Enhanced Risk-Based Supervisory Framework For Supervised Financial Institutions in Sierra Leone

A. Introduction

The Supervisory Framework

The Supervisory Framework describes the principles, concepts, and core process that Bank of Sierra Leone (BSL) uses to guide its supervision of commercial banks. These principles, concepts, and core process apply to all Commercial Banks in Sierra Leone, irrespective of their size.

Supervision involves assessing the safety and soundness of Commercial Banks, providing feedback as appropriate, and using powers for timely intervention where necessary. Its primary goal is to safeguard depositors' funds and maintain a sound financial system. As such, the focus of supervisory work is determining the impact of current and potential future events, both internal to a Commercial Bank and from its external environment, on its risk profile.

Since BSL's Supervisory Framework was first introduced in 2019, significant developments in the financial services industry have changed the nature of the risks and risk management of financial institutions. Meanwhile, international standards and requirements for supervised financial institutions have also been strengthened.

The updated Supervisory Framework described in this document reflects the enhancements made to address these changes and therefore continues to make BSL's risk-based supervision as dynamic and forward-looking as possible, thereby ensuring that BSL can respond effectively to changes in the Sierra Leonean and international financial environment, now and in the future.

Statutory Obligations

The Supervisory Framework is designed to assist BSL in meeting its statutory obligations set out in the Bank of Sierra Leone and Banking Acts of 2019 and other governing legislation regarding the supervision of Commercial Banks. These obligations are broad and overarching, and to meet them in practice requires detailed and consistent standards and criteria for supervising Commercial Banks.

International Expectations

BSL has adopted the Basel Committee on Banking Supervision's "Core Principles for Effective Banking Supervision", as its main source for detailed supervisory standards and criteria. These methodologies specify international expectations for banking supervision. BSL applies these methodologies within the context of its mandate and the nature of the financial system in Sierra Leone.

B. General Approach

The general approach of the Model RBS Framework covers the following key principles:

1. **Consolidated supervision:** the supervision of Supervised Financial Institutions (SFIs) is conducted on a consolidated basis which involves an assessment of the health of an entire group including its subsidiaries and branches both in respective Member States and internationally.

2. **Relationship Manager (RM):** Supervisory Authorities designate for each SFI a relationship manager, who serves as the main contact point on supervisory issues <u>responsible for maintaining an up-to-date assessment of the SFI, as well as being the main contact point for the SFI.</u>

3. **Principles-based supervision:** The Framework for supervision is principle-based and forward looking. It allows Supervisory Authorities to apply sound judgment in identifying and evaluating risks and determining the most appropriate approach from the available supervisory tools to employ in dealing with the risk an SFI faces. It also permits a timely and flexible response to the risks in the financial sector, as well as early identification of problems and timely intervention.

4. **Supervisory Intensity and Intervention**: The intensity of supervision depends on the nature, size, complexity, and risk profile of an SFI, and the potential consequences of its failure.

5. **Board of Directors and Senior Management**: They are responsible for the management of the SFI and ultimately accountable for its safety and soundness and compliance with relevant legislation and regulation.

6. **Reliance on External Auditors:** Supervisory Authorities rely on SFIs' external auditors for the reliability and fairness of the financial statements.

7. **Use of the work of others:** BSL uses, <u>where appropriate</u>, the work of others to reduce the scope of its supervisory work <u>and minimize duplication of effort.</u> This enhances both BSL's efficiency and its effectiveness. For example, as supervisors do not perform audit work, they may use the detailed testing performed by a SFI's external auditor and Internal Audit function to help them assess the effectiveness of controls. Similarly, they may use the detailed analysis performed by the Risk Management function to help them assess the effectiveness.

C. Essential Principles

1. Emphasis on Material Risk: The risk assessment BSL performs in its supervisory work is focused on identifying material risk to an SFI, such that there is the potential for loss to depositors or shareholders.

2. Forward-looking, early intervention: Risk Assessments puts greater emphasis on early identification of emerging risks at individual SFI and on a system-wide basis. This view facilitates the early identification of issues or problems, and timely intervention where corrective actions need to be taken, so that there is a greater likelihood of the satisfactory resolution of issues;

3. Sound predictive judgement: Risk assessment relies upon sound, predictive supervisory judgment. To ensure adequate quality, it is required that supervisory judgements have a clear, supported rationale.

4. Understanding risk determinants: Risk assessment requires understanding the drivers of material risk to an SFI. This is facilitated by sufficient knowledge of the SFI's business model (i.e., products and their design, activities, strategies and risk appetite), as well as the SFI's external environment. The understanding of how risks may develop and how severe they may become is important to the early identification of issues at a SFI.

5. Separate assessment of inherent risks and risk management control processes. Risk assessment requires differentiation between the risks inherent to the activities undertaken by the SFI, and the SFI's management of those risks – at both the operational and oversight levels. This differentiation is crucial to establishing expectations for the management of the risks and to determining appropriate corrective action, when needed.

6. Dynamic adjustment: a dynamic and proactive risk assessment process in order that changes in risk, arising from both the SFI and its external environment, are identified early. BSL's core supervisory process is flexible, whereby identified changes in risk result in updated priorities for supervisory work.

7. Assessment of the whole institution: The application of the Supervisory Framework culminates in a consolidated assessment of risk to an SFI. This holistic assessment combines an assessment of earnings, capital and liquidity in relation to the overall net risk from the SFI's significant activities, as well as an assessment of the SFI's liquidity, to arrive at the composite rating.

D. Main Risk Assessment Concepts

1. Significant Activities

The fundamental risk assessment concept within the Supervisory Framework is that of a significant activity. A significant activity could be a business line, unit or enterprise-wide process that is substantial (fundamental) in meeting the overall business objectives of the SFI.

The BSL identifies significant activities using various sources, including the SFI's strategic and business plans, organizational structure, internal and external reporting and capital allocations. This facilitates a close alignment between BSL's assessment of the SFI and the SFI's own organization and management of its risks and enables BSL to make use of the SFI's information and analysis in its risk assessment.

The selection of significant activities entails professional judgment as these can be chosen using quantitative factors (such as the activity's percentage of total SFI assets, revenue, net income, allocated capital, or its potential for material losses), and/or qualitative factors (such as its strategic importance, planned growth, risk, effect on brand value or reputation, or the criticality of an enterprise-wide process).

2. Inherent Risks

In the BSL's Supervisory Framework, **the key inherent risks, i.e., risks that are likely to have a material impact on the SFI's risk profile**, are assessed for each significant activity of an SFI. The definition of inherent risk is directly related to BSL's mandate to protect depositors. Inherent risk is the probability of a material loss due to exposure to, and uncertainty arising from, current and potential future events. A material loss is a loss or combination of losses that could impair the adequacy of the capital of a SFI such that there is the potential for loss to depositors.

Inherent risk is intrinsic to a significant activity and is assessed without regard to the size of the activity, before considering the quality of the SFI's risk management. A thorough understanding of both the nature of the SFI's activities and the environment in which these activities operate is essential to identify and assess inherent risk.

The BSL uses the following six categories to assess inherent risk: credit risk; market risk; operational risk; regulatory compliance risk; AML/CFT, reputational legal and strategic risk. For each significant activity, the key inherent risks are identified, and their levels are assessed as low, moderate, above average, or high. The categories and levels of inherent risk are described in more detail in Appendix A.

Based on the key inherent risks identified for a significant activity and their levels, supervisors develop expectations for the quality of risk management. The higher the level of inherent risk, the more rigorous the day-to-day controls and oversight are expected to be.

3. Quality of Risk Management (QRM)

BSL assesses the effectiveness of SFI's risk governance at two levels of control. These are:

3.1. Operational Management/First Line of Defence/Local Controls

Operational management/first line of defence for a given significant activity is primarily responsible for the controls used to manage all of the activity's inherent risks on a day-to-day basis. Operational management ensures that there is a clear understanding by SFI line staff of the risks that the activity faces and must manage, and that policies, processes, and staff are sufficient and effective in managing these risks. When assessing operational management, BSL's primary concern is whether operational management is capable of identifying the potential for material loss that the activity may face and has in place adequate controls.

In general, the extent to which BSL needs to review the effectiveness of operational management of a significant activity depends on the effectiveness of the SFI's risk management control functions (see next section). In a SFI with sufficient and effective risk management control functions, **it may often be possible** for BSL to assess the effectiveness of operational management for a given activity using the work of the oversight functions. **However, this approach does not preclude the need for BSL to periodically validate that key day-to-day controls are effective.**

3.2 Risk Management Control Functions (RMCF)

The RMCF are responsible for providing independent, enterprise-wide oversight to operational management/first line of defence. The Framework identifies six Risk Management Control Functions that may exist in the SFI: Board of Directors, Senior Management, Compliance, Risk Management, Internal Audit and Financial Analysis (see Appendix B). The presence and nature of these functions vary depending on the size and complexity of the SFI.

Where an SFI does not have some of these functions, and not sufficiently independent, or does not have enterprise-wide responsibility, BSL expects other functions, within or external to the SFI, to provide the independent oversight needed.

For each significant activity, BSL assesses operational management/first line of defence and each of the relevant oversight functions as Strong, Acceptable, Needs Improvement, or Weak. The appropriate rating is determined by comparing the nature and levels of the SFI's controls or oversight to BSL's expectations developed when assessing the levels of the key inherent risks.

For each relevant oversight function present in a SFI, BSL also determines an overall rating (strong, acceptable, needs improvement, or weak) that reflects the quality of the function's oversight across the entire SFI (see Appendix B). BSL has an Assessment Criteria that guide the determination of the overall rating for each oversight function.

4. Net Risk, and Direction of Net Risk

For each significant activity, the level of net risk is determined based on judgment that considers all of the key inherent risk ratings and the relevant RMCF ratings (effectiveness) for the activity. Net risk is rated low, moderate, above average, or high. Appendix C shows a typical net risk ratings for combinations of inherent risk and RMCF ratings. The net risk assessment includes a determination of the direction of net risk (decreasing, stable, or increasing).

These assessments are horizontal and multi-dimensional and are based on informed qualitative judgements.

BSL expects the SFI to maintain controls and oversight that are commensurate with the key inherent risks, so that levels of net risk are considered prudent by BSL. Where levels of net risk are considered imprudent, the SFI is expected to address the situation by improving the effectiveness of its RMCF thereby reducing inherent risk.

The effectiveness of the Risk Management Control Functions will form the basis for moderating the impact of aggregate inherent risk associated with a particular significant activity. Defined assessment criteria will be used to assess the quality of the Risk Management Control Functions.

5. Importance and Overall Net Risk

The importance of the net risk of the significant activity is a judgment of its contribution to the overall risk profile of the SFI. Importance is rated as low, medium, or high. The significant activities assigned higher importance ratings are the key drivers of the overall risk profile.

The net risks of the significant activities are combined, by considering their relative importance, to arrive at the Overall Net Risk of the SFI. The Overall Net Risk is an assessment of the potential adverse impact that the significant activities of the SFI collectively could have on the earnings performance and adequacy of the capital of the SFI, and hence on the depositors. Overall Net Risk is rated as low, moderate, above average, or high, and the direction is assessed as decreasing, stable, or increasing (See Appendix C for a typical overall net risk ratings).

6. Moderators

6.1 Earnings

Earnings are an important contributor to the SFI's long-term viability. Earnings are assessed based on their quality, quantity and consistency as a source of internally generated capital. The assessment takes into consideration both historical trends and the future outlook, under both normal and stressed conditions. Earnings are assessed in relation to the SFI's Overall Net Risk.

Earnings are rated as strong, acceptable, needs improvement, or weak, and their direction is assessed as increasing, stable, or decreasing.

6.2 Capital

Adequate capital is critical for the overall safety and soundness of SFIs. Capital is assessed based on the appropriateness of its level and quality, both at present and prospectively, and under both normal and stressed conditions, given the SFI's Overall Net Risk. The effectiveness of the SFI's capital management processes for maintaining adequate capital relative to the risks across all of its significant activities is also considered in the assessment. SFIs with higher Overall Net Risk are expected to maintain a higher level and good quality of capital and stronger capital management processes.

Capital is rated **as strong, acceptable, needs improvement, or weak, and its direction is assessed as increasing, stable, or decreasing**.

6.3. Liquidity

Adequate balance sheet liquidity is critical for the overall safety and soundness of SFIs. BSL assesses liquidity of the SFI by considering the level of its liquidity risk and the quality of its liquidity management. Liquidity risk arises from a SFI's potential inability to meet its on- and off-balance sheet obligations as and when they fall due.

The level of liquidity risk depends on the SFI's balance sheet composition, funding sources, liquidity management strategy, and market conditions and events. SFIs are required to maintain, both at present and prospectively, a level of liquidity risk and liquidity management processes that are prudent, under both normal and stressed conditions.

Liquidity is rated as strong, acceptable, needs improvement, or weak, and the direction is assessed as increasing, stable, or decreasing.

7. Composite Risk Rating (CRR)

The CRR is an assessment of the SFI's risk profile, after considering the impact of Capital, Earnings and Liquidity on the Overall Net Risk. The CRR is a significant factor in determining the supervisory response and plan for the SFI. The degree of supervisory intervention will be commensurate with the risk profile of the SFI, which the CRR reflects. The CRR is BSL's assessment safety and soundness of the SFI. The assessment is over a time horizon that is appropriate for the SFI, given changes occurring internally and in its external environment.

The CRR is assessed as Low (L), Moderate (M), Above Average (AA), or High (H). The assessment is supplemented by the Direction of Composite Risk, which is BSL's assessment of the most likely direction in which the CRR may move. The Direction of Composite Risk is rated as decreasing, stable, or increasing.

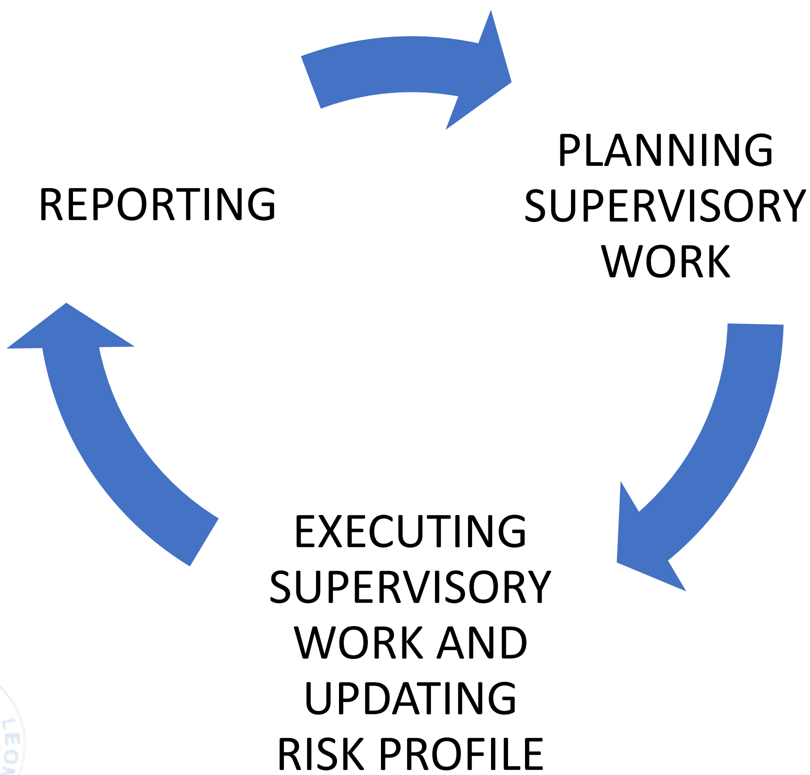
8. The Risk Matrix

A Risk Matrix (see Appendix D) is used to record all of the assessments described above. The purpose of the Risk Matrix is to facilitate a holistic risk assessment of an SFI.

While the Risk Matrix is a convenient way to summarize the conclusions of risk assessment, it is supported by documentation of the analysis and the rationale for the conclusions.

E. Supervisory Process

BSL uses a defined process to guide its SFI-specific supervisory work: the first step is planning supervisory work; the second is executing supervisory work and updating the risk profile; and the third is reporting. This process is dynamic, iterative and continuous, as shown below:



Planning Supervisory Work

A supervisory strategy for each SFI is prepared annually. The supervisory strategy identifies the supervisory work necessary to keep the SFI's risk profile current. The intensity of supervisory work depends on the nature, size, complexity and risk profile of the SFI. (SUMMARIZES THE ANALYSIS STAGE OF THE PLANNING PROCESS)

The supervisory strategy outlines the supervisory work planned for the next three years, with a fuller description of work for the upcoming year. The supervisory strategy is the basis for a more detailed annual plan, which indicates the expected work and resource allocations for the upcoming year.

Supervisory work for each significant activity is planned and prioritized after considering the net risk assessment of the activity (including the types and levels of inherent risk, the quality of risk management, and any potential significant changes in these), the need to update BSL's information on the activity (due to information decay), and the importance of the activity.

Similarly, supervisory work for each relevant oversight function is planned and prioritized after considering the assessment of the quality of its oversight, and the need to update BSL's information on the function.

In addition to SFI-specific planning, BSL's planning also includes a process to compare the work effort across SFIs. This is done to ensure that assessments of risk for individual SFIs are subject to a broader standard, and that supervisory resources are allocated effectively to higher-risk SFIs and significant activities.

Executing supervisory work and updating the risk profile

There is a continuum of supervisory work that ranges from monitoring (SFI-specific and external), to limited off-site reviews, to extensive on-site reviews, including testing or sampling where necessary.

Monitoring refers to the regular review of information on the SFI and its industry and environment, to keep abreast of changes that are occurring or planned in the SFI and externally, and to identify emerging issues.

SFI-specific monitoring includes the analysis of the SFI's financial results, typically considering its performance by business line and vis-à-vis its peers, and any significant internal developments. It may also extend to gathering information on non-regulated entities which have a significant influence on the SFI, such as a holding company or foreign parent company. SFI-specific monitoring usually also includes discussions with the SFI's management, including oversight functions.

Given the dynamic environment in which SFIs operate, BSL also continuously scans the external environment and industry, gathering information as broadly as possible, to identify emerging issues. Issues include both SFI-specific and system-wide concerns. BSL will periodically require SFIs to perform specific stress tests which BSL will use to assess the potential impact of changes in the operating environment on individual SFIs or industries. Environmental scanning and stress-testing will have an increased importance for the Supervisory Framework. Changes in the external environment is a main driver of rapid changes in the SFI risk profile.

Reviews refer to more extensive supervisory work than monitoring. The nature and scope of information reviewed, and the location of the review ("off-site" at BSL premises when the scope of the review is limited or "on-site" at the SFI's premises when the scope is more extensive), are based on the specific requirements identified in the planning process. When an on-site review is conducted, BSL may request information from the SFI in advance. Reviews include discussions with SFI management, including oversight functions.

In addition to the core supervisory work of monitoring and reviews, BSL frequently undertakes comparative or benchmarking reviews to identify standard and best industry practices.

As supervisory work is conducted, the RM updates the overall risk profile of the SFI. The Risk Matrix and supporting documentation detail BSL's formal assessment of the SFI's business model and associated safety and soundness, both current and prospective. Key documents are subject to sign-off protocols within BSL.

When there are shifts in the risk assessment of the SFI, BSL responds by adjusting work priorities set out in the supervisory strategy and annual plan, as necessary, to ensure that important matters emerging take precedence over items of lesser risk. Such flexibility is vital to BSL's ability to meet its legal mandate.

REPORTING AND INTERVENTION (SUMMARIZES REPORTING AND FOLLOW-UP)

TO SFIS

In addition to ongoing discussions with SFIs management, BSL communicates to the SFIs through various formal, written reports.

Annually, or as appropriate, the RM writes a Supervisory Letter to the SFI. The Supervisory Letter is the primary written communication to the SFI. It summarizes BSL's key findings and recommendations (and requirements, as necessary) based on the supervisory work that was conducted since the last Supervisory Letter was issued, and discloses or affirms the SFI's Composite Risk Rating.

Supervisory Letters are addressed to the Chair of the Board of Directors and copied to the Managing Director (MD) or the Chief Executive Officer (CEO), In all cases, BSL will request that a copy of the Supervisory Letter be provided to the external auditor.

During the year, BSL may also issue an Interim Letter to the SFI so as to provide the SFI with timely feedback on issues arising from a specific body of supervisory work. The Interim Letter is sent to the appropriate senior manager within the SFI, and a copy may also be provided to other individuals within the SFI, if warranted.

With both types of letters, findings and recommendations are discussed with the SFI before the letter is issued. A letter is generally issued within 45 calendar days of the completion of a review. The SFI is typically asked to provide a response within 30 calendar days. BSL analyzes the SFI's response for appropriateness, and follows up on the SFI's actions on a timely basis.

Both types of letters remind SFIs that applicable Supervisory Information Regulations prohibit them from disclosing, directly or indirectly, prescribed supervisory information, including Supervisory Letters, except as provided for in the regulations.

APPENDIX A. INHERENT RISK CATEGORIES AND RATINGS

CATEGORIES

The following are descriptions of the six (6) identified inherent risk categories for assessment purposes.

CREDIT RISK

Credit risk arises from a counterparty's inability or unwillingness to fully meet its (on- and/or off-balance sheet) contractual obligations. Concentration risk which arises from uneven distribution of exposures to particular sectors, regions, industries or products are considered as part of credit risks.

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 and commodity.

i. ***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).

ii. ***Foreign exchange risk*** arises from movements in foreign exchange rates. Exposure to this risk mainly occurs during a period in which the SFI has an open position, both on and off-balance sheet, and/or in spot and forward markets.

EQUITY RISK

Equity risk is the risk to a financial institution's condition resulting from adverse movements in the prices of stock investments. It arises from security price volatility or the risk of a decline in the value of a security or a portfolio.

COMMODITY RISK

Commodity risk is the risk to an institution, which arises from changing prices of the commodities such as crude oil, corn, rice.

OPERATIONAL RISK

Operational risk arises from glitches 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 SFI's non-conformance with laws, rules, regulations, prescribed practices, or ethical standards in the jurisdiction in which it operates.

MONEY LAUNDERING/TERRORIST FINANCING RISK

Money laundering/Terrorist financing risk is the risk that an entity could be used to disguise the origins of illegally obtained money and/or the proceeds of criminal conduct; through the process of making such funds appear to have been derived from a legitimate source. Terrorist financing risk addresses the risk where an entity is susceptible to be used as a conduit for financing or providing financial support to terrorists or terrorist groups.

STRATEGIC RISK

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

REPUTATIONAL RISKS

Reputational risk is anything that has the potential to damage the public's perception of an organization that can result to loss in financial capital, social capital and/or market share.

RATINGS

A material loss is a loss or combination of losses that could impair the adequacy of the capital of the SFI such that there is the potential for loss to depositors or policyholders.

LOW

Low inherent risk exists when there is a lower than average probability of a material loss due to exposure to, and uncertainty arising from, current and potential future events.

MODERATE

Moderate inherent risk exists when there is an average probability of a material loss due to exposure to, and uncertainty arising from, current and potential future events.

ABOVE AVERAGE

Above average inherent risk exists when there is an above average probability of a material loss due to exposure to, and uncertainty arising from, current and potential future events.

HIGH

High inherent risk exists when there is a higher than above average probability of a material loss due to exposure to, and uncertainty arising from, current and potential future event

APPENDIX B. QUALITY OF RISK MANAGEMENT CATEGORIES AND OVERALL RATINGS

CATEGORIES

OPERATIONAL MANAGEMENT / LOCAL CONTROLS

Operational management/local control is responsible for planning, directing and controlling the day-to-day operations of a significant activity of a SFI.

OVERSIGHT FUNCTIONS

Financial

Financial is an independent function responsible for ensuring the timely and accurate reporting and in-depth analysis of the operational results of a SFI in order to support decision-making by Senior Management and the Board. Its responsibilities include:

providing financial analysis of the SFI's and business line/unit performance and the major business cases to Senior Management and the Board, highlighting matters requiring their attention;

and ensuring an effective financial reporting and management information system.

Compliance

Compliance (including the Chief Anti-Money Laundering Officer) is an independent function with the following responsibilities:

- setting the policies and procedures for adherence to regulatory requirements in all jurisdictions where the SFI operates;

- monitoring the SFI's compliance with these policies and procedures; and
- reporting on compliance matters to Senior Management and the Board.

Risk Management

Risk Management is an independent function responsible for the identification, assessment, monitoring, and reporting of risks arising from the SFI's operations. Its responsibilities typically include:

- identifying enterprise-wide risks;
- developing systems or models for measuring risk;
- establishing policies and procedures to manage risks;
- developing risk matrices (e.g., stress tests) and associated tolerance limits;
- monitoring positions against approved risk tolerance limits and capital levels; and
- reporting results of risk monitoring to Senior Management and the Board.

Internal Audit

Internal Audit is an independent function with responsibilities that include:

- assessing adherence to, and the effectiveness of, operational controls and oversight, including corporate governance processes; and
- reporting on the results of its work on a regular basis to Senior Management and directly to the Board.

Senior Management

Senior Management is responsible for directing and overseeing the effective management of the general operations of the SFI. Its key responsibilities include:

- developing, for Board approval, the business model and associated objectives, strategies, plans, organizational structure and controls, and policies;
- developing and promoting (in conjunction with the Board) sound corporate governance practices, culture and ethics, which includes aligning employee compensation with the longer-term interests of the SFI;
- executing and monitoring the achievement of Board-approved business objectives, strategies, and plans and the effectiveness of organizational structure and controls; and
- ensuring that the Board is kept well informed.

Board

The Board is responsible for providing stewardship and oversight of management and operations of the entire SFI. Its key responsibilities include:

- guiding, reviewing and approving the business model and associated objectives, strategies and plans;
- reviewing and approving corporate risk policy including overall risk appetite and tolerance;
- ensuring that Senior Management is qualified and competent;
- reviewing and approving organizational and procedural controls;
- ensuring that principal risks are identified and appropriately managed;
- ensuring that compensation for employees, Senior Management and the Board is aligned with the longer term interests of the SFI;
- reviewing and approving policies for major activities; and
- Providing for an independent assessment of management controls.

OVERALL RATINGS

STRONG

The characteristics (e.g., mandate, organization structure, resources, methodologies, practices) of the function exceed what is considered necessary, given the nature, scope, complexity, and risk profile of the SFI. The function has consistently demonstrated highly effective performance. The function’s characteristics and performance are superior to sound industry practices.

ACCEPTABLE

The characteristics (e.g., mandate, organization structure, resources, methodologies, practices) of the function meet what is considered necessary, given the nature, scope, complexity, and risk profile of the SFI. The function’s performance has been effective. The function’s characteristics and performance meet sound industry practices.

NEEDS IMPROVEMENT

The characteristics (e.g., mandate, organization structure, resources, methodologies, practices) of the function generally meet what is considered necessary, given the nature, scope, complexity, and risk profile of the SFI, but there are some significant areas that require improvement. The function’s performance has generally been effective, but there are some significant areas where effectiveness needs to be improved. The areas needing improvement are not serious enough to cause prudential concerns if addressed in a timely manner. The function's characteristics and/or performance do not consistently meet sound industry practices.

WEAK

The characteristics (e.g., mandate, organization structure, resources, methodologies, practices) of the function are not, in a material way, what is considered necessary, given the nature, scope, complexity, and risk profile of the SFI. The function's performance has demonstrated serious instances where effectiveness needs to be improved through immediate action. The function's characteristics and/or performance often do not meet sound industry practices.

APPENDIX C. TYPICAL NET RISK RATINGS

Aggregate Quality of Risk management for a Significant Activity	Level of Inherent Risk for a Significant Activity			
	LOW	AVERAGE	ABOVE AVERAGE	HIGH
	Net Risk Assessment			
Strong	LOW	LOW	MODERATE	ABOVE AVERAGE
Acceptable	LOW	MODERATE	ABOVE AVERAGE	HIGH
Needs Improvement	MODERATE	ABOVE AVERAGE	HIGH	HIGH
Weak	ABOVE AVERAGE	HIGH	HIGH	HIGH

APPENDIX D. RISK MATRIX

Significant Activities	Inherent Risks							Quality of Risk management							Net Risk	Direction of Risk	Importance
	Credit	Market	Operational	Regulatory Compliance	AML/CFT	Reputational	Strategic	Operational management	Financial	Risk Management	Compliance	Internal Audit	Senior Management	Board of Directors			
Activity 1																	
Activity 2																	
Activity 3																	
Etc.																	
Overall Rating																	

	Rating	Direction	Time Frame
Earnings			
Capital			
Liquidity			
Composite Risk Rating			

Intervention Rating	

APPENDIX E. ALIGNMENT BETWEEN COMPOSITE RISK RATING AND INTERVENTION RATING

Composite Risk Rating	Intervention Rating
Low	0 Normal
Moderate	0 Normal
	1 Early warning
Above Average	1 Early warning
	2 Risk to financial viability or solvency
High	2 Risk to financial viability or solvency
	3 Furure financial viability in serious doubt
	4 Non-viable/Insolvency imminent