Risk-Based Supervisory Framework

Approved by FSRC Board: December 2, 2015
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1. INTRODUCTION

The Financial Services Regulatory Commission (FSRC) of Antigua and Barbuda activities can be divided into three broad functions: licensing, monitoring (offsite and onsite examinations) and enforcement. The FSRC of Antigua and Barbuda is charged with the responsibility of regulating numerous diverse financial service providers including: International Banks, Trust Corporations, Domestic and International Insurance companies, Cooperatives, Credit Unions, Money Service Transfer companies, Corporate Management Services and Trust providers, Online Gaming and Wagering companies operating in Antigua and Barbuda. The authority of the FSRC emanates from Section 5 of the FSRC Act 2013 which states the following:

1) The principal functions of the Commission are—

   (a) ***regulatory functions, namely—***

      i. ***to regulate and supervise financial services business carried on in or from within Antigua and Barbuda in accordance with this Act and the regulatory laws; and***

      ii. ***to perform any other regulatory or supervisory duties that may be imposed on the Commission by any other Act;***

   (b) ***collaborative functions, namely, to provide assistance to overseas regulatory authorities in accordance with this Act; and***

   (c) ***advisory functions, namely, to advise the Government on the matters set out in paragraphs (a) and (b) and, in particular, with regard to—***

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i. ***whether the regulatory functions and the collaborative functions are consistent with functions discharged by an overseas regulatory authority;***

ii. ***whether the regulatory laws are consistent with the laws and regulations of countries and territories outside Antigua and Barbuda; and***

iii. ***the recommendations of international organisations.***

2) In performing its functions and managing its affairs, the Commission shall—

(a) ***have regard to the requirements of a sound financial system in Antigua and Barbuda;***

(b) ***have regard to the maintenance of market confidence, consumer protection and the reputation of Antigua and Barbuda as a financial centre;***

(c) ***use its resources prudently for its efficient and economic operation;***

(d) ***have regard to generally accepted principles of good corporate governance;***

(e) ***comply with this and any other Act, including any regulations or directions made or given thereunder; and***

(f) ***have such ancillary powers as may be required to fulfil the functions set out in paragraphs (a) to (e).***

3) In performing its regulatory functions and its collaborative functions, the Commission shall, in addition to complying with the requirements of subsection (2)—

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(a) ***co-operate with domestic and international government agencies and statutory organisations with a view to reducing the possibility of financial services business or relevant financial business being used for the purpose of money laundering or other crime;***

(b) ***recognise the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;***

(c) ***recognise the desirability of facilitating innovation in financial services business; and***

(d) ***recognise the need for transparency and fairness on the part of the Commission.***

The initial licensing process (review of application and supporting documentation as to legal compliance and sufficiency, due diligence, issue of licence) is designed to limit entry into the jurisdiction to fit and proper owners and managers. The licensing processes are detailed within the relevant legislations, regulations and guidelines issued by the Commission.

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

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

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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 proactive 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 developments and perspectives in the assessment of individual institutions. The supervisory framework applies to companies and institutions which are regulated under the following laws along with the supporting regulations, amendments and guidelines (issued by the Commission from time to time):

(a) The International Banking Act, 2016;
(b) The Co-operative Societies Act, 2010;
(c) The Insurance Act, 2007;
(d) The Money Services Business Act, 2011;
(e) The Corporate Management and Trust Service Providers Act, 2008;
(f) The International Trust Act, 2007;
(g) The International Foundations Act, 2007;
(h) The International Limited Liability Companies Act, 2007;
(i) The Digital Asset Business Act 2016;

and any other laws that may be prescribed by the Minister by regulations made under the FSRC Act.

Effective December 2, 2015 the Board of Directors of the FSRC approved the Supervisory

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Framework, which was later amended in November 2021 where financial institutions, under the purview of the FSRC should be supervised using this Risk-Based Supervision Framework. 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 FSRC leverages the work of the institution's Corporate

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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 FSRC 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 FSRC relies on actuaries for the adequacy of policy liabilities, product pricing and uses their work to modify the scope of its work.

3. BENEFITS

The key benefits of the supervisory approach are:

- closer integration of macro and micro prudential supervision, with focus on early identification of emerging risks to facilitate timely interventions;
- assessments parallel how an institution is managed;
- 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;

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- early identification of institutions and areas in institutions with prudential issues and concerns;
- cost effective utilization of resources through prioritization of supervision based on risks;
- reporting risk focused assessments to institutions for desired outcomes;
- reducing regulatory burden on well managed institutions;
- encouraging a strong risk management culture in institutions; and
- Providing flexibility for supervisors to use professional judgment within a structured approach.

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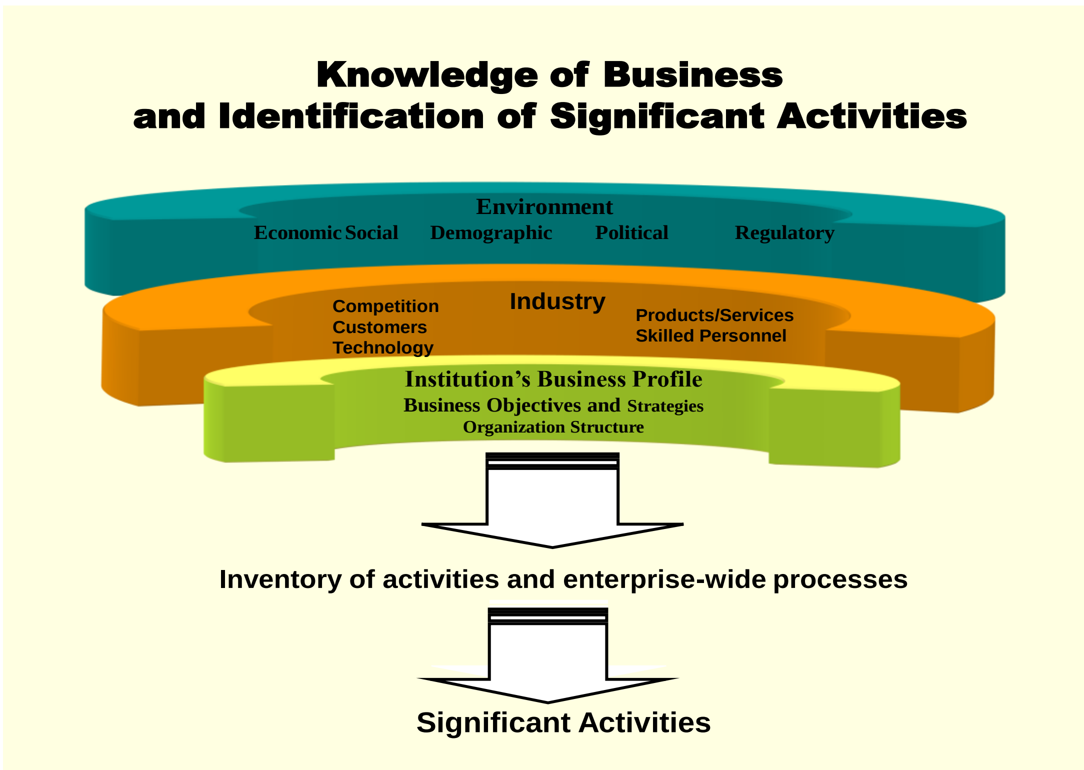
4. INTEGRATING MACRO AND MICRO PRUDENTIAL SUPERVISION

Table 1: GUIDE TO CREATE RISK PROFILE



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

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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 vice 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 –

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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 FSRC as well as on industry information available from other sources such as industry publications, rating agencies, etc. It provides supervisors with 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

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through peer comparisons.

FSRC 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, et cetera.

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5. ASSESSING RISK PROFILE OF AN INSTITUTION

An understanding and assessment of the broader economic and industry environments and the institution's business profile provide the FSRC 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 (i.e. Composite Risk).

The above steps are interrelated and operate in a systemic and 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.

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The above steps are discussed below.

A risk matrix (Appendix A) is used to summarize the assessments made through the supervisory process from the completion of the Risk Profile form.

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. The risk matrix is to be included with the Supervisory Letter which is provided to the supervised institutions.

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 judgment is applied in determining the significance or materiality of the activities. Materiality for this purpose is a measure of the

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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;
(e) internal allocation of capital to the activity in relation to total capital, and
(f) strategic importance.

Activities identified as significant would 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

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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 to assess risks inherent in its activities. For assessment purposes, inherent risks are grouped in the following six categories (Appendix B):

i. credit
ii. market
iii. insurance
iv. operational
v. legal and regulatory
vi. strategic

<u>Reputation</u>, <u>Concentration</u>, <u>Product design</u>, <u>Underwriting/liability</u> and in some instances <u>Reinsurance</u> **are not inherent risks,** but normally associated indirectly from one or combination of the 6 main risks. **[But consider in reviews]**

<u>IT risk</u> can either be inherent risk based on product/service offered but mostly an indirect risk in insurance &/or operations. (See Appendix B)

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

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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 Appendices B & C.

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 rigor 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:

a. An assessment of the day to day management of the Significant Activity (Operational Management); and

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b. An assessment of the Corporate Oversight and Governance for the Significant Activity.

<u>OPERATIONAL MANAGEMENT</u>

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.

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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; in the case of Credit Unions, the Supervisory and Compliance Committee is charged with this function with the assistance of a dedicated internal audit function, and performs such oversight function equally to a watchman or as a protector for the majority of the shareholders/membership. The Supervisory and Compliance Committee must be assessed on the effectiveness of the quality of its risk management framework, including but not limited to the assessment of the board of director's performance on periodic basis.

Senior Management retains the responsibilities not delegated to oversight functions. In smaller institutions, Senior Management sometimes performs responsibilities normally

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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 I.

Assessing Residual (Net) Risk in each Significant Activity

The assessment of the residual risk or net 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.

To assist with the offsite monitoring of the effectiveness of the board and senior management oversight the FSRC requests from the supervised institutions copies of the minutes for board and committee meetings.

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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.

Table 2: GUIDE TO RESIDUAL RISK ASSESSMENT

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 E.

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.

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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 F. 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

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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.

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

<u>LIQUIDITY</u>

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:

- The availability of assets readily convertible to cash without undue loss;
- Access to various sources of funding;
- The level of diversification of funding sources;
- The degree of reliance on short-term and volatile sources of funds;
- The trend and stability of deposits;
- 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

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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 by the regulatory team members, reviewed by the Head of the department and approved by the Chief Regulatory Officer. The process involves a comprehensive review of the adequacy of the institution's capital supported by earnings, and its liquidity in the context of the Overall Residual Risks in its Significant Activities using the required format. It is an assessment of the safety and soundness of the institution using the following guidelines described earlier in Sections 4 and 5.

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

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.

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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 addressed on a timely basis.

A Guide to Intervention is included as Appendix H. 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 Medium High, etc. Circumstances may vary significantly from case to case. The guide should not be

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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.

Section 30 of the FSRC Act 2013 set out the requirement of the establishment of a regulatory hand books as follows:

(1) ***The Board may issue, and shall from time to time amend, a regulatory handbook setting out, as far as is practicable, the policies and procedures to be followed by the Commission, its committees and its officers in performing the Commission's regulatory functions and collaborative functions.***

(2) ***The regulatory handbook shall be consistent with any act or any regulations or policy directions given or made thereunder.***

(3) ***The regulatory handbook shall include policies and procedures for—***

- ***(a) giving warning notices to persons affected adversely by proposed actions of authorized officers of the Commission;***
- ***(b) giving reasons for the decisions of authorized officers of the Commission; and***
- ***(c) receiving and dealing with complaints against the actions and decisions of authorized officers of the Commission.***

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(4) *In cases where the regulatory handbook would have the effect of creating, directly or indirectly, statements of principle or guidelines concerning the conduct of supervised institutions or their officers or employees, the Commission shall consult with the private sector associations.*

(5) *The regulatory handbook may provide for exceptions from its own requirements to be made by the Board or a specified committee or officer of the Commission.*

(6) *The Commission shall publish the regulatory handbook and any amendments to it, and the regulatory handbook and any such amendments shall take effect and come into operation on the date of such publication.*

(7) *The committees and officers of the Commission shall observe the policies and procedures contained in the regulatory handbook.*

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7. OVERALL ASSESSMENT OF CORPORATE OVERSIGHT AND GOVERANCE 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 Appendices B & D. 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.

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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. enterprise-wide risk management, concentration limits, large exposure limits, liquidity, capital, intra-group exposures, off-balance sheet exposures, etc.) are assessed on a consolidated and solo basis to ensure compliance.

The assessment considers 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 a separate assessment beyond ensuring regulatory compliance. Separate or solo assessments may be necessary in the following circumstances:

a. Where the regulated subsidiary represents a significant part of the consolidated entity and is operated independently of the group.
b. 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.
c. Where a regulated subsidiary's risk management and control practices are distinct from those of the group, and

d. 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.

Section 31 of the FSRC Act 2013 authorises the FSRC to share information with other local, regional and international regulators. Section 32 of the FSRC Act 2013 empowers the FSRC to sign Memorandum of Understandings (MOUs) with other regulators. In this connection, the FSRC has signed MOUs with a number of regulators in Austria, Canada, Panama, Uruguay, Venezuela, Single Regulatory Units within the Organization of Eastern Caribbean States (OECS), Eastern Caribbean Central Bank (ECCB), the Office of National Drug and Money Laundering Control Policy (ONDCP) etc.

9. THE SUPERVISORY PROCESS

The FSRC appoints a Regulatory Team Member for each institution. The Regulatory Team Member is the key contact for the institution at the FSRC and is responsible for the on-going supervision of the institution and ensuring that supervisory processes (which includes licensing, offsite monitoring, onsite examination and enforcement) and are completed effectively and on a timely basis.

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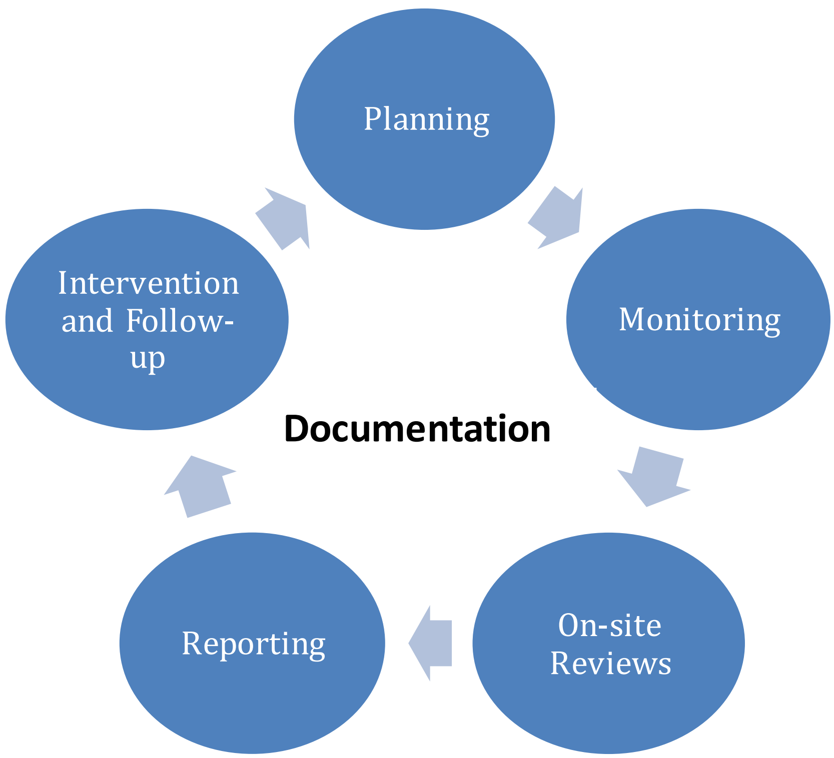
The main steps of the supervisory process are illustrated below in Table 3. Although the steps are described sequentially, updating of the risk assessment is a dynamic, iterative and a continuous process requiring frequent reassessments at various stages.

Table 3: FLOWCHART OF SUPERVISORY PROCESS



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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

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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 planning 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.

OFFSITE REVIEWS

The approach to off-site supervision/monitoring is compliance based. This is consistent with the on-site inspection work, which is based on an assessment of the supervised

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institution’s compliance with applicable legislation, codes of practice and internationally accepted standards.

Off-site monitoring is complemented by on-site inspections and is an integral part of the supervisory process. While the on-site work is conducted at intervals determined by each supervisory division, the off-site monitoring process is continuous. The objectives of Off Site reviews are as follows:

- Review, understand and explain the genesis of all significant matters disclosed by the financial statements;
- Obtain satisfactory explanations for all material variances in the current financial statements compared with those of prior years;
- Ensure that the supervisory division employs a systematic and consistent approach to monitoring supervised institutions;
- Detect early warning signs of potential problems in supervised institutions;
- Assist on-site examiners in focusing their work on areas of high risk and the greatest weakness in each supervised institution;
- Assist the on-site examiners follow up each supervised institution’s compliance with any
- recommendations made as a result of the on-site inspection;
- Determine the supervised institution’s compliance with applicable laws, codes of practice, guidelines and directives; and
- Provide meaningful reports on individual supervised institutions and the industry to the Director of the Department.

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Attention is directed to specific risk indicators within each supervisory area. This is supplemented with prudential meetings – these generally cover strategic initiatives, adherence to standards and legislation, and a discussion of the financials. Discussions are usually high-level and may involve the supervised institution's directors, staff, the parent institution, and other regulators.

KEY OFFSITE ACTIVITIES INCLUDE:

- Vetting of licence applications;
- Approval of ownership changes;
- Vetting of directors;
- Analysis of financial returns;
- Review of audited financial returns;
- Review of correspondence such as management letters and internal control memorandum;

ONSITE 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.

The on-site inspection process is fundamental to the effectiveness of the FSRC's regulatory function, post licensing. In setting out the onsite review procedures the FSRC's aims to:

- Provide a clear statement of the FSRC's policies, standards and procedures for

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- the inspection of supervised institutions;
- Provide guidance to supervisory personnel;
- Promote the consistent application of examination/inspection procedures; and
- Enhance the quality and effectiveness of on-site examinations.

THE OBJECTIVES OF AN ONSITE INSPECTION ARE TO:

- Review the supervised institution's operations to determine whether they are being conducted in prudent manner so as to mitigate against any potential liability for wrongful or negligent discharge of their responsibilities;
- Verify the current solvency of a company and obtain an informed view on the likely future solvency of the company;
- Review for compliance with applicable laws, regulations and accepted international standards of business conduct, including compliance with the money laundering regulations;
- Gather data to create a more comprehensive picture of a company than that which could be obtained from off-site analysis alone, thus gaining a better understanding of the company, the nature of its operations, and its business policy and philosophy;
- Identify potential problems and issues within a company, which might not otherwise stated ;
- Gather information on the management and staff of a company to facilitate the assessment of the competency of these individuals;

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- Gather information and views from the management of a supervised institution with regard to its plans, the business environment in which it operates and market conduct issues; Assess technical conduct of the supervised institution;
- Evaluate the supervised institution's assessment and management of risks;
- Assessment of the efficiency and reliability of the systems and adequacy of internal controls;
- Gather information on matters identified as requiring policy consideration;
- Enforce enhanced due diligence, AML/CFT requirements;
- Review AML/ CFT processes and practices and adherence to the AML/ CFT legislations , regulations and guidelines;
- Assess the quality of the management team;
- Determine solvency (quality of investments credits and other assets);
- Determine the level of and trend of risks associated with current and planned activities;
- Evaluate the overall integrity and effectiveness of the risk management process systems;
- Verify the effectiveness of corrective actions taken and if actions have not been taken, pursue timely resolution through supervisory and enforcement actions;
- Assess the effectiveness of board and other board subcommittee oversight;
- Assess the effectiveness internal control systems;
- Identify any potential risks and vulnerabilities which have not develop into problems for regulatory violations.

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In addition to the above list, during the onsite examination processes the FSRC's regulatory team members may:

- ❖ Encourage supervised institutions to develop written policies and procedures in all areas.
- ❖ Providing recommendations to correct deficiencies and to avoid potentially adverse situations.
- ❖ Contribute to the soundness of internal systems and controls by encouraging supervised institution's to follow 'best practices' in all aspects of their operations.

To some extent the results of on-site FSRC's regulatory team members will influence the intensity and frequency of monitoring. Supervised institutions that are operating in a satisfactory manner will require monitoring on a less frequent basis than supervised institutions with weaknesses and deficiencies.

Types of Onsite Inspections

There are three categories of onsite inspection, namely:

(1) A Full Scope Inspection;

(2) A Limited Scope Inspection;

(3) A Follow-up Inspection.

FULL SCOPE INSPECTION

A full scope inspection will usually involve a review of all lines of business undertaken by the supervised institution along with all areas of operations.

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LIMITED SCOPE INSPECTION

A limited scope inspection focuses on a particular segment(s) of a supervised institution's business operations or a particular theme that might be of interest to the Authority, such as AML/CFT or IT systems.

While the reasons for carrying out a limited scope inspection can vary, ordinarily such an inspection will be desirable in the following circumstances:

- Unusual results are found following offsite analysis of annual/quarterly financial statements;
- Follow-up on findings of a prior inspection Supervisory Letter;
- Unusual complaint volume either in respect of one line of business or in respect of a particular departmental function;
- Concerns expressed by stakeholders; and
- Recent developments in the supervised institution e.g. change in a key/management position, acquisition of a large block of business.

A limited scope inspection may alternatively consist of a review of a supervised institution's adherence to the money laundering regulations.

FOLLOW-UP INSPECTION

Follow-up inspections are effectively limited scope inspections that are based on specific issues and are typically shorter in duration than a limited scope inspection. The purpose

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is to determine if the supervised institution is in compliance with previous inspection Supervisory Letter recommendations.

OBJECTIVES OF THE SUPERVISORY LETTER

- To inform the FSRC, and the supervised institution's directors and management of adverse matters requiring attention;
- To effect correction of those matters; and
- To provide an accurate and complete assessment of the supervised institution's administration of its fiduciary powers.

To meet these objectives the FSRC's regulatory team members must address the many and varied aspects of the inspection. In this process, accurate and timely reporting of facts is essential to the proper understanding, and ultimately the proper correction of problems and violations by management.

The Supervisory Letter, including the attachments of the financial highlights, the risk matrix and the summary significant activity assessment, is sent to the supervised institution's board of directors within 3 weeks after the date of the onsite examination. Its primary purpose is to focus the action of the directors and management on matters warranting corrective attention.

Significant violations of law, regulations, rulings or sound fiduciary principles will be reported. Any policy or procedural deficiencies will also be reported. Isolated exceptions impacting individual accounts will be reported if the account has sustained a loss or is likely

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to sustain a loss. Any recurring items of criticism will be reported, regardless of their nature.

Technical or minor violations will and isolated exceptions will be reported but will not be subject to supervisory actions if management has agreed to take appropriate corrective action, unless the exceptions are symptomatic of an overall weakness in, for example, policies or procedures. This does not apply to institutions which are considers as systemically important by the FSRC as technical and minor violations will be reported. Comments should include the FSRC regulatory team's criticism and recommendation for corrective action. Management's view, whether representing assurances of correction or disagreement with the FSRC's position, should be stated.

Any deficiency of a regulatory or statutory nature would be addressed through "Requirements". Failure to address "Requirements" may result in regulatory action. Suggestions may be documented. These would normally address an operational issue, which was not deemed to be of regulatory concern but where implementing a "Suggestion" would improve the overall running of the company from a management point of view.

The Supervisory Letter will be sent out in draft form to allow opportunity for response and comment on the Supervisory Letter. The regulatory team should be flexible to work with the supervised institution's request for changes but be careful not to alter the substance of the Supervisory Letter. Judgement will play a major role in the amendment of the inspection Supervisory Letter.

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THE ROLE OF REGULATORY TEAM

The role of regulatory team in the onsite inspection process is to maintain a high level of familiarization with every supervised institution's operations and performance to ensure that it is operating in a satisfactory manner. The monitoring process is ongoing. The role of the regulatory team, therefore, is the early detection of weaknesses and deficiencies in the controls and systems of supervised institutions. Where **weaknesses or deficiencies have been identified**, it is the responsibility of the regulatory team to **immediately inform the FSRC's Head of the Department Division and provide recommendations** as to what appropriate remedial action should be taken by the institution. Following the communication of the required corrective action to the supervised institution, regulatory team members should monitor the progress of the institution and provide regular reports to the FSRC's Head of the Department to ensure that early detection of any further problems can be identified.

Regulatory Team members are representatives of the FSRC and have an obligation to conduct their business in a manner that enhances trust and confidence. The information obtained during the on-site inspection process regarding the company and its stakeholders remains confidential between the supervised institution and the FSRC.

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POST-EXAMINATION

At the conclusion of the examination the FSRC's Head of the Department will:

- Review the work performed by the Regulatory Team (if not previously reviewed);

- Organize the overall conclusions, and verify that all assertions of facts or opinions are specifically substantiated in the checklist(s)and any accompanying work papers;

- Formulate general comments and conclusions relative to the supervised institution's overall condition, and specific comments and conclusions relative to particular subject areas, practices, etc.;

- Present findings to the Chief Regulatory Officer for approval;

- Present the draft Supervisory Letter of results of the inspection to the management and board of the supervised institution within one month from of the date of the onsite examination.

- The supervised institution has one month to review the factual accuracy of the Supervisory Letter;

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- On receipt of the comments from the supervised institution the final Supervisory Letter is issued within one week.

FOLLOW-UP

Once the supervised institution has been provided with the Supervisory Letter it is the responsibility of the FSRC regulatory team to ensure that the institution implements the recommendations. The supervised institution should be advised of an appropriate time frame which would not normally exceed 3 months from the date of the Supervisory Letter to effect the implementation. The Regulatory Team will then conduct a follow-up visit to review the progress the supervised institution has made towards achieving the recommendations.

10. ENFORCEMENT

The FSRC's effective and proportionate use of its powers to enforce the requirements of the regulatory laws and other relevant legislation (for example, the money laundering regulations) plays an important role in pursuit of its regulatory objectives.

The FSRC has a range of regulatory tools available to help it meet its regulatory objectives. Where a supervised institution has failed to comply with the legislative requirements, it may be appropriate to address this without the need for formal disciplinary or other enforcement action. In those circumstances where the FSRC does take disciplinary action in respect of the contravention of the regulations, the effective use of the

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enforcement powers under the regulatory laws, where necessary, will play an important role in buttressing the FSRC's pursuit of its regulatory objectives.

There are a number of principles underlying the FSRC's approach to the exercise of its enforcement powers:

- The effectiveness of the regulatory regime depends to a significant extent on the maintenance of an open and co-operative relationship between the FSRC and those whom it regulates.

- The FSRC will seek to exercise its enforcement power in a manner that is transparent, proportionate, and consistent with its publicly stated policies and guidelines.

- The FSRC will seek to ensure the fair treatment of those who are subject to the exercise of its enforcement powers.

Enforcement options available to the FSRC include:

- ❖ Addressing the regulation breaches and complaints
- ❖ Discussions with Home regulators where relevant to agree strategies
- ❖ Issue a breach letter
- ❖ Meeting with the Board of Directors of the supervised institution to discuss the breaches and expected resolutions
- ❖ Issuing written directives to the supervised institution;

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- Issuing restrictions on the operations of the supervised institution to include increasing capital requirement, suspension of dividend and bonus payment, expansion of new services etc.;
- Requiring the substitution of a director, operator, senior officer, general partner, promoter, insurance manager or shareholder of the supervised institution (as applicable);
- Levying administrative penalties;
- Suspension of the licence or certificate of registration of a supervised institution and preservation of its records;
- Revocation of the licence or certificate of registration of a supervised institution;
- Appointing a person to assume control of the affairs of the supervised institution;
- Appointing a person to advise the supervised institution on the proper conduct of its affairs
- Applying to the High Court directing that the company be dissolved.

ROTATION OF PORTFOLIO

In keeping with good corporate governance the assignment of portfolio of supervised financial institutions will be expected to be rotated from time to time. There will be very few occasions in which the same regulatory team members are assigned the same supervised financial institutions for 24 months and more. In the event that there is deterioration in the risk profile of a supervised institution the assignment of the portfolio will be aligned in accordance with seniority/experience as shared (if this can be achieved in an equitable manner) as shown in the below table. The assignment related to deterioration of risk profile

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will take place as soon as possible. Under no circumstances will a licensed institution with a rating of High should be assigned to a Senior or Regulatory Team Support or Assistant Regulatory Team Support.

Additionally Systemically Important Financial Institutions (SIFIs) must be assigned to the Head or the Regulatory Team Leader or Senior Regulatory Team Support regardless of the Risk Profile and will be subject to annual onsite examination. Given the size of these institutions and the potential implications to the reputation of the jurisdiction, the Chief Regulatory Officer (CRO) will participate in the onsite examination and the quarterly peer reviews.

Where possible there will be rotation of the team members on onsite examinations and we would **not expect to see the same team members conducting consecutive onsite examinations for financial institutions with overall risk profile of Low and Moderate**. Similarly, the onsite examination of financial institution with a risk profile with Above Average and High must be completed with the appropriate seniority. (See Table 4)

There will be occasions where the Head of Department will exercise his/her discretion to rotate the assignment of portfolios during a calendar year even though there is no deterioration in the risk profile. In such cases the Director will have prior discussion with the team member.

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Table 4: ROTATION OF REGULATORY TEAM

RISK CATEGORY	RESOURCING	FREQUENCY OF ONSITE EXAMINATIONS
LOW	Regulatory Team Support (RTS)/Assistant Regulatory Team Support (ARTS)	**3-5 years**
MODERATE	RTS/SRTS or Regulatory Team Leader (RTL)	**1-3 years**
ABOVE AVERAGE	SRTS or RTL/Head (D)	**Annually**
HIGH	D/CRO	**As required**

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APPENDIX A: RISK ASSESSMENT (RISK MATRIX)

Name of Institution: ***(period of review).***

Significant Activities	Materiality	Inherent Risk						Quality of Risk Management						Residual Risk	Direction of Risk
		Credit	Market	Insurance	Operational	Legal & Regulatory	Strategic	Operational Management	Compliance	Internal	Risk Management	Senior Management	Board Oversight		
Overall Rating															

Capital		**Earnings**		**Liquidity**	
Composite Rating		**Direction of Risk**		**Time Frame**	

Note:

For *Inherent Risk, Net Risk (or residual risk) in Significant Activity; Overall net risk in all Significant Activities taken together,* and *Composite Risk*: "**H" = High; "AA" = Above Average; "M" = Moderate; "L" = Low**

For *Quality of Risk Management, Corporate Oversight and Governance, Capital, Earnings and Liquidity*: **"S" = Strong; "A" = Acceptable; "NI" = Needs Improvement; "W" = Weak**

For *Direction of Risk*: "**I" = Increasing; "S" = Stable; "D" = Decreasing**

APPENDIX B: CATEGORIES OF INHERENT RISKS AND RATING DEFINITIONS

Inherent Risk Categories

Following are descriptions of the eight 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. [Remember, **Reinsurance is not an inherent risk.** It is a mitigation practice to reduce insurance risk. **Where reinsurance activity is significant, for example in general insurers, it is also treated as a Significant Activity to assess inherent risks (mainly credit and operational) resulting from the activity.**

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. **Product design is an activity and not an inherent risk.** It is assessed as part of a line of business. Inherent risks in a line of business would generally be insurance and operational risks.

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. **Underwriting is not an inherent risk.** It is an activity undertaken by insurers. Generally, key inherent risks in underwriting a line of business are insurance and operational. Similarly, **liability is not an inherent risk**. It is an obligation resulting from the institution's activities.

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.

Concentration Risk

Concentration risk can arise from uneven distribution of exposures (or loan) to its borrowers. Such a risk is called Concentration risk. Another type is sectorial concentration risk which can arise from uneven distribution of exposures to particular sectors, regions, industries or products. **<u>Concentration is not an inherent risk.</u>** *[eg. In lending portfolio inherent credit risk would be higher if the portfolio is concentrated compared to a portfolio that is sufficiently diversified.]*

Reputation Risk

The risk of potential losses arising from negative public opinion, whether based on facts or merely public perception and the adverse impact this could have on the financial institution's revenues, liquidity, capital, operations or customer base. **<u>Reputation is not an inherent risk and is consequential.</u>** [It is an indirect impact resulting of a supervised institution not managing one of its inherent risks effectively.]

APPENDIX C: 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 D: 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 E: 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.

Normally, 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.

Normally, 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.

Normally, 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.

Normally, 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 F: 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 it's near term liquidity needs and may require external financial assistance.

APPENDIX G: 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 H: 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.

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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 then 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 I: 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.

APPENDIX J: 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:

1. 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.
2. Appropriateness of the organization structure and reporting relationships, including an appropriate level of seniority of the head of the function.
3. Adequacy of resources to carry out its mandate, including staffing levels and required skills.
4. Adequacy of its methodologies and practices for effective execution of its enterprise-wide

mandate.

5. Extent of Senior Management and Board oversight of the function.

Examples of Performance Indicators

1. 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.
2. Actively monitors adherence to compliance requirements across the institution's operations, and follows-up on significant breaches for timely resolution.
3. Escalates significant breaches of compliance requirements to Senior Management and the Board.
4. 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:

1. Independent enterprise-wide mandate to oversee 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 its risk based audit methodologies and practices.
5. Adequacy of its planning, coverage cycle and reporting and follow-up practices.

6. Extent of Senior Management and Board oversight.

Examples of Performance Indicators

1. Actively seeks relevant information from others (e.g. Compliance, Risk Management, Senior Management, external auditors, etc.) in developing risk based supervisory strategies and plans.
2. Reviews business plans and strategies to identify activities that could materially impact the institution and ensures that they will be effectively managed and overseen.
3. Effective and timely execution of its risk based audit plans, including timely reporting and follow-up of identified issues for satisfactory resolution.
4. Considers pervasiveness and significance of its findings both at the Significant Activity level and in aggregate across the institution's activities.
5. 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

Role:

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:

- Identify current and emerging risks in the institution's operations,
- Develop measurement systems for risks,
- Establish policies and practices for managing risks,
- Develop risk tolerance limits and periodically stress test limits,
- Monitor positions against approved limits, and
- 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

1. Proactively updates policies, practices and limits in response to changes in the institution or externally.
2. Integrates policies, practices and limits in to day to day business activities, and with the institutions strategic, capital and liquidity planning.
3. Regularly monitors risk positions against approved limits and ensures that material breaches are addressed on a timely basis.
4. Actively participates in the development of new initiatives to ensure processes are in place to identify and mitigate risks prior to implementation.
5. 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:

- Developing business objectives, strategies, policies (including policies for risk management and risk appetite), organizational structure and controls for Board approval;
- 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.
- Developing and promoting sound corporate governance practices; and
- 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

1. Develops appropriate strategies and plans to attain business objectives for approval by the Board of Directors, including risk policies, limits, practices and reporting systems.
2. Actively monitors execution of Board approved strategies, plans, policies, etc for effective implementation.
3. Proactively reviews business objectives, strategies, plans, policies and limits in response to significant changes and adverse trends in the external environment.
4. Sets appropriate tone from the top through the manner in which it carries out its duties.
5. Is successful in building an effective organization by attracting, developing and retaining high caliber staff.
6. Keeps the Board of Directors and its Committees fully appraised 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:

- Reviewing and approving organizational structure, including clearly defining roles and responsibilities of its committees, management and heads of oversight functions.
- Regularly reviewing, approving and overseeing the implementation of the institution's
- Business objectives, strategies to achieve the objectives and policies for major activities, including risk strategies and appetites.
- Ensuring that management and heads of oversight functions are qualified and competent.
- Providing oversight over the design and effective implementation of sound risk management and internal control systems.
- Providing for an independent assessment of, and reporting on, effectiveness of the

institutions operations.

- Approving remuneration policies and practices.
- Monitoring performance against business objectives, strategies and plans and requiring timely corrective actions were warranted; and
- 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

1. Active involvement in the selection and performance evaluation of the CEO and other members of Senior Management as appropriate
2. Performs a regular independent in-depth review and evaluation of the institution's

business objectives and strategies and risk tolerance limits.

3. Regularly reviews the institution's corporate governance and risk management structures, policies and practices
4. Clearly sets out the type and quality of information it requires and related frequency.
5. Actively engages in the review of information provided by Senior Management for Board
6. Approval, including challenging management's assumption.
7. Requires effective and timely resolution of issues identified by others, including Compliance, Internal Audit, Risk Management, actuary, external auditors, etc.