B/.520,947) which represents the excess of regulatory provision over the allowance for loan losses according IFRS.

The principal laws and regulations applicable in the Republic of El Salvador are::

- (a) *Law of the Superintendence of Corporate Obligations (formerly Business Enterprises)*  
The operations of business enterprises in El Salvador are regulated by the Superintendence of Companies and Corporations, contained in Legislative Decree No.448 of 09 October 1973.
- (b) *Securities Law*  
The operations of issuers and brokerage positions in El Salvador are regulated by the Securities in accordance with the procedures established in the Decree Law No.809 of April 31, 1994. According to Legislative Decree No.592 of 14 January 2011, the Securities ceased to exist as of August 2, 2011, which contains the Law on Regulation and Supervision of the Financial System, published in Official Journal No.23 of February 2, 2011, which became effective on August 2, 2011, and gave birth to the new Financial System Superintendence as single supervisory body that integrates the functions of the former Superintendence of the Financial System, Pensions and Securities.

The principal laws and regulations applicable in the Republic of Colombia are:

- (a) *Laws for Commercial Business*  
The operations of commercial business in Colombia are regulated by the Superintendence of Companies in accordance with the laws established in the Decree Law No.222 of December 20, 1995.

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

**Notes to the Consolidated Financial Statements**

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**(32) Main Applicable Laws and Regulations, continued**

*(b) Equity Tax*

According to Decree 4825 of December 29, 2010, issued by the Ministry of Finance and Public Credit, establishing the state tax applicable to juridical persons, natural and indeed societies. This tax is generated by the possession of wealth by January 1st of 2011, whose value equals or exceeds one billion dollars and less than three billion pesos. The tax rate ranges from 1% to 1.4% and added a surcharge of 25% of the estate tax result. The estate tax is presented in the consolidated statement of comprehensive income in the area of taxes.