Risk-based Supervisory Framework

Approved by the FSRC Board of Commissioners
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1. INTRODUCTION

The Financial Services Regulatory Commission (FSRC) is the regulatory body which licenses, supervises and regulates the operations of the financial services sector in St. Kitts and Nevis. All regulated entities are expected to adhere to the relevant laws and regulations, which includes periodic onsite inspections and regulatory reporting requirements. The FSRC monitors regulated financial services activities to safeguard the public against any illegal and or unauthorised financial services business operating within or from St. Kitts and Nevis.

The authority of the FSRC emanates from the Financial Services Regulatory Commission Act, Cap 21.10.

The FSRC's mission is to promote good governance and accountability in a strong regulatory environment, aimed at protecting and strengthening the reputation and viability of the St. Kitts and Nevis Financial Services Industry.

The core functions of the FSRC inter alia, are to:

- Be the ultimate regulatory body for financial services and for anti-money laundering for St. Kitts and Nevis;
- Maintain a general review of the operation of all regulated entities;
- Monitor financial services business carried on in or from St. Kitts and Nevis and to take action against persons carrying on unauthorised business;
- Monitor compliance by regulated persons with the Proceeds of Crime Act, the Anti-Terrorism Act and such Acts, regulations, codes or guidelines relating to money laundering or financing of terrorism;
- Monitor the effectiveness of the relevant enactments in providing for the supervision and regulation of financial services business carried on in or from St. Kitts and Nevis in accordance with internationally accepted standards;
- Authorise and examine the affairs or business of a regulated entity for the purpose of satisfying itself that the provisions of relevant legislation and regulations are complied with and that a regulated entity is in a sound financial position and is managing its business in a prudent manner; and

- Monitor compliance by regulated persons with Core Principles and regulatory and supervisory measures that apply for prudential purposes but which are also relevant to money laundering and terrorist financing.

The FSRC has responsibility for the administration of the following pieces of legislation:

- Financial Services Regulatory Commission Act, Cap. 21.10
- Anti-Money Laundering Regulations, No. 46 of 2011 (as amended)
- Anti-Terrorism (Prevention of Terrorist Financing) Regulations, No. 47 of 2011 (as amended)
- Financial Services (Implementation of Industry Standards) Regulations No. 51 of 2011
- Proceeds of Crime Act, Cap 4.28 (as amended)
- Money Services Business Act, Cap 21.21

St. Kitts Branch:

- Insurance Act, Cap 21.11 (as amended)
- Captive Insurance Companies Act, Cap 21.20 (as amended)
- Co-operative Societies Act, No. 21 of 2011 (as amended)
- Money Services Business Act, Cap 21.21
- Financial Services (Regulations) Order, Cap 21.03. (Seventh Schedule)
- Development Bank of St. Kitts and Nevis, Cap 21.05.

Nevis Branch:

- Nevis Business Corporation Ordinance, Chapter 7.01
- Nevis Limited Liability Company Ordinance, Chapter 7.04
- Nevis International Exempt Trust Ordinance, Chapter 7.03
- Nevis Multiform Foundations Ordinance, Chapter 7.08
- Nevis International Insurance Ordinance, Chapter 7.07
- Nevis International Mutual Funds Ordinance, Chapter 7.09
- Nevis International Banking Ordinance, 2014

The FSRC's main activities can be divided into two broad functions: regulation and supervision.

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

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

The supervisory framework is a principle and risk-based structured methodology designed to facilitate 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-economics and industry perspectives in the assessment of individual institutions.

This document presents the Risk Based Supervision Framework as adopted by the FSRC in 2015. The framework applies to all regulated entities. It is applicable to both off-site and on-site surveillance and includes the actions to be performed during the supervisory process. 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 principles 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 regulated entities; 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 regulated entities 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 regulated entity's Corporate Oversight and Governance functions to minimize duplication of effort.
7. Communication of assessments and recommendations to regulated entities 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 regulated entity. Regulated entities that are well managed relative to their risks will require less supervision. Not all areas within a regulated entity need to be reviewed every year.
9. It enables the assessment of the risk profile of a regulated entity to be maintained current and provides an objective basis for allocating supervisory resources across regulated entities and within a regulated entity.
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.

3. BENEFITS OF THE SUPERVISORY APPROACH

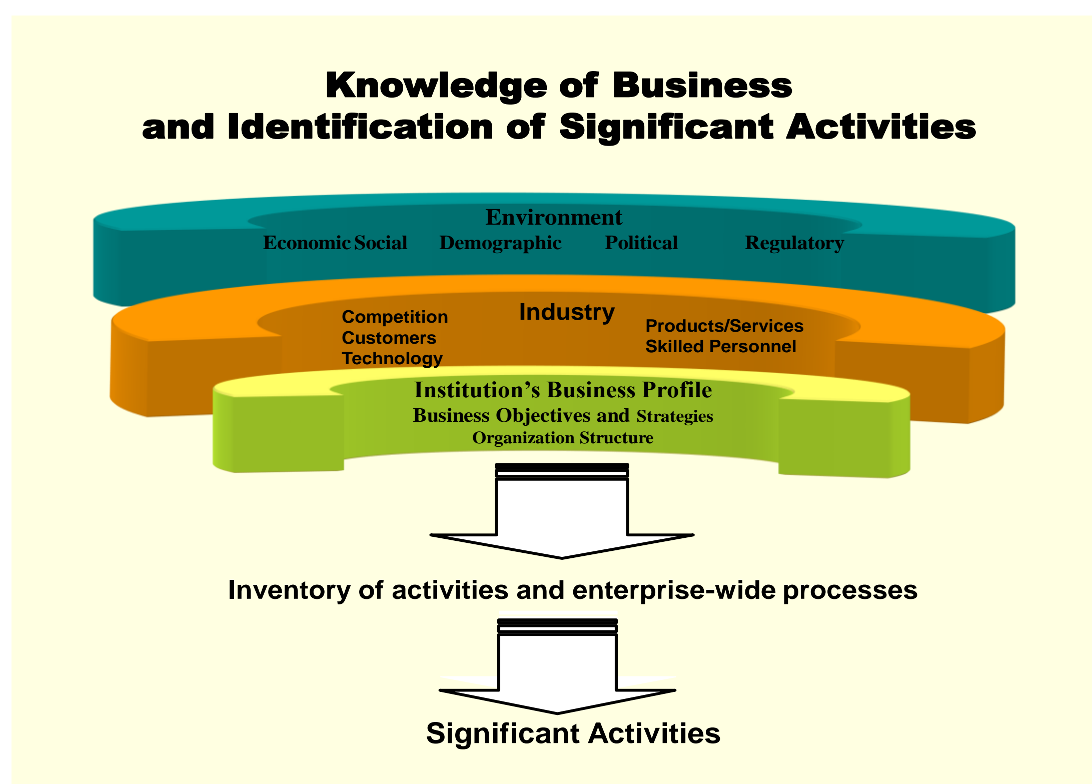
The key benefits of the supervisory approach are:

- closer integration of macro and micro prudential supervision, with focus on early identification of emerging risks to facilitate timely interventions;
- assessments parallel how a regulated entity is managed;
- better evaluation of risk through separate assessment of inherent risks and risk management processes resulting in a deeper understanding of a regulated entity's

operations, its risk appetite and the key drivers of its risk profile;

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

4. INTEGRATING MACRO AND MICRO PRUDENTIAL SUPERVISION.



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

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

Methods of introducing macro prudential supervision factors include surveillance of the broader economic environment and the industry to identify emerging trends and vulnerabilities, as well as peer comparisons of individual institutions. It also includes regular exchange of information and assessments with other regulators as appropriate.

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

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

Table 1 details reliable external sources that can be consulted to assist Supervisors in identifying and monitoring macro prudential factors.

Table 1: Macro-prudential consultative materials and degree of reliance

Materials	Reference	Degree of Reliance
IAIS supervisory Materials (including Insurance Core Principles)	http://www.iaisweb.org/page/supervisory-material	High
WOCCU Publications	http://www.woccu.org/publications	High
FATF Publications (including FATF 40 Recommendations)	www.fatf-gafi.org/publications/	High
ACAMS Publications	http://www.acams.org/aml-resources/#publications	High
The World Bank Publications	http://www.worldbank.org/en/publication/reference	High
International Monetary Fund Publications	https://www.imf.org/external/publications/	High
CARTAC Reports and Publications	http://cartac.org/library/	Moderate
Rating Agencies	https://www.standardandpoors.com http://www.ambest.com http://www.caricris.com/	Moderate

Macro Prudential Risk Factors

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

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

Industry Risk Factors

Industry analysis involves research and assessments of the state of the industry with a view to identifying issues or emerging risks. Industry analysis is based on periodic information filed by

institutions with the FSRC as well as industry information available from other sources such as industry publications, websites, 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 through peer comparisons.

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

Institution's Business Profile

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

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

Supervising an organization is the act or process of overseeing the performance or operations by regulating control or direction in accordance to rule, principle or law.

In order for the FSRC to regulate licensed entities, Supervisors would abide by the following principles:

- Identify the nature of the business or sector
- Familiarize one's self with the business environment
- Identify the risk(s) posed and how to adequately mitigate these risks; and
- Implement a risk matrix to ensure effective supervision is carried out.

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

Risk-based Supervision Methodology

The following table is comprised of five key elements, each of which uses certain written procedures to facilitate and coordinate the risk-based supervisory process of regulated entities:

No	ACTIVITY	DELIVERABLE
1	Assessing Risk Profile of the Regulated Entity	a) Understanding the Regulated Entity b) Identifying and assessing significant activities c) Summary of risks identified
2	Planning and Scheduling Supervisory Activities	a) Meeting with Management b) Targeted Examinations c) Use of off-site surveillance tools including financial statements and regulatory returns
3	Defining On-site Examination Activities	a) Timeline b) Letter of Intent/Request c) Pre-Examination Report

No	ACTIVITY	DELIVERABLE
4	Performing On-site Examination	a) Compilation of Examination Work Papers b) Prepare Draft Examination Report
5	Identification of Deficiencies and Follow-up Examination	a) Presentation of Report to FSRC Board of Commissioners i) Identification of matters that require attention ii) Timeframe for Compliance b) Presentation of Report to Regulated Entity c) Conduct Follow-up Examination d) Monitoring

5. ASSESSING THE RISK PROFILE OF A REGULATED ENTITY

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

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

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

The above steps are interrelated and operate in a dynamic manner. They represent building

blocks for assessing the risk profile of an institution. The quality of assessment in each step can impact the quality of the assessments in the steps that follow, ultimately impacting the quality of the overall assessment. Hence, it is important that each step is carried out at an appropriate level of quality for a sound overall assessment of the institution's risk profile.

The above steps are discussed below.

The first risk matrix (**Appendix A**) is used to summarize the assessments made through the supervisory process for financial institutions, i.e. prudentially supervised entities, such as development banks, international banks, credit unions, insurance companies and money services businesses.

It highlights the financial 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 second risk matrix (**Appendix A**) is used to assess Authorized Persons and Registered Agents for AML/CFT Compliance.

The risk matrices provide a one page window into the regulated entity's operations and facilitate visualization of the components that are the key drivers of the regulated entity's risk profile. Assessments recorded in the risk matrices are supported by supervisory documentation.

Identifying Significant Activities

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

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

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

a. assets generated by the activity in relation to total assets;
b. revenue generated by the activity in relation to total revenue;
c. net income before tax for the activity in relation to total net income before tax;
d. risk-weighted assets generated by the activity in relation to total risk-weighted assets;
e. internal allocation of capital to the activity in relation to total capital,;
f. return of investments;
g. number of clients;
h. type of products/services offered;
i. growth of premiums from insurance products and services, and
j. 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

Inherent risk is a risk which cannot be segregated from the activity. It is intrinsic to an activity and arises from exposure to and uncertainty from potential future events. Inherent risks are

evaluated by considering the degree of probability and the potential size of an adverse impact on an institution's capital or earnings.

A thorough understanding of the environment in which an institution operates and its various business activities is essential to effectively identify and assess risks inherent in its activities.

For assessment purposes, the FSRC assesses the risk of, monitors and regulates the following sectors: Insurance Companies, Development Banks, International Banks, Trust and Corporate Service Providers, Credit Unions and Money Services Businesses. The inherent risks of each sector would be evaluated based on seven unique categories out of thirteen depending on the sector being evaluated.

- Credit
- Market
- Underwriting/Liability
- Operational
- Legal/Regulatory
- Strategic
- Reputational
- Concentration
- Geographical
- Actuarial
- Money Laundering/Financing of Terrorism
- Product
- Counterparty

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

Key risks are assessed without regards to the size of the activity and without considering the impact of risk mitigation by the institution. The assessment is dynamic and forward looking. Size

of the activity is considered separately in assessing Overall Residual Risk in all of the institution's Significant Activities taken together.

The levels of key inherent risks are assessed as **1=Low (L), 2=Medium Low(ML), 3=Moderate (M), 4=Medium High (MH)or 5=High(H)**. The above risk categories and the rating definitions are described in Appendix B.

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

Assessing Operational Management, Corporate Oversight and Governance

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

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

Operational Management

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

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

Corporate Oversight and Governance

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

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

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

Senior Management retains the responsibilities not delegated to oversight functions. In smaller institutions, Senior Management sometimes performs responsibilities normally carried out by Operational Management. In these cases, the institution will need to demonstrate how independent oversight is provided over these responsibilities.

Operational Management, Corporate Oversight and Governance functions are assessed as **1=Strong (S),2=Satisfactory (SA),3=Needs Improvement (NI),4=Weak (W) or 5=Critically Deficient (CD).**These rating categories are described in Appendix C.

Assessing Residual Risk in each Significant Activity

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

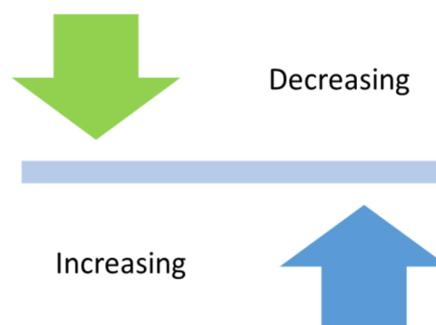
For example, a corporate lending activity may be assessed as having a high credit risk, and a moderate level of operational risk. However, the residual risk for the activity may be assessed as moderate due to an acceptable level of risk management by Operational Management and a strong oversight by Internal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

Net residual risk for an activity is assessed as**1=Low (L),2=Medium Low (ML),3=Moderate (M), 4=Medium High (MH) or 5=High (H).**

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

Quality of Risk Management		Level of Inherent Risk				
		1	2	3	4	5
		Low	Medium Low	Moderate	Medium High	High
1	Strong	Low	Low	Low	Medium Low	Moderate
2	Satisfactory	Low	Low	Medium Low	Moderate	Medium High
3	Needs Improvement	Low	Medium Low	Moderate	Medium High	High
4	Deficient	Medium Low	Moderate	Medium High	High	High
5	Critically Deficient	Moderate	Medium High	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.

The direction of residual risk adds a forward looking perspective to the risk-based approach. It looks at the adverse impact that an institution may face due to exposure and uncertainty from potential future events, including, but not limited to:

- Changes in Management;
- Changes in the institution's external environment;
- New products;
- New markets;
- New distribution channels; and
- Change in IT systems/Software upgrade compatibility issues.

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 1=**Low (L), 2=Medium Low (ML), 3=Moderate (M), 4=Medium High (MH)or 5=High (H)**. Definitions of these rating levels are included in Appendix D. The direction of Overall Residual Risk is assessed as **Decreasing (D), Stable (S), or Increasing (I).**

Assessing Earnings, Capital and Liquidity

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

Earnings, Capital and Liquidity are assessed as **1=Strong (S), 2=Satisfactory (SA), 3=Needs Improvement (NI),4=Weak (W) or 5=Critically Deficient (CD).** Definitions for these rating levels are included in Appendix E. The criteria used to assess Earnings, Capital and Liquidity are summarized below:

Earnings

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

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

Capital

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

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

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

Liquidity

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

Assessment of liquidity considers the current level and prospective sources of liquidity compared to funding needs (both under normal and stressed conditions) as well as the adequacy of liquidity management practices in the context of the size, complexity, and risk profile of the institution. The assessment, for example, considers:

- 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 funding plans.

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

Assessing the Risk Profile of the Institution

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

The risk profile is assessed as **1=Low (L), 2=Medium Low (ML), 3=Moderate (M), 4=Medium High or5=High (H)**.Definitions of these rating levels are included in Appendix F.

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

The stability of the assessment is indicated in terms of a time frame. For example, a shorter time frame is assigned in cases where the risk profile is likely to be more volatile and a longer time frame in cases where the risk profile is expected to be more stable.

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

6. GUIDE TO INTERVENTIONS

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

A Guide to Intervention is included as Appendix G. It outlines the types of actions that supervisors consider, depending on the regulated entity'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 interpreted as limiting the actions that can be taken in dealing with specific concerns. The guide aims to outline at which level an intervention would typically occur. The actions indicated are cumulative; i.e. actions indicated at the lower level of risk are implicitly included in actions that could be considered for institutions with a higher risk profile. Also, if circumstances warrant, actions can be taken at a risk level lower than that indicated in the guide.

7. OVERALL ASSESSMENT OF CORPORATE OVERSIGHT AND GOVERNANCE FUNCTIONS

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

Corporate Oversight and Governance functions are rated as **1=Strong (S), 2=Satisfactory (ST), 3=Needs Improvement (NI), 4=Weak (W) or 5=Critically Deficient (CT).**

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

8. CONSOLIDATED SUPERVISION

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

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

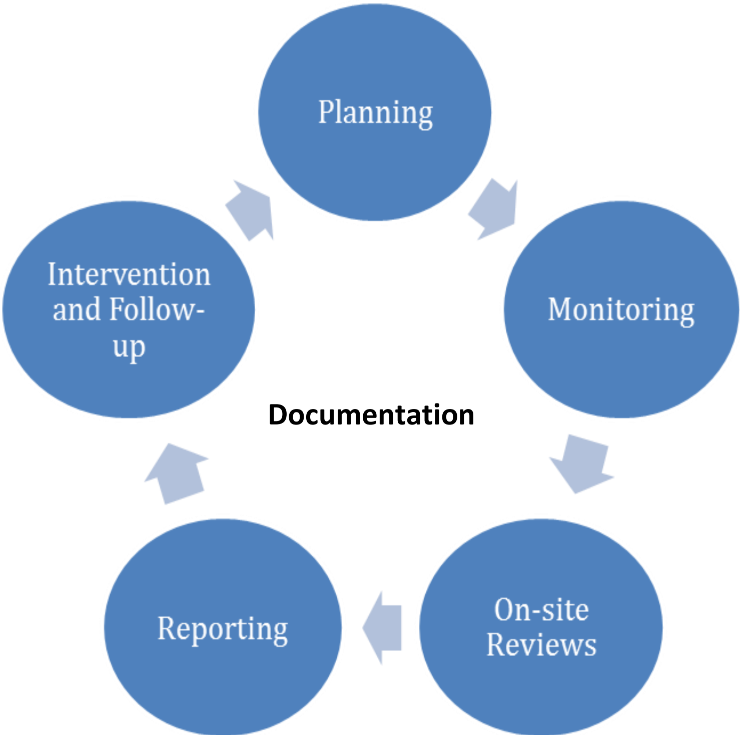
a. Where the regulated subsidiary represents a significant part of the consolidated entity and is operated independently of the group.
b. Where a regulated subsidiary requires a more in-depth review to adequately assess the subsidiary's impact on the consolidated entity than would be possible at the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

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

9. THE SUPERVISORY PROCESS

The FSRC has established supervisory departments for each sector. Each department is responsible for the ongoing supervision of the financial institutions in each sector and for ensuring that supervisory processes are completed effectively and on a timely basis.

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



Planning

The risk-based supervision framework begins with an understanding of the regulated entity. The supervisory plan involves developing/updating a supervisory strategy for a regulated entity and developing an annual supervisory plan. It must be tailored to meet the characteristics of the regulated entity and adjusted based on current circumstances.

A supervisory strategy is a multi-year plan for supervising a regulated entity, taking into account the nature, size, complexity and risk profile of the regulated entity. It outlines the supervisory work planned for three to four years, with an overall objective of reviewing all material areas of the regulated entity 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 regulated entity. Not all activities of a regulated entity need to be reviewed each year; but, higher risks 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 regulated entities. Not all regulated entities need to be reviewed each year. Reviews of regulated entities are prioritized taking into account their systemic importance, their risk profiles, their volatility, material changes in strategies, any significant changes in management or corporate governance, etc. This is to ensure that available supervisory resources are allocated effectively across regulated entities based on risk.

Monitoring

Institution specific monitoring includes a review of company information (including regulatory returns, audited financial statements) 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 regulated entity 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 regulated entity, the supervisory strategy and plan are adjusted in the context of the changes. These adjustments are dynamic and help ensure effective utilization of resources across institutions as well as for any institution.

On-site Examinations

On-site examinations are a critical part of the supervisory process. The scope of the on-site examination will be tailored to the size, complexity and risk profile of the regulated entity and the nature of prudential concerns, if any. The examination procedures will focus on understanding and adequately assessing management's ability to identify, measure, monitor, control and mitigate risks which are inherent in the regulated entity's activities. Examiners should be able to understand and assess the adequacy of the risk management processes which are in place to support the regulated entity's risk profile. The on-site review and interaction with the regulated entity's management and staff are critical to effective supervision of a regulated entity and deepen the FSRC's understanding of the regulated entity and its risk profile.

Documentation

Effective supervision requires a sufficiently deep understanding of a regulated entity. This understanding is acquired over time through on-site and off-site surveillance as well as through interactions with management and staff of the regulated entity. Hence, it is critical that knowledge acquired through the supervisory process be captured and built over time. Utility of this knowledge across the FSRC will increase if it is captured using a standard structure.

Working papers are an essential part of the examination process. They include any documentation, whether printed or stored electronically prepared by the examiners or obtained from the regulated entity during the process.

Once the initial assessments of Significant Activities and Corporate Oversight and Governance functions are captured, future changes are incorporated by updating the original documents which makes the process more efficient.

Reporting

Regulated Entities are required to provide the FSRC with annual reports. Pursuant to the Financial Services Regulatory Commission Act, Cap 21.10, regulated entities are required to prepare and submit a copy of their financial statements and auditor's report to the FSRC within three months of the end of their financial year. Regulation 3 of the Financial Services (Implementation of Industry Standards) Regulations, 2011 also stipulates that all regulated entities carrying on financial services in the jurisdiction are required to submit reports as well as a Certificate of Compliance to the FSRC.

Additionally, Supervisors prepare a Status Report, at least quarterly, to the Director of the FSRC to communicate their overall assessment of an institution's risk profile, any prudential concerns identified and recommendations for addressing them. The Director also prepares and submits an examination report, at least annually to the FSRC Board of Commissioners.

In the case of on-site reviews, the final stage of the process includes issuing an FSRC Board of Commissioners' approved Examination Report to the Board of Directors of the regulated entity. Assessments, findings and recommendations are first discussed with appropriate senior managers of the regulated entity. This is followed by reporting to the Chief Executive Officer (CEO) and the Board, as appropriate. This report can communicate, inter alia, an overall assessment of the regulated entity's risk profile, any prudential concerns identified and recommendations for addressing them.

Examination Reports to companies incorporated in the country are addressed to the Chairman of the Board or the CEO. Examination Reports to foreign institutions operating branches in the country are addressed to the Principal Officer of the branch. For Regulated Entities that are not companies, the Report is addressed to the Managing Partner of the Regulated Person. Where there are significant issues with a branch, a copy of the Examination Report may be sent to the CEO and the Chair of the Audit Committee at the home office. In all cases, the covering letter requests that a copy of the Examination Report be provided to the external auditors and to the actuary, where applicable.

Follow-up

The objective of this activity is to follow up on implementation of the prescribed directives and recommendations made to the regulated entity. Identified deficiencies and concerns are monitored by FSRC for timely resolution by the entity. Status reports from regulated entities are submitted to the FSRC based on specified timeframes and shall detail any remedial action being taken by the regulated entity.

APPENDIX A

RISK MATRIX

RISK ASSESSMENT WORKSHEET

NAME OF FINANCIAL INSTITUTION	ABC Company	
DATE	Oct-15	
Composite Risk Rating		Direction

Significant Activities	Materiality	Inherent Risks	Inherent Risk Score (CORBASCLE)	Quality of Risk Mgn.	Quality of Risk Management - Oversight					Overall Quality of Risk Mgn.	Residual Risk	Direction of Risk	
				Operation Management	Compliance	Internal Audit	External Audit	Risk Management	Senior Management				
Trusts	M	Geographic										STABLE	Materiality
International Business Company	M	Operational										STABLE	
Limited Liability Company	M	Legal / Regulatory										STABLE	M = Material
Registered Agent	M	Reputation										STABLE	
Nominee Director	M	Strategic										STABLE	N = Not Material
Citizenship by Investment	M	Concentration										STABLE	
Overall Rating of Inherent Risks												Agg. Risk Assessment	
Composite Risk		Direction	Stable	Capital		Earnings		Liquidity					

Rating Schedule for " Operation Management and Quality of Risk Management"
1 = Strong; 2 = Satisfactory; 3 = Needs Improvement; 4 = Deficient; 5 = Critically Deficient

Rating Schedule for "Capital, Liquidity and Earnings and Inherent risks"
1 = Low; 2 = Medium Low; 3 = Moderate; 4 = Medium High; 5 = High

Step 1: Identify the Significant Activities (SA) in FI
Step 2: Determine Materiality in the Significant Activities identified
Step 3: Identify the Inherent Risks in the FI
Step 4: Assess each of the Inherent Risk identified
Step 5: Score the OM and QRM for each Inherent risk identified.
Step 6: Assess the Capital, Liquidity and Earnings components
Step 7 Compare Composite Risk with prior period and determine Risk Direction
Step 8: Determine Composite Risk for each FI

COMMENTS
The Examiners were able to assess the financial soundness of the Regulated Person as the Annual Accounts were submitted to the FSRC for review and anlysis.

AML/CFT Risk Assessment

COMPLIANCE ASSESSMENT WORKSHEET

NAME OF FINANCIAL INSTITUTION	ABC Company			
DATE	Oct-15	Composite Risk	#DIV/0!	Direction: Increasing

Elements of Inherent Risks	Inherent Risk	Quality of Risk Mgn.	Quality of Risk Management - Oversight				Overall Quality of Risk Mgn.	Residual Risk	Direction of Risk
		Mandate/ Objective	Organization Structure	Resources	Methodology and Practices	Senior Management and Board Oversight			
Policies and Procedures Manual							#DIV/0!	#DIV/0!	Stable
Training							#DIV/0!	#DIV/0!	Stable
Recognition of Suspicious Activities							#DIV/0!	#DIV/0!	Stable
Know Your Customer (KYC) Procedures							#DIV/0!	#DIV/0!	Stable
AML/CFT Compliance Program							#DIV/0!	#DIV/0!	Stable
Customer Due Diligence							#DIV/0!	#DIV/0!	Stable
Reporting of Suspicious Activities							#DIV/0!	#DIV/0!	Stable
Record Keeping Procedures							#DIV/0!	#DIV/0!	Stable
Compliance Officer							#DIV/0!	#DIV/0!	Stable
Know Your Employee Procedures (KYE)							#DIV/0!	#DIV/0!	Stable
Internal/Independent Audit Function							#DIV/0!	#DIV/0!	Stable
Risk Assessment							#DIV/0!	#DIV/0!	Stable
Composite Risk	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	Agg. Risk Assessment

Rating Schedule for "Quality of Risk Management"

1 = Strong; 2 = Satisfactory; 3 = Needs Improvement; 4 = Deficient; 5 = Critically Deficient

Step 1: Identify the Elements of Inherent Risk in FI/Entity/Regulated Person.
Step 2: Identify the Inherent Risks in the FI/Entity/Regulated Person.
Step 3: Assess each of the Inherent Risks identified.
Step 4: Score the QRM for each Inherent risk identified.
Step 5: Determine Composite Risk for FI/Entity/Regulated Person.
Step 6: Compare Composite Risk with prior period and determine Risk Direction.

COMMENTS

Prepared by: **Reviewed by:**

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 re-pricing of assets and liabilities, both on and off balance sheet, as they either mature (fixed rate instruments) or are contractually re-priced (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.

APPENDIX B (cont'd)

Insurance Risk

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

Product Design and Pricing Risk

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

Underwriting and Liability Risk

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

Operational Risk

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

Legal and Regulatory Risk

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

Strategic Risk

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

APPENDIX B (cont'd)

Concentration Risk

Concentration risk can arise from uneven distribution of exposures (or loan) to its borrowers. Such a risk is called Name Concentration risk. Another type is sector concentration risk which can arise from uneven distribution of exposures to particular sectors, regions, industries or products.

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.

Geographical Risk

Supervisors would assess the geographical risk by evaluating the host/parent country of the entity and would verify their existence on the sanction lists, for example UN, OFAC and FATF sanction list.

Risk would also integrate the possible impact from the host/parent country in reference to inference to inadequate regime of the host country which can negatively impact the financial stability and reputation of the entity.

Money Laundering/Financing of Terrorism Risk

Money Laundering/Financing of Terrorism (ML/FT) risk arises when a regulated entity or person, during the provision of designated services to customers for lawful purposes, is exposed by its customers who use those designated services for money laundering or the financing of terrorism.

Actuarial Risk

Actuarial risk arises from the absence of a method by which companies assess and plan for the financial impact of risk.

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.

Medium Low Inherent Risk:
Medium 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.

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

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

APPENDIX C

OPERATIONAL MANAGEMENT, CORPORATE OVERSIGHT AND GOVERNANCE FUNCTIONS RATING CATEGORIES

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

Strong

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

Satisfactory

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.

Critically Deficient

Critically Deficient means major weaknesses exist that are material to the safety and soundness of the institution and are not being addressed.

APPENDIX D

OVERALL RESIDUAL RISK IN SIGNIFICANT ACTIVITIES

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

LOW

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

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.

MEDIUM LOW

The institution has risk management that 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 above average 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.

APPENDIX D (Cont'd)

MEDIUM HIGH

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 E

EARNINGS, CAPITAL AND LIQUIDITY DEFINITIONS

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

Earnings

Strong

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

Satisfactory

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.

Deficient

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

APPENDIX E (Cont'd)

Critically Deficient

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.

Satisfactory

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.

APPENDIX E (Cont'd)

Deficient

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.

Critically Deficient

Institution is insolvent, undercapitalized and does not meet 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.

Satisfactory

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.

APPENDIX E (Cont'd)

Deficient

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

Critically Deficient

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

APPENDIX F

RISK PROFILE RATING DEFINITIONS

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

Low Risk

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

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

Medium Low Risk

A generally sound financial institution that is being managed satisfactorily. 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 satisfactory, 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 short time frame.

An institution in this category would have a moderately low Overall Residual Risk coupled with satisfactory 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.

APPENDIX F (Cont'd)

Moderate Risk

A 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.

Medium High 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.

APPENDIX F (Cont'd)

High Risk

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

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

APPENDIX G

GUIDE TO INTERVENTION

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

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

LOW TO MODERATE RISK PROFILE

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

MODERATE TO MEDIUM HIGH 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.

APPENDIX G (Cont'd)

- 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.

MEDIUM HIGH TO HIGH RISK PROFILE

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

HIGH RISK PROFILE

- Require the institution to retain external specialist to assess specific areas such as quality and valuation of assets, liquidity, etc.
- Further enhance the conditions already imposed on the institution, including for example restricting lending, investments, level of deposits, expansion of operations, payment of interest on subordinated debt, payment of dividends, and other such restrictions warranted by the circumstances.

APPENDIX G (Cont'd)

- Locate supervisory staff at the institution to interact with management and monitor developments on an ongoing basis.
- Put pressure on management and Board of Directors to restructure or sell part or whole of the company's operations.
- Ensure home regulators are kept abreast of the circumstances and the intervention measures taken.
- Develop plans to take control of assets of the company or the company if the circumstances warrant.

HIGH RISK PROFILE WITH AN INCREASING TREND

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

APPENDIX H

OVERALL ASSESSMENT OF CORPORATE OVERSIGHT AND GOVERNANCE FUNCTIONS

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

Strong

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

Satisfactory

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.

Deficient

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 H (Cont'd)

Critically Deficient

Characteristics of the function are critically deficient for the nature, scope, complexity and risk profile of the institution, and the function has demonstrated serious weakness in performance on a consistent basis.

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 Commission 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.

APPENDIX H (Cont'd)

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.

APPENDIX H (Cont'd)

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

9. APPENDIX H (Cont.)

timely resolution.

10. 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 into day to day business activities, and with the institution's 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.

APPENDIX H (Cont'd)

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.

APPENDIX H (Cont'd)

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 Directors' 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

Active involvement in the selection and performance evaluation of the CEO and other members of Senior Management as appropriate

1. Performs a regular independent in-depth review and evaluation of the institution's business objectives and strategies and risk tolerance limits.
2. Regularly reviews the institution's corporate governance and risk management structures, policies and practices
3. Clearly sets out the type and quality of information it requires and related frequency.
4. Actively engages in the review of information provided by Senior Management for Board approval, including challenging management's assumption.
5. Requires effective and timely resolution of issues identified by others, including Compliance, Internal Audit, Risk Management, actuary, external auditors, etc.