



KINGDOM OF THE NETHERLANDS-CURAÇAO AND SINT MAARTEN

TECHNICAL ASSISTANCE REPORT—IMPLEMENTATION OF RISK-BASED SUPERVISION

March 2022

This Technical Assistance report on the Kingdom of the Netherlands-Curaçao and Sint Maarten was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in June 2021.

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TECHNICAL ASSISTANCE REPORT

KINGDOM OF THE NETHERLANDS- CURAÇAO AND SINT MAARTEN

Implementation of Risk-based Supervision (Diagnostic Review to Determine Harmonized Framework for Supervisory Assessments)

JUNE 2021

PREPARED BY

Ralph Lewars (Long-term Expert) and Naren Sheth (Short-term Expert)



MEMBERS

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GLOSSARY

AML/CFT	Anti-Money Laundering/Combatting the Financing of Terrorism
CAMELS	Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to Market Risks
CARAMELS	Capital, Asset, Reinsurance, Actuarial, Management, Earnings, Liquidity, Subsidiaries
CARTAC	Caribbean Regional Technical Assistance Centre
CBvCSM	Central Bank of Curacao and St Maarten
DNB	De Nederlandsche Bank
RBS	Risk-Based Supervision
RFSF	Risk-Focused Surveillance Framework
RM	Relationship Manager
STX	Short-term Expert
SWOT	Strengths, Weaknesses, Opportunities, and Threats

PREFACE

In response to a request from the Central Bank of Curacao and St Maarten (CBvCSM) to assess the practicality and appropriateness of developing and implementing a harmonized risk assessment/rating system for assessing the risk profile of banks and non-bank institutions, insurance firms, asset management and trust companies, a Caribbean Regional Technical Assistance Centre (CARTAC) mission comprising Ralph Lewars, CARTAC's Resident Adviser for Financial Sector Regulation and Supervision, and Narendra Sheth, CARTAC's Short-Term Expert (STX) provided the assistance requested remotely during the period February 1 to 5, 2021.

The mission met with Mr. Arnoud Vossen, the Deputy Director of the supervision department and members of his management team; and conducted separate discussions with staff members from the different functional units within supervision, including Account Supervision, and Expert Supervision. The mission also met separately with the President of the CBvCSM, Mr. Richard Doornbosch and the Deputy Director on the last day of the mission to discuss the mission's findings and preliminary recommendations. The mission wishes to thank the Deputy Director and staff of the supervision department for their cooperation, productive discussions, and feedback provided on the draft version of the Report.

This Report presents the mission's assessment and main conclusions.

EXECUTIVE SUMMARY

The CBvCSM is the sole supervisory authority for all regulated financial institutions operating locally and in the offshore (or international) sector, as well as the stock exchange in Curacao and St Maarten. The financial sector comprises different types of institutions, which include banks and non-bank institutions, insurance companies (both Life, and Non-life), securities intermediaries, asset management firms, investments institutions, fund administrators, management of pension funds, reinsurers, and trust companies.

In January 2021, the CBvCSM implemented a revised organizational structure for financial sector supervision. The new structure comprises 4 functional units (Supervision Policy; Account Supervision; Expert Supervision; and Cross Sectoral Supervision). The revised structure is designed to support the introduction of a Risk-Focused Surveillance Framework (RFSF) across all financial institutions or sectors supervised by the CBvCSM.

Currently, there appears to be some element of overlap between the responsibilities of the Expert and Account Supervision units. It is important to designate which of the two units will assume the lead role in determining the risk profile of each institution and engaging with supervised institutions in executing supervisory work on an ongoing basis. The mission recommends that experienced staff from Account Supervision be assigned as the Relationship Manager (RM) or Lead Supervisor for each institution or portfolio of institutions within the same sector. The RM's principal responsibilities should include all aspects of supervisory work relating to planning and executing the annual supervisory plan and multi-year supervisory strategy for each assigned institution and/or financial group, including review and updating their respective risk profile; liaising and collaborating with staff within Expert Supervision to undertake and share the results of risk reviews (e.g. credit, market, operational) and assessments conducted. The results from these reviews should be utilized by the RM and staff in Account supervision as inputs in assessing and/or updating the risk profile of supervised institutions.

The supervision department of the CBvCSM uses different methodologies or approaches for conducting risk assessment and assessing the risk profile of institutions within the different sectors covered by its mandate. Based on the findings from the review conducted by the mission team, including discussions held with the different groups of sectoral supervisors, the mission concluded that it is practical and feasible to develop and implement a harmonized risk rating or assessment methodology. A harmonized assessment methodology would serve to minimize duplication in the supervisory process, particularly for banking and insurance supervision, and allow for a standardized process to assess the risk profile of supervised institutions.

The mission recommends that CBvCSM review the approach adopted by several CARTAC member countries for consideration as part of the process of deciding on an appropriate harmonized risk assessment system across the different sectors¹. The risk assessment approach currently utilized by the banking supervisors at the CBvCSM reflect some features of the risk-based supervisory framework and risk assessment system adopted and being implemented by several member countries of CARTAC (such as Jamaica, Barbados, Belize, Grenada, St Vincent and the Grenadines, Turks and Caicos Islands) and the Eastern Caribbean Central Bank and would therefore require fewer changes or modifications. The assessment methodology embedded in the risk-based supervisory framework utilized by CARTAC member countries can also be applied to other sectors such as insurance, asset management, trust and pensions with few modifications to reflect differences in underlying business models, and whether the supervisory objective is prudential or market conduct.

The framework proposed for consideration is activity-based and reflects how institutions manage their business activities and risk exposures irrespective of the sector. The approach would result in standardization and consistency across the sectors in terms of the methodologies and related rating systems, which is a key objective of the supervision department. Any differences resulting from customization of the framework adopted in terms of risk coverage, governance requirements and supervisory expectations should be based on the underlying businesses and supervisory objectives (prudential and/or market conduct) of the institution rather than the supervisory methodology. The methodology should allow for flexibility in application across institutions from different sectors of varied size and complexity. It should also reflect a uniform rating scale and incorporates standardized definition and assessment criteria for risks and control functions.

The key recommendations are shown in Table 1. Additional details on each recommendation are provided in the referenced paragraphs.

¹ The RBS Framework is similar to the methodology developed and utilized by the Office of the Superintendent of Financial Institutions, Canada (OSFI, Canada).

Table 1. Key Recommendations

Recommendations and Authority Responsible for Implementation	Paragraph Reference	Priority	Timeframe ²
<i>Responsibilities of the Expert and Accounts Supervision Units</i>			
<p>To minimize duplication of supervisory work and overlap in the responsibilities of the Expert and Accounts Supervision units, the CBvCSM should assign experienced staff from Account Supervision as the Relationship Managers (RMs) or Lead Supervisors for each institution or portfolio of institutions within the same sector. The RM's principal responsibilities should include all aspects of supervisory work relating to planning and executing the annual supervisory plan and multi-year supervisory strategy for each institution and/or financial group assigned, including review and updating their respective risk profile; liaising and collaborating with staff within Expert Supervision to undertake and share the results of review and assessment of control functions and risk (e.g. credit, market, operational) conducted.</p>	15-16	High	Near Term
<i>Harmonized Framework for Supervisory Assessments</i>			
<p>The CBvCSM should consider adopting the framework proposed by the Mission Team, which has been adopted in several CARTAC member countries for assessing the risk profile of supervised institutions with appropriate modifications for each financial sector. The framework is activity-based and reflects how institutions manage their business activities and risk exposures irrespective of the sector, and includes standardized assessment ratings, and uniform definition and assessment criteria for risks and control functions.</p>	17-19	High	Near Term
<i>Implementation of Harmonized Framework</i>			
<p>Once the decision regarding choice of harmonized framework for supervisory assessments is made, the CBvCSM should immediately commence process for its implementation. The process should include the development of an implementation plan, reassessment of staffing strategies to ensure appropriate skill sets are in place to implement the framework, and modifications in current supervisory practices and processes for effective implementation of the methodology.</p>	20-21	High	Near Term

²Near term: < 12 months.

I. INTRODUCTION

- 1. The CBvCSM is the sole regulatory and supervisory authority in Curaçao and St. Maarten.** The main office of the CBvCSM is located in Curaçao. The CBvCSM supervises all regulated financial institutions in both countries that conduct business locally as well as financial institutions licensed and registered with the CBvCSM but limited to doing offshore business only. It also supervises the stock exchange. Of the 44 banks operating locally and offshore, 8 are considered significant. 8 of the 31 insurance companies, and 5 trust and pension funds management firms are also deemed significant by the CBvCSM. The CBvCSM defines an institution as “significant” based on the following criteria: the size of the institution, the market share, the number of customers, the products they offer and their relevance to the local financial system. For example, the 8 significant banks account for 76 percent of the combined assets of all banks operating in the domestic and offshore sectors.
- 2. The economies of Curaçao and St. Maarten are heavily dependent on tourism (both stopover and cruise arrivals) and revenue from offshore financial businesses.** The COVID-19 pandemic inflicted a major shock on the Curaçao economy that had already been struggling with a protracted recession³. Stopover tourism arrivals in 2020 were 68 percent lower than in 2019, and a spike of COVID-19 cases in December 2020 resulted in the reintroduction of social distancing measures. Subsequent spikes in COVID-19 cases in March/April 2021 resulted in a near-lockdown of the economy. Formal private employment in December 2020 was 12 percent lower than in December 2019 and total 2020 tax revenue fell by 14 percent. The economic response measures supported by substantial financing from the Netherlands helped to cushion the shock.
- 3. In November 2020, Curaçao signed an agreement with the government of the Netherlands that included the implementation of measures across several sectors, including the financial sector to improve Curaçao’s resilience to shocks and raise potential growth.** The agreement requires an overall review of the financial markets supervisory system (legislation and regulations, supervisory policy). As part of the process to strengthen its supervisory function, the CBvCSM has restructured its supervision department. Assessing the practicality and appropriateness of developing and implementing harmonized risk assessment methodology across all financial sectors is intended to complement other initiatives being undertaken to strengthen supervisory oversight⁴.

³ Curaçao and Sint Maarten—Back-to-Office Report on Staff Visit to Curaçao, January 11–22, 2021.

⁴ The CBvCSM did not request technical assistance (TA) from CARTAC on the development of its Risk-Focused Surveillance Framework and the new organizational structure of the supervision department. With respect to the current request for TA on the feasibility of introducing a harmonized risk assessment/rating system, the CBvCSM advised that they have not submitted a similar request for assistance from De Nederlandsche Bank (DNB) and will make appropriate use of or leverage from relevant
(Continued)

4. **Currently, the supervision department of the CBvCSM uses different methodologies or approaches for conducting risk assessment and assessing the risk profile of institutions within the different sectors covered by its mandate.** Once the CBvCSM decides on an appropriate methodology for harmonized risk assessment across all sectors, consideration should be given to reassessing current and target staffing levels in the supervision department and the skills required for the effective implementation of the methodology. The mission team presented and discussed key behavioral and technical competencies for successful implementation and incorporation of a harmonized framework for risk assessment as part of its risk-based supervision (RBS) framework (or the CBvCSM equivalent, i.e. RFSF). The RBS entails conducting different types of activities across the supervisory cycle, including risk assessments, assessing the effectiveness of controls and governance to manage risk exposures, and assessing the risk profile of regulated institutions both currently and prospectively.
5. **The CBvCSM indicated to the mission team that it recently completed a Strengths, Weaknesses, Opportunities, and Threats (SWOT) analysis of the supervision sector⁵.** The SWOT analysis covered several areas (i.e. laws and regulations; workflow processes; perception of external stakeholders; organization, people, and resources; and internal and external developments) and strategies for addressing weaknesses during the period 2020 to 2024.

II. ORGANIZATIONAL STRUCTURE AND STAFFING OF THE SUPERVISION DEPARTMENT

6. **Effective January 2021, the CBvCSM implemented a new organization structure for supervision.** Under the revised structure, the supervision department is organized into 4 units. The revised organizational structure, responsibilities, and key deliverables of each unit are depicted in Appendix 1. The responsibilities of each unit are summarized below:
 - **Account Supervision:** responsible for maintaining and updating the overall risk profile of institutions. It is organized in three main groups: (1) Banks and Non-banks, (2) Insurance and Pension Funds, and (3) Investments Institutions, Fund administrators, Securities, Exchange Company, and Trusts. Each of these groups is organized by types of institutions.
 - **Expert Supervision:** responsible for assessing and assigning ratings to the different risk exposures of each regulated entity. It is organized in three groups: (i) financial

TA provided by CARTAC and/or the IMF-HQ to strengthen regulatory and supervisory oversight of the financial sector. The CBvCSM has requested follow-up TA to review and provide feedback on several risk management guidelines to support Basel II/III-Pillar 2 implementation and other supervisory processes in mid-2021. During the mission team's wrap-up meeting with the Deputy Director of Supervision on May 5, 2021, he advised that the CBvCSM will be requesting follow-up TA from CARTAC to implement the RBS framework proposed for consideration.

⁵ A PDF power point version (in Dutch) of the SWOT analysis report was provided to the mission team with the requirement that the content of the report should not be distributed or circulated. The version provided was machine translated by the mission team.

Risks (credit, market, insurance, etc.); (ii) cyber and operational risks, and (iii) Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT); governance, culture, behavior; compliance; and market conduct issues.

- **Cross Sector Supervision:** responsible for licensing, reassessments, and interventions and enforcements.
- **Supervision Policy:** comprised three sub-groups responsible for international cooperation, laws and regulations, and projects. Supervision Policy leads all initiatives relating to legislative amendments, introduction of new or amendments to existing regulations.

7. **The new organizational structure introduced in the supervision department with discrete functional units, including the establishment of a dedicated team for risk (Expert Supervision) assessment is not typically found in supervision departments at most Central Banks and other supervisory agencies in the region.** The new organizational structure could potentially enhance efficiency in the supervisory process and allow for the development of specialized teams to conduct focused risk assessments, and governance reviews. The new structure is similar to that in place at other supervisory agencies outside the region, such as Canada, United Kingdom, Australia, Malaysia in varying degrees. The allocation of supervisory responsibilities within the Account Supervision unit appears to reflect both sectoral and functional approaches to supervision⁶. Except for risk assessments, which will be conducted by staff within the Expert Supervision, all elements of the supervisory process for each regulated institution will be conducted by staff from the Accounts Supervision and the Cross- sectoral Department. The Supervision Regulation Department will be responsible for the drafting of supervisory policy guidelines and regulations.
8. **The mission team stressed the importance of coordination between the Account and Expert Supervision teams in planning and executing supervisory activities especially with respect to ongoing assessments of material risk exposures of each regulated institution.** All supervised institutions will require a minimum level of supervisory oversight, including onsite reviews, to identify weaknesses which cannot be easily detected via prudential reporting and offsite monitoring. Experience in other jurisdictions have shown that the bulk of supervisory time and resources, including focused risk assessments

⁶ The sectoral approach provides for institutions to be supervised based on industry – e.g. banking, insurance; while the functional approach focuses on the essential elements of supervision – off-site monitoring, on-site inspections and other specialized functions. The portfolio approach incorporates elements of the sectoral and functional approaches by assigning each institution to one supervisor or examiner who is responsible for all elements of the supervisory process. This approach is evident at some supervisory agencies in the region including those transitioning to risk-based supervision. For a discussion on supervisory architecture, see “**Financial Supervisory Architecture: what has changed after the crisis**”; Daniel Calvo, Juan Carlos Crisanto, Stefan Hohl and Oscar Pascual Gutiérrez; Bank for International Settlements, FSI Insights on policy implementation, No 8; April 2018.

will be allocated to financial groups⁷, high risk institutions irrespective of size and importance, and systemically important institutions⁸ during both normal and stressed situations. The mission recommends that a designated team of supervisors be assigned to each financial group comprising different types of regulated entities.

9. **Annex 1 shows the current staffing level in each of the 4 units within the supervision department.** Current staffing levels appears inadequate across all units given the number of regulated institutions, including entities deemed significant by the CBvCSM. The mission team was advised that the current staff levels in some units are below the optimal or approved level. The CBvCSM will need to urgently address inadequate staffing across the different units within the supervision department. If staffing levels across the different units are inadequate, the likelihood of supervisors devoting disproportionate level of resources to the largest institutions and groups will be high. All institutions require a minimum level of supervisory oversight, and if not done, may result in risks in some institutions remaining undetected or detected too late. Once the CBvCSM decides on a harmonized framework for risk assessment, it will need to reassess optimal staff levels that were earlier established for each unit, and skills required, both behavioral and technical for the effective implementation of the methodology, including assessment of financial and non-financial risks.

III. SUPERVISORY FRAMEWORK AND ASSESSMENT METHODOLOGIES

A. Risk-Focused Surveillance Framework

10. **The Risk-Focused Surveillance Framework (RFSF) adopted by the supervision department at the CBvCSM is designed to provide continuous regulatory and supervisory oversight.** The RFSF as articulated requires coordinated efforts and continuous exchange of information between the field examination function (on-site examination) and the financial analysis function (desk supervision) in Account Supervision to ensure that all members of the supervision department are kept informed about the risk profile of all regulated institutions and pension plans.
11. **The RFSF and workflow processes will be applied to each financial institution across all regulated sectors.** Appendix 2 summarizes the supervisory workflow processes for insurance firms, which appear very comprehensive for each of the six elements of the Risk-Focused Surveillance Cycle. The workflow processes are similar across each regulated

⁷ The CBvCSM advised that there are 8 financial groups operating in the jurisdiction. The groups are predominantly mixed-activity groups.

⁸ The CBvCSM reported a total of 22 “significant institutions” spanning the banking, insurance, pensions, and trust sectors. The CBvCSM defines an institution as “significant” based on the following criteria: the size of the institution, the market share, the number of customers, the products they offer and their relevance to the local financial system.

sector, except for minor variations to account for differences in business model or activities. The process includes the following activities, which are intended to be integrated: (i) risk-focused examination; (ii) financial analysis; (iii) review of internal/external changes/developments; (iv) priority system; (v) conduct supervision, and (vi) supervisory plan. The expectation is for supervisors to apply these processes consistently in developing the risk profile of each institution.

B. Assessment Methodologies

12. **Currently, each group of sectoral (Banks and non-bank institutions, Insurers and pension funds, and Securities and Trusts) supervisors utilize different methodologies to assess the risk profile of institutions within their respective sector.** The rating systems or methodologies used are also different:

- **Banks and non-bank institutions (credit unions and specialized credit institutions):** These institutions are assessed using CAMELS⁹ and two risk-based methodologies. Assessments under the two risk-based methodologies are based on: (i) the functional and business activities of an institution, and (ii) on categories of risk (e.g., credit, market, etc.) across all activities of an institution. An overall composite risk rating of either low, moderate, or high is assigned to institutions based on the functional approach. Assessment based on categories of risk assign similar qualitative ratings to each category of risk across an institution's activities and an assessment of the effectiveness of risk management for each the category of risk to arrive at the residual risk and its direction. However, neither of the above approaches consider an institution's resources (earnings, capital, and liquidity) in assessing the overall risk profile of these institutions - these are assessed under the CAMELS methodology.
- **Insurance and Pension funds:** Two different methodologies are utilized to assess the risk profile of institutions within these sectors. One approach considers various factors [Financial (including assets, solvency, liquidity, and earnings), Corporate Governance, Compliance and Other] to arrive at an overall assessment of the supervised entity. The assessments of these factors are subjectively aggregated to arrive at an overall assessment of the entity, which is rated as low, medium, or high. Similar to banks and non-bank institutions, the second approach focuses on risk categories. Assessment of capital is not considered in determining the overall risk profile of an insurer under the latter approach.
- **Securities and Trust:** supervisors utilize a risk matrix that requires an assessment of several factors, including type and size of an institution, lines of businesses, country of origin, reporting, financial position, level of complaints, and findings from a

⁹ **CAMELS:** a traditional methodology used for assessing banks and non-bank institutions. It requires an assessment of capital, assets, management, earnings, liquidity, and sensitivity to market risk as well as a composite rating for the institution. Numerical rating of one to five are used for these assessments. The lower the numerical rating assigned the stronger the area being assessed

questionnaire survey. Numerical ratings are assigned to the applicable factors, which are aggregated to arrive at a composite score for the entity.

13. **The use of more than one methodology, as is the case with two of the three sectors, to assess institutions results in significant duplication of effort and ineffective utilization of supervisory resources.** Since the underlying basis of assessments under the methodologies are different, they result in inconsistent assessments, which makes it difficult to reconcile and explain.
14. **As is evident from the above observations, there is an opportunity for the CBvCSM to harmonize supervisory methodologies and rating systems across the different sectors.** The CBvCSM needs to identify a methodology that could be used across all sectors, while recognizing that any methodology selected will require some modification for application in the different sectors due to differences in the underlying businesses, and objectives of supervision (prudential or market conduct).
15. **There appears to be some element of overlap between the responsibilities of the Expert and Account Supervision units.** It is unclear how the risk assessment conducted by the Expert Supervision team will be integrated with the analytical work performed by Account Supervision. The staff within Expert Supervision will be responsible for conducting, inter alia, supervisory work relating to risk identification and assessment, including the assignment of ratings, and advising on risk mitigation strategies. The responsibilities of the supervision team within Account Supervision include ongoing monitoring and updating the risk profile of supervised institutions, which will necessitate utilizing the results of assessments undertaken by Expert Supervision. It is also unclear which of the two units will assume the lead role in determining the risk profile of each institution and engaging with supervised institutions in executing supervisory work on an ongoing basis.
16. **The mission recommends that experienced staff from Account Supervision be assigned as the Relationship Manager (RM) or Lead Supervisor for each institution or portfolio of institutions within the same sector.** The RM or Lead Supervisor should be supported by a team of supervisors if assigned to a financial group. The RM's principal responsibilities should include all aspects of supervisory work relating to planning and executing the annual supervisory plan and multi-year supervisory strategy for each assigned institution and/or financial group, including review and updating their respective risk profile; liaising and collaborating with staff within Expert Supervision to undertake and share the results of review and assessment of control functions and risk (e.g. credit, market, operational) conducted. The results of these reviews should be utilized by the RM and staff in Account supervision as inputs in assessing and updating the risk profile of supervised institutions.

IV. PROPOSED HARMONIZED FRAMEWORK FOR SUPERVISORY ASSESSMENTS

A. Essential Features

17. **Based on the findings from the review, including discussions held with the different groups of sectoral supervisors, the mission team concluded that it is practical and feasible to develop and implement a harmonized risk rating or assessment methodology.** The mission discussed different risk-based supervisory approaches and risk assessment methodology adopted by various jurisdictions, including the approach adopted by several member countries of CARTAC. Irrespective of the harmonized rating system ultimately adopted by the CBvCSM, the methodology should reflect the following features which have been incorporated in the RBS approach adopted and being implemented by several member countries of CARTAC:
- **Flexibility:** should allow for application across deposit-taking institutions, insurers, trust, pensions, and asset management companies. Any differences in the methodology and its application should be based on the underlying business model of the regulated entity and supervisory objectives (prudential vs. market conduct as in the case of trusts, and asset management companies).
 - **Uniform rating scale or assessment system:** ideally the rating scale adopted should be limited to 4-level system rather than 3 or 5 levels to prevent supervisors opting for the mid-point of the rating scale in their assessments even when not warranted. The use of numerical rating sometimes results in averaging of risk ratings to determine overall assessment rating without considering the materiality or significance of each rating. To allow for differentiation between ratings assigned to risk, control functions, and other areas of institution's operation such as capital, and liquidity, the use of numerical rating scale should be avoided.
 - **Uniform definition and assessment criteria for risk categories and control functions:** The supervision department has identified several risk categories, and control functions (such as compliance, governance, internal audit), which will be assessed by staff within the Expert Supervision unit.

B. Recommendations

18. **The key elements of the RBS framework adopted by several member countries of CARTAC was discussed during one of the two presentations delivered by the mission team¹⁰.** The methodology was briefly discussed with the President of the CBvCSM at the end of the mission. The mission recommends that the CBvCSM consider as an option for implementation, the framework adopted by several member countries of CARTAC. The framework reflects all the above features and includes a harmonized approach for conducting supervisory assessment and assigning ratings across banks, insurers, and trust

¹⁰ Copies of both presentations delivered by the mission team are attached at Appendix 4

companies¹¹. It incorporates all elements of the CAMELS and CARAMELS framework utilized by some jurisdictions for supervisory review and assessment of banks, and insurance firms, respectively¹². The proposed methodology is similar to the methodology currently used to assess banks and non-bank institutions at the CBvCSM based on functional activities described above. However, there are some material differences in how activities are identified for assessment purposes and how risk mitigation is assessed. This methodology also considers the adequacy of an institution's capital, earnings, and liquidity to assess its overall risk profile.

- 19. The framework proposed for consideration is activity-based and reflects how institutions manage their business activities and risk exposures irrespective of the sector.** The approach would result in high level of consistency across the sectors in terms of the methodologies and related rating systems, which is a key objective of the supervision department. The approach can also be applied to the pension sector with appropriate modifications as is the case for the supervision of private pension plans in Canada¹³. The supervisory rating classifications are qualitative, and rating terminologies assigned to risk assessments are different from those assigned to control functions, capital, earnings, liquidity, and solvency and funding (in the case of pension plans). The approach and training of staff would entail: (i) identification of the activities of an institution (ii) an assessment of the risks inherent in those activities, (iii) an assessment of mitigation by the institution in the context of the risks inherent in its activities, and (iv) an assessment of the adequacy of an institution's capital, earnings, and liquidity in relation to the residual risk across all activities taken together.
- 20. Additional considerations to support the transition to harmonized rating/assessment framework should include resourcing and staffing strategies, and the importance of an effective oversight process to ensure consistent application of the methodology across the Account and Expert Supervision units.** The mission discussed key elements, including behavioral and technical competencies, adequate staffing, training and strategies to build supervisory competencies, change management and leadership, that are essential

¹¹ A copy of the RBS Framework is attached at Appendix 3. Appendix 3 also includes copy of a TA Report prepared by CARTAC, which reviewed and assessed implementation of the RBS methodology across several member countries of CARTAC.

¹² **CAMELS:** Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to Market Risks; **CARAMELS:** Capital, Asset, Reinsurance, Actuarial, Management, Earnings, Liquidity, Subsidiaries. CARAMELS is currently utilized by the CBvCSM for the supervision of insurance companies. Neither CAMELS nor CARAMELS are inherently risk-based. The insurance supervisors at the CBvCSM currently utilize the STAMECERRR framework (Solvency, Technical Provisions, Assets, Management, Earnings, Compliance, Earnings, Reinsurance, Ratios, and Risks) to assess various areas of an insurance company's operations. The framework reflects some elements of CARAMELS but is not risk-based.

¹³ Risk Assessment Framework for Federally Regulated Private Pension Plans; Office of the Superintendent of Financial Institutions Canada (<https://www.osfi-bsif.gc.ca/Eng/pp-rr/rai-eri/Pages/default.aspx>)

for the successful implementation of risk-based supervision. Senior management's oversight and leadership along with an effective quality assurance process will be necessary to prevent the development of silos and inconsistent application of the methodology. Strategies to prevent silo-driven operations across supervisory teams should be considered as part of the reassessment of the current supervisory practices and processes during the implementation of the harmonized risk rating methodology.

V. CONCLUSION

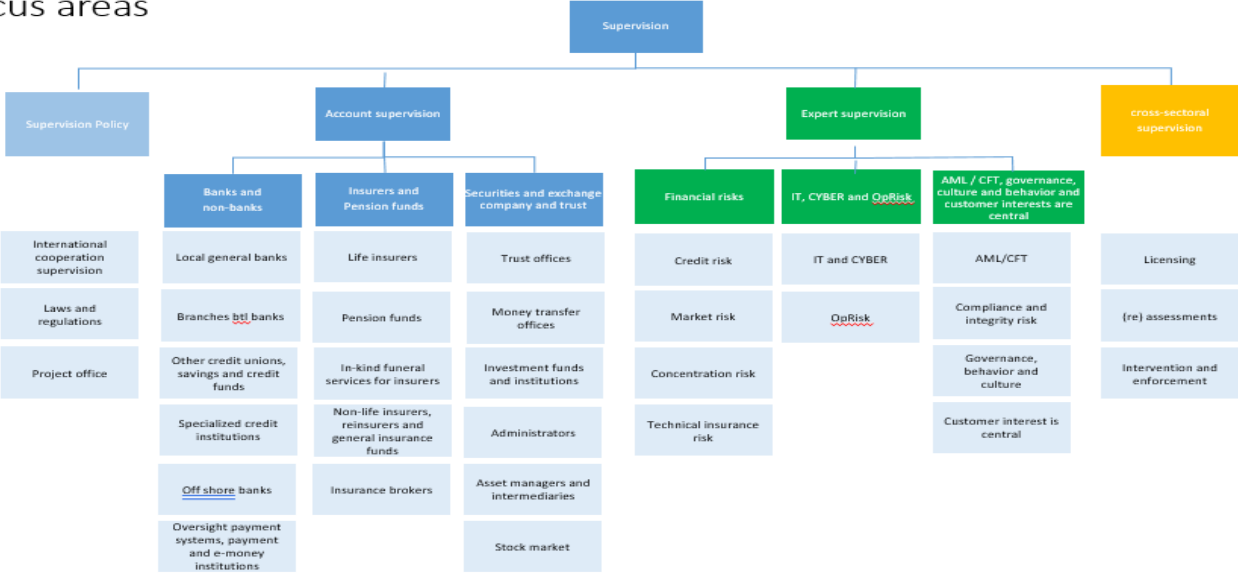
21. **The framework being proposed as an option for consideration is a generic methodology that will need to be adapted to the circumstances and requirements of the CBvCSM.** Transition from the current system of multiple rating/assessment methodologies to assess institutions within different sectors to a harmonized rating system will be a multi-year process that will require appropriate planning, commitment, and technical assistance. The process will require some modification in current supervisory practices and processes to facilitate effective implementation of the methodology. The CBvCSM has established timeframes for addressing staffing related issues. The implementation of the harmonized rating/assessment methodology as part of the overall process of strengthening the institutional structure and operational procedures for RBS is scheduled for 2021 to 2024.

Appendix 1

Supervision Department: Organizational Structure, Key Responsibilities, and Deliverables

Blueprint for new tz organization focus areas

Rectangular Snip
DRAFT



detail processes

Supervision Policy	Account supervision	Expert supervision	Cross sectoral TZ
<ul style="list-style-type: none"> Develop supervisory policy Drafting and implementing the legal and regulatory calendar Drafting draft legislation and AVVs Source of information for the interpretation of legislation and regulations and Q & As Preparing international consultative bodies MoUs for home-host supervision & supervisory colleges Training and information on supervisory legislation and regulations and supervisory policy Project office 	<ul style="list-style-type: none"> Conduct regular supervisory interviews with the institution, the Supervisory Board and external auditor Follow up on signals in ongoing supervision Update the institution's risk profile based on signals, investigations and reports Assess the institution's risk profile and indicate priorities for further investigation Prepare administrative decisions that require approval from CBCS as a supervisor Draw up annual monitoring calendar setting and monitor its implementation Internal and external management of supervisory relationships Directing the implementation of oversight of payment systems Risk mitigation by drawing up two-pager (conducting the risk assessment and root cause analysis and drawing up the supervisory objectives and supervision strategy) and direct its implementation. 	<ul style="list-style-type: none"> Risk identification at supervised institutions and drawing up supervisory reports with findings and risk scores based on investigations, risk surveys, assessments, periodic analyzes, etc. Complaints handling and market conduct Advising on risk mitigation at an institution for the risk areas concerned In collaboration with account supervision, assess the products to be delivered by the institution based on the supervision strategy that is being implemented Co-drawing up supervision policy and legislation and regulations for the risk areas involved Developing monitoring tools, such as research work programs, checklists for assessments and regular risk surveys and reports Training, information and first line of information regarding various risk areas 	<ul style="list-style-type: none"> Assessment of license requests and accessions Assessment of illegal immigrants File management for voluntary redundancies and liquidations Conduct fitness assessments Conduct assessment of shareholders and UBOs Provide binding advice and formulate formal supervisory measures in ongoing supervision, including fines, periodic penalty payments and retests Co-drawing up supervision policy and legislation and regulations for own areas of special interest Training, information and first line of information regarding own areas of attention

draft deliverables

Supervision Policy	Account supervision	Expert supervision	Cross sectoral TZ
<ul style="list-style-type: none"> Legislative and regulatory calendar Draft legislation General Binding regulations External guidance Internal policies Q & As Policy notes Files external consultation MoUs Speeches, presentations and workshops Rolling project calendar Two-pager progress reports Project progress reports 	<ul style="list-style-type: none"> Supervisory year calendar setting Risk profile institution Two-pagers Results of supervisory interviews Findings of the external auditor and internal supervision Instruction letters Designation letters Penalty letters Order subject to periodic penalty payments Successful risk mitigation Research proposal for expert departments Proposal for legal decisions Administrative decisions 	<ul style="list-style-type: none"> Investigate annual calendar Work programs Checklists Risk surveys Risk reports Risk score methods Research reports Peer group analyzes Grade assessments Findings and risk scores Technical advice own risk areas Internal policy rules for own risk areas Answers to interpretation questions Education and training for deductible areas 	<ul style="list-style-type: none"> Permits and licenses Registrations in and cancellations from register Termination letters in case of voluntary liquidation Instruction letters <u>illigals</u> Decisions tested (co-) policymakers Decisions tested shareholders Compelling advice on the application of intervention and enforcement instruments External progress information on procedures in progress (reviews, permits, etc.) Warnings

Source: Central Bank of Curacao and St Maarten

Appendix 2

Workflow Processes – Insurance



Appendix 3

Risk-Based Supervisory Framework



DRAFT for DISCUSSION

**Risk-Based
Supervisory Framework**

September, 2013

Note: This draft Supervisory Framework is developed as a generic framework. It will need to be adjusted for use by a given supervisory agency in a country.

Prepared for the Caribbean Regional Technical Assistance Center by Naren Sheth, NAS Consulting Inc.

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1. INTRODUCTION

A supervisory agency's activities can be divided into two broad functions: regulation and supervision.

Regulation involves the development, consultation, introduction and enforcement of appropriate legislations, regulations and guidelines for institutions, including authorizing institutions to operate in and from the country.

Supervision involves dynamic assessments of the operations of supervised institutions to ensure they continue to operate in a safe and sound manner and comply with their governing statutes or supervisory requirements, and intervening effectively on a timely basis in cases where prudential issues or concerns are identified.

The supervisory framework is a principle- and risk-based structured methodology designed to facilitate pro active and dynamic assessment of supervised institutions. It is outcome focused with sufficient flexibility to enable supervisors to identify and respond to new and emerging risks through an integration of macro economic and industry perspectives in the assessment of individual institutions.

The framework provides a structured approach for understanding and assessing key risks inherent in an institution's activities, whether its risk management processes (i.e. identification, assessment, measurement, monitoring, controlling, mitigating and reporting of risks) are adequate in the context of the key risks and whether its earnings, capital and liquidity are sufficient to enable it to support its risk profile and withstand unexpected shocks.

2. SUPERVISORY APPROACH

The following are the key principles of the supervisory approach:

1. It is risk and principle based, forward-looking and outcome focused.

2. It recognizes that Board of Directors and Senior Management of institutions are primarily responsible for their financial soundness and prudent management.
3. It is intended to reduce the risk of failure or inappropriate behavior by institutions; but, it cannot prevent all failures as that would result in excessive regulatory burden for the industry and could negatively impact its efficiency.
4. Supervision of institutions is conducted on a consolidated basis, in coordination with other regulators and using information from them as appropriate. It includes an assessment of all material entities, both national and international.
5. The exercise of sound judgment in identifying and evaluating risks is central to the effectiveness of the supervisory approach.
6. Where appropriate, the agency leverages of the work of the institution's Corporate Oversight and Governance functions to minimize duplication of effort.
7. Communication of assessments and recommendations to institutions are risk focused and timely.
8. The level and frequency of supervisory scrutiny and the degree of intervention depends on the risk profile of the institution. Institutions that are well managed relative to their risks will require less supervision. Not all areas within an institution need to be reviewed every year.
9. It enables the assessment of the risk profile of an institution to be maintained current and provides an objective basis for allocating supervisory resources across institutions and within an institution.
10. The agency relies on external auditors for the fairness of the financial statements and uses their work to modify the scope of its reviews to minimize duplication of effort. Similarly, the agency relies on actuaries for the adequacy of policy liabilities and uses their work to modify the scope of its work.

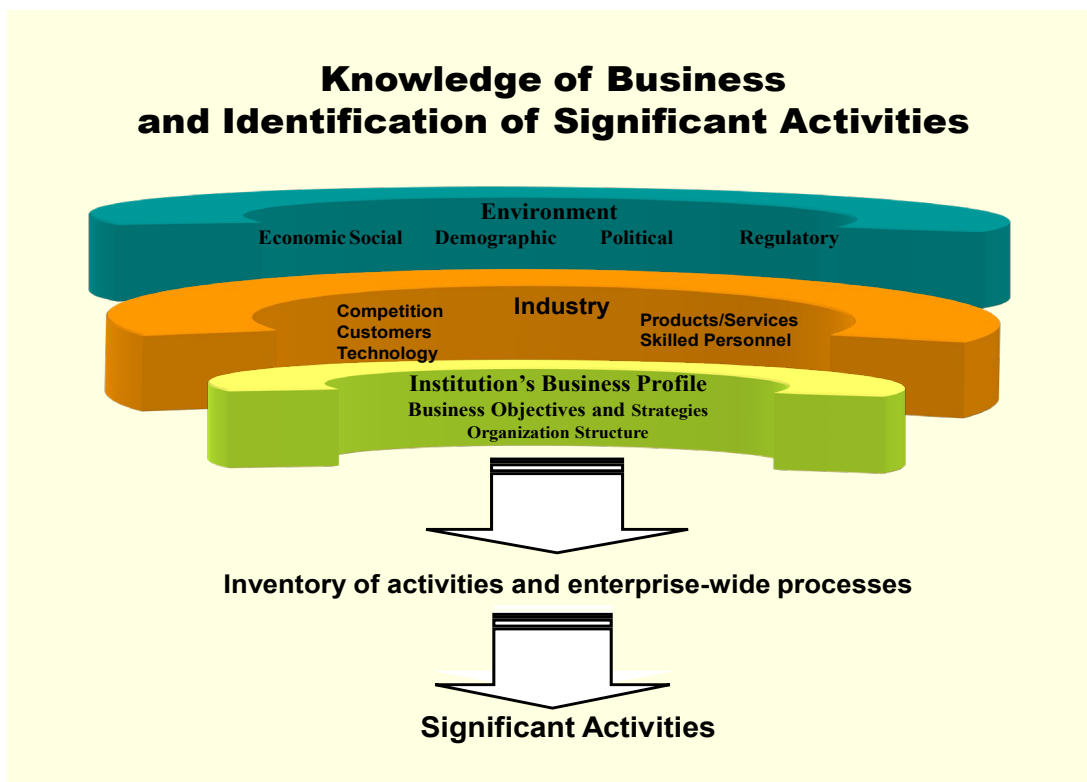
3. BENEFITS

The key benefits of the supervisory approach are:

1. closer integration of macro and micro prudential supervision, with focus on early

- identification of emerging risks to facilitate timely interventions;
2. assessments parallel how an institution is managed;
 3. better evaluation of risk through separate assessment of inherent risks and risk management processes resulting in a deeper understanding of an institution's operations, its risk appetite and the key drivers of its risk profile;
 4. early identification of institutions and areas in institutions with prudential issues and concerns;
 5. cost effective utilization of resources through prioritization of supervision based on risks;
 6. reporting risk focused assessments to institutions for desired outcomes;
 7. reducing regulatory burden on well managed institutions;
 8. encouraging a strong risk management culture in institutions; and
 9. providing flexibility for supervisors to use professional judgment within a structured approach.

4. INTEGRATING MACRO AND MICRO PRUDENTIAL SUPERVISION



The operations of financial institutions are increasingly more connected with each other and with other segments of the economy. Consequently, effective supervision of institutions require an understanding and an assessment of the broader economic and industry environment in which institutions operate.

The supervisory methodology looks beyond individual institutions. It adopts a stronger macro prudential perspective with a focus on specific areas of risk and supervisory themes, without detracting from the supervision of individual institutions. This enables it to identify, monitor and analyze, market, financial and other material environmental factors that could impact an institution and the financial sectors.

Methods of introducing macro prudential supervision factors include surveillance of the broader economic environment and the industry to identify emerging trends and vulnerabilities,

as well as peer comparisons of individual institutions. It also includes regular exchange of information and assessments with other regulators as appropriate. .

Through this process, supervisors also engage management of financial institutions in a discussion of risks facing their institution as well as their views on risks in the industry and the broader operating environment.

The assessment aims at establishing a dynamic approach to identifying potential risks and vulnerabilities. It enables supervisors to link activities and risks of individual institutions to the industry and the wider financial system and visa versa. This assessment process is iterative.

Macro Prudential Risk Factors

Identifying and monitoring macro prudential risk factors in an institution's operating environment requires monitoring of factors such as level of economic activity and gross domestic product, financial market indices, level of business failures, level of interest rates – current and projected, projected rates of inflation, health of the real estate sector, availability of investment products, introduction of new products, country risks, etc.

By monitoring the important macro prudential factors, supervisors are able to assess their probable impact on the industry as well as on individual institutions.

Industry Risk Factors

Industry analysis involves research and assessments of the state of the industry with a view to identifying issues or emerging risks. Industry analysis is based on periodic information filed by institutions with the agency as well as on industry information available from other sources such as industry publications, rating agencies, etc. It provides supervisors with an up-to-date information on industry developments and emerging issues and trends.

Supervisors consider factors such as trends and experience on products and services offered, nature and extent of competition, introduction of new products, trends in growth, profitability, capital levels and liquidity, availability of required skilled resources, investment trends, rate of return on investments, etc.

The analysis, done on a comparative basis, provides supervisors with a good understanding of industry experience and trends, as well as risks faced by the industry and system-wide vulnerabilities.

The analysis provides a macro industry level input into the supervisory process and equips supervisors to assess individual institutions in the context of the industry, supported through peer comparisons.

Agencies normally centralize macro-economic and industry level analysis in a given group for efficiency and consistency, with the results of the analysis shared regularly with supervisors for them to consider in the assessment of their institutions.

Institution's Business Profile

To understand the business profile of an institution, supervisors need to understand its business objectives, strategies to achieve its objectives, and organization and accountability structures used.

A supervisor needs to understand how the institution plans to achieve its objectives, and the activities it engages in or plans to engage in. It is also important to understand the institution's risk tolerance as well as the institution's track record in executing its strategies. The institution's organization and accountability structures need to be aligned with its strategies for successful execution.

Other factors that need to be considered include: growth strategies and the level of growth compared to peers and economic indicators, actual performance against plans, earnings and capital levels and trends, new products and activities being pursued, nature and stability of funding sources, nature and level of off balance sheet exposures, asset quality and concentrations, delinquencies compared to industry experience, liquidity, etc.

5. ASSESSING RISK PROFILE OF AN INSTITUTION

An understanding and assessment of the broader economic and industry environments and the institution's business profile provides the supervisor with the necessary context for

assessing the institution's risk profile.

Assessing the risk profile of an institution is a dynamic process comprising the following steps:

1. Identifying Significant Activities;
2. Assessing key risks inherent in each Significant Activity;
3. Assessing Operational Management, Corporate Oversight and Governance for each Significant Activity;
4. Assessing residual risk in each Significant Activity;
5. Assessing Overall Residual Risk for all Significant Activities;
6. Assessing Earnings, Capital and Liquidity; and
7. Assessing the Risk Profile of the institution.

The above steps are interrelated and operate in a dynamic manner. They represent building blocks for assessing the risk profile of an institution. The quality of assessment in each step can impact the quality of the assessments in the steps that follow, ultimately impacting the quality of the overall assessment. Hence, it is important that each step is carried out at an appropriate level of quality for a sound overall assessment of the institution's risk profile.

The above steps are discussed below.

A risk matrix (Appendix A) is used to summarize the assessments made through the supervisory process.

The risk matrix highlights the institution's Significant Activities, key risks inherent in those activities, how well the key risks are managed and overseen, residual risk for each Significant Activity, residual risk in all Significant Activities taken together, adequacy of its capital, earnings, and liquidity and the risk profile as well as direction and stability of the

risk profile. The risk matrix provides a one page window into the institution's operations and facilitates visualization of the components that are the key drivers of the institution's risk profile.

Assessments recorded in the risk matrix are supported by supervisory documentation.

Identifying Significant Activities

An institution's activities can include a line of business, business unit or an enterprise-wide process (such as information technology). Its activities can be identified from various sources of information, including its organization structure, strategic and business plans, capital allocations, internal and external financial reporting; etc.

Once an institution's activities are identified, sound judgement is applied in determining the significance or materiality of the activities. Materiality for this purpose is a measure of the relative significance of the activities to the attainment of the institution's objectives. It is multi-dimensional, current and prospective and considers both qualitative and quantitative factors.

The following are examples of criteria that may be used for determining materiality:

- a. assets generated by the activity in relation to total assets;
- b. revenue generated by the activity in relation to total revenue;
- c. net income before tax for the activity in relation to total net income before tax;
- d. risk-weighted assets generated by the activity in relation to total risk-weighted assets;
- f. internal allocation of capital to the activity in relation to total capital, and
- g. strategic importance.

Activities identified as significant would be those that are important to the achievement of the institution's business objectives and strategies. They would also generally parallel those

considered significant by management and how they are organized and managed by the institution. It may be appropriate to group or sub-divide activities for efficient and effective assessment. However, in doing so, supervisors need to ensure that key risks in the activities are not masked and would be assessed at an appropriate level.

Once activities considered significant (i.e. Significant Activities) are identified, risks inherent in those activities are assessed.

Assessing Risks Inherent in Significant Activities

Inherent risk is a risk which cannot be segregated from the activity. It is intrinsic to an activity and arises from exposure to and uncertainty from potential future events. Inherent risks are evaluated by considering the degree of probability and the potential size of an adverse impact on an institution's capital or earnings.

A thorough understanding of the environment in which an institution operates and its various business activities is essential to effectively identify and assess risks inherent in its activities. For assessment purposes, inherent risks are grouped in the following six categories:

- credit;
- market;
- insurance;
- operational;
- legal and regulatory; and
- strategic.

An institution's Significant Activities are likely to have a number of above risks. However, since the inherent risk assessments are in the context of assessing the risk profile (safety and soundness) of an institution, supervisory assessments are focused on risks that are likely to have a material impact on the institution's risk profile; i.e. key risks in its Significant Activities.

Key risks are assessed without regards to the size of the activity and without considering the impact of risk mitigation by the institution. The assessment is dynamic and forward looking. Size of the activity is considered separately in assessing Overall Residual Risk in all of the institution's Significant Activities taken together.

The levels of key inherent risks are assessed as **Low (L), Moderate (M), Above Average (AA) or High (H)**. The above risk categories and the rating definitions are described in Appendix B.

The assessment of the level of key risks inherent in an institution's Significant Activities enables a supervisor to build expectations of the type and rigour of risk management and controls that would be required by the institution to effectively manage the key risks down to acceptable levels. This, in turn, equips the supervisor to assess the quality of the institution's risk management and controls in the context of the key risks inherent in its activities. The higher the level of inherent risks, the more rigorous the day to day management and oversight are expected to be.

Assessing Operational Management, Corporate Oversight and Governance

The quality of risk management and controls for each Significant Activity is assessed at two levels:

- An assessment of the day to day management of the Significant Activity (Operational Management); and
- An assessment of the Corporate Oversight and Governance for the Significant Activity.

Operational Management

Operational Management is primarily responsible for the day to day management of a Significant Activity. This function ensures that policies, processes, control systems, staff levels and experience are sufficient and effective in managing and mitigating the key risks inherent in the Significant Activity. The organization structure and controls must be effective in preventing and detecting material errors and irregularities in a timely manner.

The degree to which an institution's Operational Management for a Significant Activity needs to be assessed directly depends on the assessment of the effectiveness of its Corporate Oversight and Governance functions. In cases where Corporate Oversight and Governance functions are assessed as effective, supervisors would be able to use the results of the work carried out by these functions in respect of the activity as input into the assessment of the effectiveness of Operational Management for the activity. Where institutions lack some or all of the Corporate Oversight and Governance functions (e.g. in case of branches), supervisors look to other functions, within or external to the institution, that handle these responsibilities.

Corporate Oversight and Governance

The presence and nature of Corporate Oversight and Governance functions vary based on the size, structure and complexity of an institution.

Institutions incorporated in the country are required by legislation to have a Board of Directors and Senior Management. In branches of institutions incorporated outside the country, the principle officer generally carries out the role and responsibilities of Senior Management.

The Board of Directors is ultimately accountable for the management and oversight of an institution. The Board normally delegates management and oversight responsibilities to Senior Management. Depending on the size and complexity of an institution, Senior Management, in turn, may delegate some of its oversight responsibilities to other oversight functions. Oversight functions that may be set-up include Risk Management, Internal Audit and Compliance.

Senior Management retains the responsibilities not delegated to oversight functions.

In smaller institutions, Senior Management sometimes performs responsibilities normally carried out by Operational Management. In these cases, the institution will need to demonstrate how independent oversight is provided over these responsibilities.

Operational Management, Corporate Oversight and Governance functions are assessed as **Strong (S), Acceptable (A), Needs Improvement (NI) or Weak (W)**. These rating categories are described in Appendix C.

Assessing Residual Risk in each Significant Activity

The assessment of the residual risk in each Significant Activity considers the extent to which the key risks inherent in the activity are effectively managed by Operational Management and independently overseen by Corporate Oversight and Governance functions. For each Significant Activity, the effectiveness and oversight of each key inherent risk is considered separately and then compiled into an assessment of the residual risk for the activity. Hence, these assessments are multi dimensional and are based on informed qualitative judgements.

For example, a corporate lending activity may be assessed as having a high credit risk, and a moderate level of operational risk. However, the residual risk for the activity may be assessed as moderate due to an acceptable level of risk management by Operational Management and a strong oversight by Internal Audit and Senior Management and an acceptable level of oversight by the Board.

Net residual risk for an activity is assessed as **Low (L), Moderate (M), Above Average (AA) or High (H)**.

The following table is used to guide the residual risk assessments.

Quality of Risk Management	Level of Inherent Risk			
	Low	Moderate	Above Average	High
Strong	Low	Low	Moderate	Moderate
Acceptable	Low	Moderate	Above Average	Above Average
Needs Improvement	Moderate	Above Average	High	High
Weak	Above Average	High	High	High

Direction of residual risk

The residual risk assessments include a determination of the direction of residual risk. Direction is assessed as **Decreasing (D)**, **Stable (S)**, or **Increasing (I)** over an appropriate time horizon for the institution; for example, generally the time horizon for a larger more complex institution may need to be longer than for a smaller institution.

Assessing Overall Residual Risk for all Significant Activities

Overall Residual Risk of all Significant Activities taken together is a weighted aggregate of the residual risk of the individual Significant Activities. The assessment considers the residual risk in each activity and its relative materiality in developing the overall assessment. The overall assessment is a qualitative assessment of the institution's susceptibility to adverse events that might impact its earnings or capital in the foreseeable future.

Overall Residual Risk is rated as **Low (L)**, **Moderate (M)**, **Above Average (AA)** or **High (H)**. Definitions of these rating levels are included in Appendix D.

The direction of Overall Residual Risk is assessed as **Decreasing (D)**, **Stable (S)**, or **Increasing (I)**.

Assessing Earnings, Capital and Liquidity

After assessing the Overall Residual Risk in an institution's Significant Activities, supervisors assess Earnings, Capital and Liquidity in the context of the Overall Residual Risk. Under the methodology, Earnings and Capital are first assessed separately to understand how they individually contribute to the safety and soundness of the institution, and then considered together to assess their adequacy in the context of the Overall Residual Risk in the institution's Significant Activities.

Earnings, Capital and Liquidity are assessed as **Strong (S)**, **Acceptable (A)**, **Needs Improvement (NI)** or **Weak (W)**. Definitions for these rating levels are included in Appendix E. The criteria used to assess Earnings, Capital and Liquidity are summarized below:

Earnings

Earnings are intended to provide for an institution's expected losses, generate an adequate return for the shareholders and contribute to capital.

The assessment of earnings considers the quality, quantity, volatility, composition and sustainability in the context of the institution's business objectives and its Overall Residual Risk. It also considers historical trends and future outlook, both under normal and stressed

conditions, as well as reliability of its contribution to capital.

Capital

Capital represents resources of an institution to enable it to withstand unexpected losses and shocks (i.e. it is an institution's safety net.).

The assessment of capital considers the adequacy of capital (quality and quantity) both at present and prospectively and under normal and stressed conditions in the context of the institution's Overall Residual Risk. It also considers capital management processes, access to capital in the context of the institution's Overall Residual Risk and planned business activities. It is not sufficient for an institution to merely meet minimum regulatory requirements. Capital has to be sufficient to support the risk profile of the institution as well as its planned activities. Also, no matter how substantial an institution's capital is, it cannot be considered a substitute for appropriate risk management and oversight of the institution's activities.

Assessment of a bank's ICAAP is integral to the assessment of the adequacy of its capital in the context of its risk profile.

Capital planning and management needs to be effectively overseen by Senior Management and the Board.

Liquidity

Adequate level of liquidity is critical for the overall safety and soundness of an institution.

Assessment of liquidity considers the current level and prospective sources of liquidity compared to funding needs (both under normal and stressed conditions) as well as the

adequacy of liquidity management practices in the context of the size, complexity, and risk profile of the institution. The assessment, for example, considers:

1. The availability of assets readily convertible to cash without undue loss;
2. Access to various sources of funding;
3. The level of diversification of funding sources;
4. The degree of reliance on short-term and volatile sources of funds;
5. The trend and stability of deposits;
6. The capabilities of management to identify, measure, monitor and control the institutions liquidity position, including the effectiveness of fund management strategies, liquidity policies, management information systems and contingency funding plans.

Liquidity management needs to be effectively overseen by Senior Management and the Board.

Assessing the Risk Profile of the Institution

The assessment of the risk profile is an overall assessment of the institution after considering the adequacy of its capital supported by earnings, and its liquidity in the context of the Overall Residual Risks in its Significant Activities. It is an assessment of the safety and soundness of the institution.

The risk profile is assessed as **Low (L), Moderate (M), Above Average (AA) or High (H)**. Definitions of these rating levels are included in Appendix F.

The assessment also includes an assessment of the direction of the institution's risk profile. Direction is assessed as **Decreasing (D), Stable (S) or Increasing (I)**.

The stability of the assessment is indicated in terms of a time frame. For example, a shorter

time frame is assigned in cases where the risk profile is likely to be more volatile and a longer time frame in cases where the risk profile is expected to be more stable.

The supervisory methodology provides for a baseline level of activity to assess the risk profile of each institution. It provides the basis from which to determine risk based priorities and the level of intervention considered necessary in individual cases. Once an institution's risk profile has been assessed it is refreshed through a dynamic assessment of the impact of any material changes for the institution. Accordingly, beyond this dynamic monitoring and up-dating of an institution's risk profile, most of the supervisory resources are invested in institutions that require attention based on their risk profile and the prudential issues that need to be addressed.

6. GUIDE TO INTERVENTIONS

The supervisory methodology includes an intervention system that triggers appropriate supervisory actions when prudential concerns of an institution become elevated. The objective being to ensure these concerns are addressed on a timely basis.

A Guide to Intervention is included as Appendix G. It outlines the types of actions that supervisors consider, depending on the institution's risk profile and the nature and significance of prudential concerns.

The intervention process is not rigid and every situation cannot necessarily be addressed with a predetermined set of actions. Accordingly, the actions indicated in the guide are for a range of ratings; for example, Low to Moderate, Moderate to Above Average, etc. Circumstances may vary significantly from case to case. The guide should not be interpreted as limiting the actions that can be taken in dealing with specific concerns. The guide aims to outline at which level an intervention would typically occur. The actions indicated are cumulative; i.e. actions indicated at the lower level of risk are implicitly included in actions

that could be considered for institutions with a higher risk profile. Also, if circumstances warrant, actions can be taken at a risk level lower than that indicated in the guide.

7. OVERALL ASSESSMENT OF CORPORATE OVERSIGHT AND GOVERNANCE FUNCTIONS

The methodology facilitates the development of an overall assessment of the effectiveness of the Corporate Oversight and Governance functions. The overall assessment combines an assessment of the characteristics of the functions (how they have been set-up to provide the oversight) and an assessment of their effectiveness (how well they carry out their oversight roles) across all Significant Activities of the institution.

Corporate Oversight and Governance functions are rated as **Strong (S)**, **Acceptable (A)**, **Needs Improvement (NI)** or **Weak (W)**.

Rating definitions, criteria for assessing the characteristics and examples of performance indicators are summarized in Appendix H. Performance assessment, which is the major part of the overall assessment, is derived from the effectiveness assessments for the function across the institution's Significant Activities.

8. CONSOLIDATED SUPERVISION

Consolidated supervision is an essential tool for supervising financial groups. It involves a comprehensive approach that seeks to evaluate the strength of an entire group, taking into account all the risks which may affect the group, regardless of whether the risks are carried by the institution or related entities.

In the case of financial groups, the methodology is applied at the level of the top regulated entity in the group (either operating or non-operating) to ensure that all risks incurred by the group, no matter where they are located or booked, are evaluated and controlled across the group on an enterprise-wide basis. All assessments are made and documented on a consolidated

basis. Various regulatory requirements (e.g. concentration limits, large exposure limits, liquidity, capital, intra-group exposures, off-balance sheet exposures, etc.) are monitored and assessed on a consolidated and on a solo basis to ensure compliance.

The assessments consider the implications of, and relationship with, other regulated and non-regulated down-stream entities in the group, as well as potential impact of up-stream or other related entities outside the supervised group. The latter are assessed for any contagion risks likely to emanate from them for the supervised group.

Not all regulated entities in a group require separate standalone assessments. Separate or standalone assessments may be necessary in the following circumstances:

1. Where the regulated subsidiary represents a significant part of the consolidated entity and is operated independently of the group.
2. Where a regulated subsidiary requires a more in-depth review to adequately assess the subsidiary's impact on the consolidated entity than would be possible at the consolidated level.
3. Where a regulated subsidiary's risk management and control practices are distinct from those of the group, and
4. Where regulated entity's risk profile is materially different from that of the group.

For groups operating across borders, supervisors will need to deal with home/host considerations. These would include establishing memorandum of understandings, regular and timely exchange of information, co-ordination of supervisory activities, co-ordination of supervisory intervention as appropriate, establishment of colleges of supervisors, etc.

9. THE SUPERVISORY PROCESS

The agency appoints a Relationship Manager (RM) for each institution. The RM is the key contact for the institution at the agency and is responsible for the on-going supervision of the institution and ensuring that supervisory processes are completed effectively and on a timely

basis.

The main steps of the supervisory process are illustrated below. Although the steps are described sequentially, updating of the risk assessment is a dynamic, iterative and a continuous process requiring frequent reassessments at various stages.



Planning

Supervisory planning involves developing/updating a supervisory strategy for an institution and developing an annual supervisory plan.

A supervisory strategy is a multi-year plan for supervising an institution, taking into account the nature, size, complexity and risk profile of the institution. It outlines the supervisory work

planned for three to four years, with an overall objective of reviewing all material areas of the institution at least once during the cycle. Supervisory work on significant activities is planned and prioritized after considering their residual risks, when they were last reviewed, the volatility of the activity, and the importance of the activity in the context of the risk profile of the institution. Not all activities of an institution need to be reviewed each year; but, higher risk or more volatile activities may need to be reviewed more frequently.

Similarly, supervisory work for each relevant oversight function is planned and prioritized based on the assessment of the quality of its oversight, timing of its last review and the level of changes in the function.

The supervisory strategy is the basis for a more detailed annual supervisory plan, which indicates work planned for the year and the required resources.

In addition to institution specific supervisory planning, planning also includes comparing allocation of supervisory resources across institutions. Not all institutions need to be reviewed each year. Reviews of institutions are prioritized taking into account their systemic importance, their risk profiles, their volatility, material changes in strategies, any significant changes in management or corporate governance, etc. This is to ensure that available supervisory resources are allocated effectively across institutions based on risk.

Monitoring

Institution specific monitoring includes a review of company information (including regulatory returns) and comparative analysis (both historical and against peers) of the results of early warning tests and ratios and the material changes in the industry and its operating environment that are likely to impact the institution in order to assess the probable impact of these changes on the institution's risk profile. Monitoring also includes meeting with key individuals at the institution to discuss trends and emerging issues.

The frequency and scope of monitoring depends on the size, complexity and risk profile of the institution; but, each institution should be monitored at least quarterly. Higher risk institutions will require to be monitored more frequently. Results of monitoring are used to update the risk profile of the institution and provide the context for the on-site reviews.

Where there are shifts in the risk assessment of the institution, supervisory strategy and plan are adjusted in the context of the changes. These adjustments are dynamic and help ensure effective utilization of resources across institutions as well as for an institution.

On-site Reviews

On-site reviews are a critical part of the supervisory process. The scope of on-site reviews depends on the size, complexity and risk profile of the institution and the nature of prudential concerns, if any. These reviews and interactions with the institution's management and oversight functions are critical to effective supervision of an institution and deepen the supervisor's understanding of the institution and its risk profile.

Documentation

Effective supervision requires a sufficiently deep understanding of an institution. This understanding is acquired over time through monitoring and on-site reviews as well as through interactions with management and oversight functions of the institution. Hence, it is critical that knowledge acquired through the supervisory process be captured and build over time. Utility of this knowledge across the agency will increase if it is captured using a standard structure.

Once the initial assessments of Significant Activities and Corporate Oversight and

Governance functions are captured, future changes are incorporated by updating the original documents which makes the process more efficient.

Reporting

Supervisors prepare a Management Report, at least annually, to institutions to communicate their overall assessment of the institution's risk profile, any prudential concerns identified and recommendations for addressing them. It is the key written document sent to the institution.

In the case of on-site reviews, the final stage of the process includes issuing a Management Report.

Assessments, findings and recommendations are first discussed with appropriate senior managers in the institution. This is followed by reporting to the Chief Executive Officer (CEO) and the Board (Audit Committee).

Management Reports to companies incorporated in the country are addressed to the CEO and copied to the Chair of the Audit Committee. Management Reports to foreign institutions operating branches in the country are addressed to the Principal Officer of the branch. Where there are significant issues with a branch, a copy of the Management Report may be sent to the CEO and the Chair of the Audit Committee at the home office. In all cases, the covering letter requests that a copy of the Management Report be provided to the external auditors and to the actuary, where applicable.

Follow-up

Prudential concerns identified are monitored by supervisors for timely resolution by the institution.

APPENDIX A
RISK MATRIX

Risk Assessment

RISK MATRIX						
Significant Activities	Materiality	Inherent Risks	Quality of Risk Management		Residual Risk	Direction of Risk
Activity 1 Activity 2 Etc...		<input type="checkbox"/> Credit <input type="checkbox"/> Market <input type="checkbox"/> Insurance <input type="checkbox"/> Operational <input type="checkbox"/> Legal & Regulatory <input type="checkbox"/> Strategic	Operational Management	Oversight <input type="checkbox"/> Compliance <input type="checkbox"/> Internal Audit <input type="checkbox"/> Risk Management <input type="checkbox"/> Senior Management <input type="checkbox"/> Board Oversight		
Overall Rating			Overall Assessment			

Capital		Earnings		Liquidity	
Composite Risk		Direction of Risk		Time Frame	

APPENDIX B

CATEGORIES OF INHERENT RISKS AND RATING DEFINATIONS

Inherent Risk Categories.

Following are descriptions of the six inherent risk categories for assessment purposes. These descriptions should be read within the context of the definition of inherent risk contained in the Supervisory Framework.

Credit Risk

Credit risk arises from a counterparty's inability or unwillingness to fully meet its on- and/or off-balance sheet contractual obligations. Exposure to this risk results from financial transactions with a counterparty including issuer, debtor, borrower, broker, or guarantor.

Market Risk

Market risk arises from changes in market rates or prices. Exposure to this risk can result from market-making, dealing, and position-taking activities in markets such as interest rate, foreign exchange, equity, commodity and real estate.

Interest rate risk and foreign exchange risk are described further below:

a. Interest Rate Risk

Interest rate risk arises from movements in interest rates. Exposure to this risk primarily results from timing differences in the repricing of assets and liabilities, both on- and off-balance sheet, as they either mature (fixed rate instruments) or are contractually repriced (floating rate instruments).

b. Foreign Exchange Risk

Foreign exchange risk arises from movements in foreign exchange rates. Exposure to this risk mainly occurs during a period in which the institution has an open position, both on-

and off balance sheet, and/or in spot and forward markets.

Insurance Risk

Insurance risk arises from claims and/or policy benefits exceeding the pure premiums charged for the products.

Product Design and Pricing Risk

Product design and pricing risk arises from the exposure to financial loss from transacting insurance and/or annuity business where costs and liabilities assumed in respect of a product line exceed the expectation in pricing the product line.

Underwriting and Liability Risk

Underwriting and liability risk is the exposure to financial loss resulting from the selection and approval of risks to be insured, the reduction, retention and transfer of risk, the reserving and adjudication of claims, and the management of contractual and non-contractual product options.

Operational Risk

Operational risk arises from problems in the performance of business functions or processes. Exposure to this risk can result from deficiencies or breakdowns in internal controls or processes, technology failures, human errors or dishonesty and natural catastrophes.

Legal and Regulatory Risk

Legal and regulatory risk arises from an institution's non-conformance with laws, rules, regulations, prescribed practices, or ethical standards in any jurisdiction in which the institution operates.

Strategic Risk

Strategic risk arises from an institution's inability to implement appropriate business plans, strategies, decision-making, resource allocation and its inability to adapt to changes in its business environment.

Definitions of Inherent Risk Ratings

Low Inherent Risk:

Low inherent risk exists when there is a lower than average probability of a material adverse impact on an institution's capital or earnings due to exposure and uncertainty from potential future events.

Moderate Inherent Risk:

Moderate inherent risk exists when there is an average probability of a material adverse impact on an institution's capital or earnings due to exposure and uncertainty from potential future events.

Above Average Inherent Risk

Above Average inherent risk exists when there is a higher than average probability of a material adverse impact on an institution's capital or earnings due to exposure and uncertainty from potential future events.

High Inherent Risk:

High inherent risk exists when there is a higher than above average probability of a material adverse impact on an institution's capital or earnings due to exposure and uncertainty from potential future events.

APPENDIX C

OPERATIONAL MANAGEMENT, CORPORATE OVERSIGHT AND GOVERNANCE FUNCTIONS RATING CATEGORIES

The following ratings categories are used for assessing the effectiveness of Operational Management, Corporate Oversight and Governance functions at the Significant Activity level:

Strong

Strong means the function consistently demonstrates highly effective performance in the context of the key risks inherent in the Significant Activity.

Acceptable

Acceptable means the function demonstrates effective performance in the context of the key risks inherent in the Significant Activity.

Needs Improvement

Needs improvement means the function may generally demonstrate effective performance, but there are some areas where effectiveness needs to be improved in the context of the key risks inherent in the Significant Activity.

Weak

Weak means the function has demonstrated serious instances where effectiveness needs to be improved in the context of the key risks inherent in the Significant Activity.

APPENDIX D

OVERALL RESIDUAL RISK IN SIGNIFICANT ACTIVITIES

The following rating categories are used to assess the Overall Residual Risk in an institution's Significant Activities taken together.

Low

The institution has risk management that substantially mitigates risks inherent in its Significant Activities down to levels that collectively have lower-than-average probability of a material adverse impact on its capital and earnings in the foreseeable future.

Institutions in this category will have a predominance of Significant Activities rated as low residual risk. Other combinations may be possible depending on the circumstances of the institution.

Moderate

The institution has risk management that sufficiently mitigates risks inherent in its Significant Activities down to levels that collectively have an average probability of a material adverse impact on its capital and earnings in the foreseeable future.

Institutions in this category will have a significant number of their Significant Activities rated as moderate residual risk, or a few of their Significant Activities rated as high residual risk with others rated as low residual risk. Other combinations may be possible depending on the circumstances of the institution.

Above Average

The institution has weaknesses in its risk management that, although not serious enough to

present an immediate threat to solvency, give rise to high residual risk in a number of its Significant Activities. As a result, residual risks in its Significant Activities collectively have an above average probability of a material adverse impact on its capital and earnings in the foreseeable future.

Institutions in this category will have a number of their Significant Activities rated as high residual risk with others mainly rated as moderate residual risk. Other combinations may be possible depending on the circumstances of the institution.

High

The institution has weaknesses in its risk management that may pose a serious threat to its financial viability or solvency and give rise to high residual risk in a number of its Significant Activities. As a result, residual risks in its Significant Activities collectively have a high probability of a material adverse impact on its capital and earnings in the foreseeable future.

Institutions in this category will have the majority of their Significant Activities rated as high residual risk, or will have rated as high residual risk one or more Significant Activities that have a pervasive impact on its operations. The weaknesses in risk management lead to considerable doubt about the institution's capability and/or willingness to apply prompt and effective corrective measures to sufficiently mitigate high residual risks in its Significant Activities. Other combinations may be possible depending on the circumstances of the institution.

APPENDIX E

EARNINGS, CAPITAL AND LIQUIDITY DEFINITIONS

The following rating definitions are used for assessing Earnings, Capital and Liquidity.

Earnings.

Strong

The institution has consistent earnings performance, producing returns that significantly contribute to its long-term viability, and there is no undue reliance on non-recurring sources of income to enhance earnings. The earnings outlook for the next 12 months continues to be positive.

Acceptable

The institution has satisfactory earnings performance, producing returns needed to ensure its long-term viability, and there is no undue reliance on non-recurring sources of income to enhance earnings. Although there is some exposure to earnings volatility, the outlook for the next 12 months remains positive.

Needs Improvement

The institution has inconsistent earnings performance, with returns that may, at times, be inadequate to ensure its long-term viability. It may occasionally depend on non-recurring sources of income to show a profit. The earnings outlook for the next 12 months is uncertain.

Weak

The institution has consistently recorded operating losses or earnings that are insufficient to ensure its long term viability. It may be heavily dependent on non-recurring sources of income to show a profit. The earnings outlook for the next 12 months is expected to remain negative.

Capital

Strong

Capital adequacy is strong for the nature, scope, complexity, and risk profile of the institution, and meets regulatory and internal target levels. The trend in capital adequacy over the next 12 months is expected to remain positive. Capital management policies and practices are superior to generally accepted industry practices.

Acceptable

Capital adequacy is appropriate for the nature, scope, complexity, and risk profile of the institution and meets regulatory and internal target levels. The trend in capital adequacy over the next 12 months is expected to remain positive. Capital management policies and practices meet generally accepted industry practices.

Needs Improvement

Capital adequacy is not always appropriate for the nature, scope, complexity, and risk profile of the institution and, although meeting minimum regulatory requirements, may not meet, or is trending below, regulatory and internal target levels. The trend in

capital adequacy over the next 12 months is expected to remain uncertain. Capital management policies and practices may not meet generally accepted industry practices.

Weak

Capital adequacy is inappropriate for the nature, scope, complexity, and risk profile of the institution and does not meet, or marginally meets, regulatory requirements. The trend in capital adequacy over the next 12 months is expected to remain negative. Capital management policies and practices do not meet generally accepted industry practices.

Liquidity.

Strong

The institution has strong liquidity levels and well developed liquidity management practices. The institution has reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.

Acceptable

The institution has satisfactory liquidity levels and liquidity management practices. The institution has access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs. Modest weaknesses may be evident in liquidity management practices.

Needs Improvement

The institution has liquidity levels or liquidity management practices that need improvement. It lacks ready access to funds on reasonable terms or has significant weaknesses in liquidity management practices.

Weak

The institution has liquidity levels or liquidity management practices that are inadequate. It does not have or is able to obtain sufficient funds at reasonable terms to meet its near-term liquidity needs and may require external financial assistance.

APPENDIX F

RISK PROFILE RATING DEFINITIONS

The following rating categories are used to assess the risk profile of an institution.

Low Risk

A strong, well-managed institution. The combination of its Overall Residual Risk and its capital supported by earnings, and its liquidity makes the institution resilient to most adverse business and economic conditions without materially affecting its risk profile. Its performance has been consistently good, with most key indicators in excess of industry norms, allowing it ready access to additional capital. Any supervisory concerns have a minor effect on its risk profile and can be addressed in a routine manner.

An institution in this category would have a low Overall Residual Risk coupled with acceptable capital, earning, and liquidity, or a moderate Overall Residual Risk coupled with strong capital, earnings, and liquidity. Other combinations may be possible depending on the circumstances of the institution.

Moderate Risk

A sound, generally well-managed institution. The combination of its Overall Residual Risk and its capital supported by earnings, and its liquidity makes the institution resilient to normal adverse business and economic conditions without materially affecting its risk profile. The institution's performance is satisfactory, with key indicators generally comparable to industry norms, allowing it reasonable access to additional capital. Supervisory concerns are within the institution's ability to address.

An institution in this category would have moderate Overall Residual Risk coupled with

acceptable capital, earnings, and liquidity. Other combinations may be possible depending on the circumstances of the institution.

Above Average Risk

The institution has issues that indicate an early warning or that could lead to a risk to its financial viability. One or more of the following conditions are present. The combination of its Overall Residual Risk and its capital supported by earnings, and its liquidity makes the institution vulnerable to adverse business and economic conditions. Its performance is unsatisfactory or deteriorating, with some key indicators at or marginally below industry norms, impairing its ability to raise additional capital. The institution has issues in its risk management that, although not serious enough to present an immediate threat to financial viability or solvency, could deteriorate into serious problems if not addressed promptly.

An institution in this category would have moderate Overall Residual Risk coupled with capital, earnings, and liquidity that need improvement. Other combinations may be possible depending on the circumstances of the institution.

High Risk

The institution has serious safety and soundness concerns. One or more of the following conditions are present. The combination of its Overall Residual Risk and its capital supported by earnings, and its liquidity is such that the institution is vulnerable to most adverse business and economic conditions, posing a serious threat to its financial viability or solvency unless effective corrective action is implemented promptly. Its performance is poor, with most key indicators below industry norms, seriously impairing its ability to access additional capital.

An institution in this category would have above average Overall Residual Risk with capital, earnings, and liquidity that need improvement. Other combinations may be possible depending on the circumstances of the institution.

APPENDIX G

GUIDE TO INTERVENTION

The intervention guide outlines the types of actions that supervisors consider depending on the risk profile of the institution and the nature and significance of prudential concerns. It is important that interventions are proportionate to the desired outcomes. The actions indicated below are for a range of ratings as the intervention process needs to be flexible to enable supervisors to use interventions that are likely to be most effective in individual cases.

The actions indicated below are cumulative; i.e. actions indicated at lower levels of risk are implicitly included in actions that could be considered for institutions with a higher risk profile. Also, if circumstances warrant, actions can be taken at risk levels lower than that indicated in the guide.

LOW TO MODERATE RISK PROFILE

- Continue dynamic up-dating of the institution's risk profile (financial condition and operating performance) through review of information obtained from regulatory filings and other sources, including discussions with the institution, and through periodic on-site reviews.
- Meet annually with the institution to discuss its risk profile and related findings and recommendations and communicate these in writing.
- Monitor timely implementation of the material recommendations by the institution.

MODERATE TO ABOVE AVERAGE RISK PROFILE

- Meet with management and Board of Directors (or a Board committee) to discuss prudential concerns and remedial actions required. These meetings may include external

auditors and/or actuaries as appropriate.

- Notify in writing management and Board of Directors of the prudential concerns and remedial actions required.
- Require submission of Board approved action plans by the institution indicating the time frame in which the deficiencies will be addressed.
- Escalate monitoring of the institution as warranted, including expanding the scope, level and frequency of information to be reported to ensure concerns are being addressed on a timely basis.
- Increase the frequency, depth and scope of on-site supervisory reviews as warranted.
- Impose operating conditions on the institution and/or issue directive of compliance if warranted.
- Require the institution to increase capital.

ABOVE AVERAGE TO HIGH RISK PROFILE

- Require the institution to submit a Board approved business plan which incorporates appropriate remedial measures to address identified prudential concerns within specified time-frames.
- Require the external auditor and/or actuary of the institution to carry out examination of specific areas and report there on.
- Require the institution to arrange for a special audit by an auditor, other than the institution's regular auditor.
- Consider further operating conditions on the institution.
- Inform the institution's home/host regulators of the circumstances and the status of the supervisory actions taken, and
- Commence contingency planning.

HIGH RISK PROFILE

- Require the institution to retain external specialist to assess specific areas such as quality and valuation of assets, liquidity, etc.
- Further enhance the conditions already imposed on the institution, including for example restricting lending, investments, level of deposits, expansion of operations, payment of interest on subordinated debt, payment of dividends, and other such restrictions warranted by the circumstances.
- Locate supervisory staff at the institution to interact with management and monitor developments on an ongoing basis.
- Put pressure on management and Board of Directors to restructure or sell part or whole of the company's operations.
- Ensure home regulators are kept abreast of the circumstances and the intervention measures taken.
- Develop plans to take control of assets of the company or the company if the circumstances warrant.

HIGH RISK PROFILE WITH AN INCREASING TREND

- Meet with management and the Board of Directors to communicate the likely regulatory actions if prudential concerns are not addressed quickly.
- Advise home/host regulators (national and foreign) of the impending regulatory action.
- Take control of assets of the company or the company, if the situation warrants such action.
- In conjunction with the Attorney General, commence action to obtain the necessary Court order to liquidate the institution.

APPENDIX H

OVERALL ASSESSMENT OF CORPORATE OVERSIGHT AND GOVERNANCE FUNCTIONS

The following rating categories are used to assess the Corporate Oversight and Governance functions:

Strong.

Characteristics of the function meet or exceed what is considered necessary for the nature, scope, complexity and risk profile of the institution, and the function has demonstrated highly effective performance on a consistent basis.

Acceptable

Characteristics of the function meet what is considered necessary for the nature, scope, complexity and risk profile of the institution, and the function has demonstrated effective performance.

Needs Improvement

Characteristics of the function generally meet what is considered necessary for the nature, scope, complexity and risk profile of the institution; but, there are some significant areas that require improvement. Performance has generally been effective; but, there are some significant areas where effectiveness needs to be improved. These areas are not likely to cause serious prudential concerns if addressed on a timely basis.

Weak

Characteristics are not, in a material way, what is considered necessary given the nature, scope, complexity and risk profile of the institution. Performance has demonstrated serious instances where effectiveness needs to be improved through immediate action.

Role, Characteristics and Examples of Performance Indicators

The following criteria for characteristics (how a function is set-up to oversee) and examples of performance indicators (how well the function carries out its responsibilities) are used to assess the overall performance of the functions. The assessments are made in the context of the nature, scope and complexity of the institution. The assessment of performance is derived from the assessments of Significant Activities. In developing an overall assessment of a function, it is important to bear in mind that while characteristics are generally predictive of performance, they in themselves do not ensure effective performance. Accordingly, the function's performance across the institution's Significant Activities (taking their materiality into account) is the key driver of the overall assessment of the function.

Compliance

Role:

Compliance is an independent function within an institution that ensures that the institution meets the legal and regulatory obligations by 1) ensuring the institution has adequate policies and practices for adhering to the requirements; 2) monitoring adherence to those policies and practices and 3) reporting on compliance matters to Senior Management and the Board of Directors.

Characteristics:

- An enterprise-wide authority to independently oversee compliance, including periodic reporting to Senior Management and the Board, and follow-up of identified issues for satisfactory resolution.
- Appropriateness of the organization structure and reporting relationships, including an appropriate level of seniority of the head of the function.
- Adequacy of resources to carry out its mandate, including staffing levels and required skills.
- Adequacy of its methodologies and practices for effective execution of its enterprise-wide mandate.
- Extent of Senior Management and Board oversight of the function.

Examples of Performance Indicators.

- Develops and communicates new and revised compliance policies and legal and regulatory requirements to all impacted areas of the institution on a timely basis, including assisting management in integrating the requirements into business activities.
- Actively monitors adherence to compliance requirements across the institution's operations, and follows-up on significant breaches for timely resolution.
- Escalates significant breaches of compliance requirements to Senior Management and the Board.
- Periodically monitors compliance practices for continued effectiveness.

Internal Audit

Role:

Internal audit is an independent function within an institution that assesses adherence to and effectiveness of operational and organizational controls and governance practices. In addition, internal audit may also assess adherence to and effectiveness of compliance and risk management policies and practices.

Characteristics:

- Independent enterprise-wide mandate to oversee the institution's operations.
- Appropriateness of the organization structure and reporting, including seniority of the head of the function and direct reporting to the Board.
- Adequacy of resources to carry out its mandate, including the level of staffing and availability of required skills.
- Adequacy of its risk-based audit methodologies and practices.
- Adequacy of its planning, coverage cycle and reporting and follow-up practices.
- Extent of Senior Management and Board oversight.

Examples of Performance Indicators.

- a. Actively seeks relevant information from others (e.g. Compliance, Risk Management, Senior Management, external auditors, etc) in developing risk based supervisory strategies and plans.
- b. Reviews business plans and strategies to identify activities that could materially impact the institution and ensures that they will be effectively managed and overseen.
- c. Effective and timely execution of its risk-based audit plans, including timely reporting and follow-up of identified issues for satisfactory resolution.

- d. Considers pervasiveness and significance of its findings both at the Significant Activity level and in aggregate across the institution's activities.
- e. Proactively communicates significant findings to the Board (Audit Committee) and regularly engages the Board (Audit Committee) in discussions on the appropriateness of its audit strategies and adequacy of its resources.

Risk Management

Risk management is an independent function responsible for planning, directing and controlling the impact on the institution of the risks arising from its operations. The function may address the following:

1. Identify current and emerging risks in the institution's operations,
2. Develop measurement systems for risks,
3. Establish policies and practices for managing risks,
4. Develop risk tolerance limits and periodically stress test limits,
5. Monitor positions against approved limits, and
6. Report on risk monitoring to senior management and the Board.

Characteristics:

1. Independent enterprise-wide mandate to oversee risks in the institution's operations.
2. Appropriateness of the organization structure and reporting, including seniority of the head of the function and direct reporting to the Board.
3. Adequacy of resources to carry out its mandate, including the level of staffing and availability of required skills.
4. Adequacy of practices to periodically review and update risk management policies and practices, including periodically assessing their appropriateness.
5. Extent to which risk management policies and practices are coordinated with strategic,

capital and liquidity planning.

6. Adequacy of policies and practices to monitor positions against approved limits and for timely follow up of material variances.
7. Adequacy of policies and practices to monitor trends and identify emerging risks, and to effectively respond to unexpected significant events.
8. Adequacy of policies and practices to report and follow-up on identified issues for timely resolution.
9. Extent of Senior Management and Board oversight.

Examples of Performance Indicators.

- Proactively updates policies, practices and limits in response to changes in the institution or externally.
- Integrates policies, practices and limits in to day to day business activities, and with the institution's strategic, capital and liquidity planning.
- Regularly monitors risk positions against approved limits and ensures that material breaches are addressed on a timely basis.
- Actively participates in the development of new initiatives to ensure processes are in place to identify and mitigate risks prior to implementation.
- Provides regular, comprehensive reports to the Board and Senior Management on the effectiveness of the institution's risk management policies and practices and recommends changes for approval, as appropriate.

Senior Management.

Role:

Senior Management is responsible for directing and overseeing the effective management of the institution's operations. Its key responsibilities include:

1. Developing business objectives, strategies, policies (including policies for risk management and risk appetite), organizational structure and controls for Board approval;

2. Effectively overseeing the operations of the institution to ensure day to day operations are carried out in accordance with Board approved business objectives, strategies and policies.
3. Developing and promoting sound corporate governance practices; and
4. Providing the Board with sufficient and timely information to enable it to carry out its responsibilities, including monitoring and reviewing performance and risk exposures of the institution.

Characteristics:

1. Extent to which the Board has delegated responsibilities for developing and implementing policies and practices for the effective management of the institution's operations, including business objectives, strategies and plans and a risk management framework.
2. Adequacy of Senior Management organization structure and reporting lines and appropriate delegation of responsibilities from the CEO to other senior management positions and Corporate Oversight functions.
3. Appropriateness of the committee structure used by Senior Management.
4. Adequacy of Senior Management resources and expertise.
5. Adequacy of Senior Management policies and practices for effective execution of its mandate.
6. Extent of Board oversight of Senior Management.

Examples of Performance Indicators.

- Develops appropriate strategies and plans to attain business objectives for approval by the Board of Directors, including risk policies, limits, practices and reporting systems.
- Actively monitors execution of Board approved strategies, plans, policies, etc for effective implementation.
- Proactively reviews business objectives, strategies, plans, policies and limits in response to significant changes and adverse trends in the external environment.

- Sets appropriate tone from the top through the manner in which it carries out its duties.
- Is successful in building an effective organization by attracting, developing and retaining high caliber staff.
- Keeps the Board of Directors and its Committees fully apprised on a timely basis.

Board of Directors

Role:

The Board of Directors is responsible for establishing and implementing a corporate governance framework for a sound and prudent management of the institution. Its key responsibilities include:

1. Reviewing and approving organizational structure, including clearly defining roles and responsibilities of its committees, management and heads of oversight functions.
2. Regularly reviewing, approving and overseeing the implementation of the institution's
3. business objectives, strategies to achieve the objectives and policies for major activities, including risk strategies and appetites.
4. Ensuring that management and heads of oversight functions are qualified and competent.
5. Providing oversight over the design and effective implementation of sound risk management and internal control systems.
6. Providing for an independent assessment of, and reporting on, effectiveness of the institutions operations.
7. Approving remuneration policies and practices.
8. Monitoring performance against business objectives, strategies and plans and requiring timely corrective actions were warranted; and
9. Providing effective oversight over management and oversight functions.

Characteristics:

1. Adequacy of Board size, range of Director qualifications, knowledge, skills and experience.
2. Adequacy of roles and responsibilities of the Board, including the composition, role and responsibilities of Board committees and committee reporting requirements to the Board.
3. Adequacy of Board policies and practices for:
 - a. Nomination, selection and removal of Directors.
 - b. Orienting new Directors and periodically up-dating other Directors on the institution's business and related risks.
 - c. The role of independent directors.
 - d. Ensuring the Board is provided with timely, relevant, accurate and complete information. and, where required, the Board requests additional information.
 - e. Establishing and monitoring work plans for Board goals and responsibilities.
 - f. Promoting independent, effective and timely decision making, including practices for setting Board agenda and priorities.
 - g. Ensuring Directors' compensation promotes prudent decision making and self assessment of Board performance on an annual basis.

Examples of Performance Indicators.

- a. Active involvement in the selection and performance evaluation of the CEO and other members of Senior Management as appropriate
- b. Performs a regular independent in-depth review and evaluation of the institution's business objectives and strategies and risk tolerance limits.
- c. Regularly reviews the institution's corporate governance and risk management structures, policies and practices
- d. Clearly sets out the type and quality of information it requires and related frequency.

- e. Actively engages in the review of information provided by Senior Management for Board approval, including challenging management's assumption.
- f. Requires effective and timely resolution of issues identified by others, including Compliance, Internal Audit, Risk Management, actuary, external auditors, etc.