

Generic GIF Tool Adjustments and Complementing

**Pillar IV, “Compliance
and **risk** management”,
complemented by the
risk management model**

September 2017

Author:



www.rfr.org.ec

Jointly executed by:

www.biminvestments.com

BIM

Financed by:



Fondo Multilateral de Inversiones
Miembro del Grupo BID



Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Agencia Suiza para el Desarrollo
y la Cooperación COSUDE

Content

I.	GOVERNANCE MANUAL	1
II.	DIAGNOSIS AND EVALUATION INSTRUMENT.....	6
	CHAPTER III: GUIDELINES AND CRITERIA FOR EVALUATING COMPLIANCE WITH THE STANDARDS.....	6
	CHAPTER IV: PARAMETERS FOR QUALIFYING AND DETERMINING COMPLIANCE WITH THE STANDARDS	12
	CHAPTER V: PERFORMANCE AND GOVERNANCE INDICATORS	13
III.	GIF TOOLBOX	19
	Bibliographic annex to risk management.....	21

I. GOVERNANCE MANUAL

In section 7.2, General Standards; of chapter VII, Governance Standards; of Volume II of the Governance Manual, Standards 24 and 35 on risk management state the following:

7.2. GENERAL STANDARDS

Standard 34: Comprehensive risk management

The Governing Body approves the comprehensive risk management policy, a document that indicates the processes and procedures of identifying, evaluating and managing risks; it also defines the roles, responsibilities and reporting lines within the Organization, taking into consideration the Organization's size and complexity.

Regarding the policy approved, the Chief Executive is responsible for ensuring that a system be implemented that allows identifying, measuring, managing, and doing follow-up on the risks.

The Governing Body receives follow-up reports on comprehensive risk management at least quarterly. Periodically, the Governing Body, on its own or through an independent third party, evaluates the comprehensive risk management system.

Component	Tool
Approval of the comprehensive risk management policy	Governing Body agreement
Implementing the comprehensive risk management system	Processes, procedures, roles, and responsibilities for comprehensive risk management
Follow-up on comprehensive risk management	Reports specific for the purpose
Periodical evaluation of the comprehensive risk management system	

Standard 35: Risk committee

The Organization has implemented a functional risk committee made up mostly or exclusively of Board Members with experience in risk management, the functions of which are:

- To propose, evaluate and review the comprehensive risk management policy of the Organization, approved by the Governing Body
- To propose, evaluate, review, and approve the methodology and models for identifying, measuring, monitoring, controlling, informing on, and revealing the different types of risks facing the Organization
- To inform the Governing Body on the risks to which the Organization is exposed and the measures adopted for managing them, as well as realizing the applicable recommendations

Component	Tool
1. Appointment of the risk committee	Governing Body agreement or risk committee regulations
2. Responsibility of the committee to propose, evaluate and review the Organization's risk management policy	
3. Responsibility of the committee to propose, evaluate, review, and approve the methodology and models to identify, measure, monitor, control, inform on, and reveal the different types of risks facing the Organization	
4. Responsibility of the committee to inform the Governing Body on the risks to which the Organization is exposed and the measures adopted for managing them, as well as realizing the applicable recommendations	

Added to the present definition of Standard 35 with its four components is an additional component, as follows:

Component	Tool
5. The existence of a risk unit or administrator responsible, with capacities and independence in relation to the Organization's size	Governing Body agreement or risk committee regulations

7.3. COMPLEMENTARY STANDARDS

Section 7.3, Complementary Standards, includes the Standard pertaining to managing the risks of credits, liquidity, the market, and operations.

Standard R1: Credit risk management

Credit risk management must be in line with the business strategy. The Governing Body shall establish limits for credit risks, particularly considering matters pertaining to the borrower's segments, geographical areas and characteristics.

Senior Management must structure an efficient scheme for preventing and mitigating credit risk, through adequate processes allowing to identify, measure, control/mitigate, and monitor exposure to counterpart risk, maintaining an adequate level of hedging.

Component	Tool
1. The Organization has a credit risk policy and regulations.	Governing Body agreement
2. There are methodologies in place for identifying and measuring credit risk.	Minutes of Governing Body or of corresponding body
3. There is a control process for credit risk.	Specific reports
4. There is a monitoring process for credit risk.	

Standard R2: Liquidity risk management

Liquidity is one of the main risks to be managed by Organizations. The process includes asset and liability administration over time, with the aim of having the capacity to employ resources for fulfilling obligations by maturity dates, to finance ongoing and projected operations, and to attend to the activities of the business itself.

The Governing Body must establish limits for managing liquidity risk, considering matters relating to obtaining and allocating funds.

Senior Management must establish an efficient scheme for preventing and mitigating liquidity risk, through adequate processes allowing to identify, measure, control/mitigate, and monitor exposure, considering the characteristics of assets and liabilities.

Component	Tool
1. The Organization has policies and internal regulations for managing liquidity risk.	Governing Body agreement
2. There are methodologies in place for measuring liquidity risk.	Governing Body or risk committee minutes
3. There is a control process for liquidity risk.	Specific reports
4. There is a monitoring process for liquidity risk.	
5. There is a liquidity contingency plan.	Governing Body or risk committee minutes
6. There is an assets-liabilities committee (ALCO)	Governing Body or risk committee minutes
7. There is follow-up in the ALCO of compliance with the limits related to liquidity and interest rates.	Assets-liabilities committee minutes
8. There are strategies in the ALCO related to liquidity and interest rates.	Assets-liabilities committee minutes

Standard R3: Market risks management

The Chief Executive, aided by Senior Management, must establish an efficient scheme for controlling market risk, particularly risk originating from interest rate changes, considering the dynamics of the Organization's assets and liabilities, through processes allowing to identify, measure, control/mitigate, and monitor this risk.

Market risk management must be in line with the business strategy and the complexity of this risk, considering the policies established by the Governing Body, and it must be supported by a management-type committee for administrating assets and liabilities (assets-liabilities committee), taking into account matters relating to interest rates.

Component	Tool
1. The Organization has policies and internal regulations for managing market risks.	Governing Body agreements
2. There are methodologies in place for identifying and measuring market risk.	Governing Body or risk committee minutes
3. There is a control process for market risk.	Specific reports
4. There is a monitoring process for market risk.	

Standard R4: Operational risk management

The design of the operational risk management process must allow Organizations to identify, measure, control/mitigate, and monitor their exposure to this risk that they face in performing their business and operations. Every institution must develop its own management techniques or schemes, considering their social aim, size, nature, complexity, and other particular characteristics.

Even when there are no specific regulations for managing operational risk, the best practices that could be included in internal control, auditing or Governance regulations must be considered.

The Governing Body must establish efficient schemes for managing and controlling operational risk that exists in carrying out the business, considering the risk factors of: processes, persons, technology, and external factors, as well as external events.

Component	Tool
1. The Organization has policies and internal regulations for managing operational risk.	Governing Body agreement
2. There is a processes manual that determines the methodology for applying processes, control mechanisms and persons responsible.	Governing Body or risk committee minutes
3. There are monitoring processes in place for operational risk.	Specific reports

Component	Tool
4. There are processes and procedures in place for implementing and developing a plan for continuity of the business.	Governing Body or risk committee minutes

II. DIAGNOSIS AND EVALUATION INSTRUMENT

In section 3.1, General Standards; of chapter III, Guidelines and criteria for evaluation and compliance with the standards; of the Diagnosis and Evaluation Instrument, Standards 34 and 35 on risk management state the following:

CHAPTER III: GUIDELINES AND CRITERIA EVALUATING COMPLIANCE WITH THE STANDARDS

3.1 General Standards

Pillar IV: Compliance and risk management

STANDARD	FORMAL/DOCUMENTARY EVIDENCE	FACTUAL EVIDENCE/APPLICATION					
Standard 34: Comprehensive risk management	Formal evidence exists if it is verified that: The document of establishment or Governing Body regulations state that the following are responsibilities of the Governing Body: 1. Approval of the comprehensive risk management policy 2. Implementation of the comprehensive risk management system 3. Follow-up on comprehensive risk management 4. Periodical evaluation of the comprehensive risk management system	Factual evidence or evidence of application of the Standard's components may be verified as follows: 1. The component of approval of the comprehensive risk management policy: Verification is done that there is approval of the comprehensive risk management policy in minutes of the Governing Body or in another document, establishing the processes and procedures for identifying, evaluating and managing risks, also defining the roles, responsibilities and reporting lines within the Organization. 2. The component of implementation of the comprehensive risk management system: Verification is done that there is approval of the comprehensive risk management system in Governing Body minutes. 3. The component of follow-up on comprehensive risk management: Verification is done that these matters are dealt with in Governing Body minutes. 4. The component of periodical evaluation of the comprehensive risk management system: Verification is done that these matters are dealt with in Governing Body minutes or minutes of a committee in charge of risks. Application is thus as follows:					
	Complies	Does not comply	Null	Weak	Partially less	Partially more	Complete
	All components	Does not have all components	No component	1 component	2 components	3 components	4 components

Added to the present definition of Standard 35, with its four components, is a component related to the existence of a risk unit or a risk administrator:

STANDARD	FORMAL/DOCUMENTARY EVIDENCE	FACTUAL EVIDENCE/APPLICATION
<p>Standard 35: Risk committee</p>	<p>Formal evidence exists if it is verified that:</p> <ol style="list-style-type: none"> 1. The Governing Body regulations state this body's responsibility for establishing a risk committee made up mostly or exclusively of Board Members with experience in risk management. 2. The Governing Body or risk committee regulations state that it is the responsibility of the committee to propose, evaluate and review the Organization's risk management policy. 3. The Governing Body or risk committee regulations state that it is the responsibility of the committee to propose, evaluate, review, and approve the methodology and models for identifying, measuring, monitoring, controlling, informing on, and revealing the different types of risks that the Organization faces. 4. The Governing Body or risk committee regulations state that it is the responsibility of the committee to inform the Governing Body on the risk that the Organization is exposed to and the measures adopted for managing them, and to make the applicable recommendations. 5. There is a risk unit or risk administrator in charge, with capacities and independence in relation to the size of the 	<p>Factual evidence or evidence of application of the Standard's components may be verified as follows:</p> <ol style="list-style-type: none"> 1. The component of appointment of members to the risk committee: Verification is done that minutes of the Governing Body indicate approval of appointment to the committee mostly or exclusively of Board Members with experience in risk management. 2. The component of responsibility to propose, evaluate and review the risk management policy of the Organization's committee: Verification is done that the committee minutes approve these topics. 3. The component of responsibility of the committee to propose, evaluate, review, and approve the methodology and models for identifying, measuring, monitoring, controlling, informing on, and revealing the different types of risks that the Organization faces. 4. The component of responsibility of the committee to inform the Governing Body on the risks that the Organization is exposed to and the measures adopted for managing them, and to make the applicable recommendations: Verification is done that Governing Body minutes state having knowledge of the reports issued by the committee on these matters. 5. The component of the existence of a risk unit or risk administrator in relation to the Organization's size: Verification is done that that Governing Body minutes state approval of the risk unit or risk administrator. <p>Application is thus as follows:</p>

	Organization						
	Complies	Does not comply	Null	Weak	Partially less	Partially more	Complete
	All components	Does not have all components	No component	1 component	2 components	3 to 4 components	5 components

3.2. Complementary Standards

Section 3.2, Complementary Standards, includes Standards on the management of risks relating to credit, liquidity, the market, and operations.

STANDARD	FORMAL/DOCUMENTARY EVIDENCE	FACTUAL EVIDENCE/APPLICATION					
Standard R1: Credit risk management	<p>Formal evidence exists if it is verified that:</p> <ol style="list-style-type: none"> The Organization has an updated policy and regulations for credit risk. There are methodologies in place for identifying and measuring credit risk. There is a control process for credit risk. There are monitoring processes in place for risk management. 	<p>Factual evidence or evidence of application of the Standard's components may be verified as follows:</p> <ol style="list-style-type: none"> The component of updated policy and internal regulations for credit risk management: Verification is done that Governing Body minutes include approval of the policy and manuals for credit risk management that determine the processes for identifying, measuring, controlling, and monitoring credit risk. The component of the existence of methodologies for identifying and measuring credit risk: Verification is done by means of Governing Body or comprehensive risk management committee minutes of approval, indicating that they are specific methods for evaluating each of the credit segments that the Organization operates in, particularly the microfinance segment, additionally considering aspects pertaining to amounts, terms, geographical areas, segments, and borrower characteristics. The component of the existence of control processes: Verification is done that minutes of the corresponding associated bodies have documents on credit risk, establishing limits, particularly for default and provision hedging, with recommendations for Senior Management to make decisions. The component of the existence of monitoring processes: Verification is done that minutes of the corresponding associated bodies have, at all times, information on the credit risk levels that deals with the following indicators: concentration, hedging, default, big borrower risk, and legal and regulatory limits. <p>Application is thus as follows:</p>					

STANDARD	FORMAL/DOCUMENTARY EVIDENCE	FACTUAL EVIDENCE/APPLICATION
<p>Standard R2: Liquidity risk management</p>	<p>Formal evidence exists if it is verified that:</p> <ol style="list-style-type: none"> 1. The Organization has updated policies and internal regulations for liquidity risk management. 2. There are methodologies in place for identifying and measuring liquidity risk. 3. There is a control process for liquidity risk. 4. There is a monitoring process for liquidity risk. 5. There is a liquidity contingency plan that determines the realizable assets and alternative sources of funding contracted for covering liquidity needs. 6. There is an assets-liabilities committee responsible for doing follow-up on assets and liabilities, and for determining the operating strategies at least monthly, in relation to the Organization's size. 7. The assets-liabilities committee does follow-up on the limits pertaining to liquidity, interest rates and exchange rates. 8. The assets-liabilities committee determines strategies pertaining to liquidity, interest rates and exchange rates. 	<p>Factual evidence or evidence of application of the Standard's components may be verified as follows:</p> <ol style="list-style-type: none"> 1. The component of policies and internal regulations: Verification is done that Governing Body minutes include the approval of updated policies and manuals for managing liquidity risk that determine the processes for identification, measurement, control, and monitoring. There is an assets-liabilities committee at the level of the Governing Body or Senior Management. 2. The component of methodologies for identifying and measuring liquidity risk: Verification is done that there are minutes of approval of the Governing Body or of the comprehensive risk management committee that indicate that these methods specify coefficients for liquidity reserves and that they establish the obligation to keep liquid assets as a percentage of deposits, and also deal with deposits concentration levels from single sources, and the assessment of the maturity dates of assets and liabilities. 3. The component of control processes: Verification is done that minutes of the corresponding associated bodies include documents on liquidity risk, with recommendations for decision-making by Senior Management, by establishing obligations to keep levels of liquid assets as a percentage of deposits and limits for concentration of deposits from single sources. 4. The component of monitoring processes: Verification is done that minutes of the corresponding associated bodies mention having levels of liquidity risk on a permanent basis that take into consideration indicators for liquidity, liquidity gaps, concentration levels, and a liquidity plan for emergency situations. 5. The component of the existence of a liquidity contingency plan: Verification is done that minutes of the corresponding associated bodies include the approval of a liquidity contingency plan that determines the assets that the entity will realize and the existence of lines of funding contracted for covering liquidity needs. <p>7.The component of doing follow-up on liquidity limits, interest rates and exchange rates: Verification is done that the committee minutes state that there is knowledge of compliance with the limits pertaining to liquidity, interest rates and exchange rates, and that action was taken in relation to these matters.</p> <p>8.The component of establishing strategies for liquidity, interest rates and exchange rates: Verification is done that the committee minutes state that strategies were defined for managing liquidity, interest rates and exchange rates.</p> <p>Application is thus as follows:</p>

	Complies	Does not comply	Null	Weak	Partially less	Partially more	Complete
	All components	Does not have all components	No component	1 to 2 components	3 to 4 components	5 to 7 components	8 components

STANDARD	FORMAL/DOCUMENTARY EVIDENCE	FACTUAL EVIDENCE/APPLICATION					
Standard R3: Market risks management	<p>Formal evidence exists if it is verified that:</p> <ol style="list-style-type: none"> The Organization has updated policies and internal regulations for managing market risk. There are methodologies in place for measuring market risk. There is a control process in place for market risk. There is a monitoring process in place for market risk. 	<p>Factual evidence or evidence of application of the Standard's components may be verified as follows:</p> <ol style="list-style-type: none"> The component of policy and internal regulations for managing market risk: Verification is done that Governing Body minutes state approval of the updated policy and manuals for managing market risk, and that the latter determine the processes for identifying, measuring, controlling, and monitoring market risk, essentially considering interest rates and exchange rates. There is an assets-liabilities committee at the level of the Governing Body or Senior Management. The component of methodologies for measuring market risk: Verification is done that there are minutes of approval of the Governing Body or of the comprehensive risk management committee, indicating that they are methods of evaluation that consider the particularities of the entity's assets and liabilities, such as: portfolio allocation in the national currency and financing in foreign currency; or the parameters for setting loan and deposit rates. The component of control processes: Verification is done that minutes of the applicable associated bodies have documents on market risk (particularly interest rate and exchange rate fluctuations, and deposit and portfolio allocation amounts), with recommendations for decision-making by Senior Management. The component of monitoring processes: Verification is done that minutes of the applicable associated bodies have information on indicators such as: fluctuations in interest rates, financial margin sensitivity, and equity value and exchange rate sensitivities. <p>Application is thus as follows:</p>					
	Complies	Does not comply	Null	Weak	Partially less	Partially more	Complete
	All components	Does not have all components	No component	1 component	2 components	3 components	4 components

STANDARD	FORMAL/DOCUMENTARY EVIDENCE		FACTUAL EVIDENCE/APPLICATION				
<p>Standard R4: Operational risk management</p>	<p>Formal evidence exists if it is verified that:</p> <ol style="list-style-type: none"> 1. The Organization has updated policies and internal regulations for managing operational risk. 2. There is a processes manual that determines the methodology for applying processes, control mechanisms and persons responsible. 3. There are monitoring processes in place for operational risk. 4. There are processes and procedures in place for implementing and developing a business continuity plan. 		<p>Factual evidence or evidence of application of the Standard's components may be verified as follows:</p> <ol style="list-style-type: none"> 1. The component of policies and internal regulations: Verification is done that Governing Body minutes indicate approval of updated policies and manuals for operational risk management that determine the processes for identification, measurement, control, and monitoring. 2. The component of having a processes manual: Verification is done of Governing Body or comprehensive risk management committee minutes of approval, observing that the methodology for applying processes, control mechanisms and persons responsible is defined. 3. The component of the existence of processes for monitoring: Verification is done that minutes of the corresponding associated bodies deal with risk factors for the following: persons, processes, IT, and external events that affect of may affect the Organization. 4. The component of processes and procedures for implementation and development of a business continuity plan: Verification is done that Governing Body minutes include the approval of processes and procedures for business continuity; and recognition is made of progress of the process for implementing the business continuity plan. <p>Application is thus as follows:</p>				
	Complies	Does not comply	Null	Weak	Partially less	Partially more	Complete
	All components	Does not have all components	No component	1 component	2 components	3 components	4 components

The following modifications are made to section 4.1, General Standards; and section 4.2, Complementary Standards; of chapter IV, Parameters for qualifying and determining compliance with the Standards; in the Diagnosis and Evaluation Instrument:

CHAPTER IV: PARAMETERS FOR QUALIFYING AND DETERMINING COMPLIANCE WITH THE STANDARDS

4.1. General Standards

STANDARD	FORMAL/ DOCUMENTARY EVIDENCE		FACTUAL EVIDENCE/APPLICATION				
	Com-plies	Does not comply	Null	Weak	Partially less	Partially more	Complete
Pillar IV: Compliance and risk management							
Standard 35: Risk committee	1	0	0	0.25	0.50	0.75	1

4.2. Complementary Standards

STANDARD	FORMAL/ DOCUMENTARY EVIDENCE		FACTUAL EVIDENCE/APPLICATION				
	Com-plies	Does not comply	Null	Weak	Partially less	Partially more	Complete
Applicable to risk management							
Standard R1: Credit risk management	1	0	0	0.25	0.50	0.75	1
Standard R2: Liquidity risk management	1	0	0	0.25	0.50	0.75	1
Standard R3: Market risks management	1	0	0	0.25	0.50	0.75	1
Standard R4: Operational risk management	1	0	0	0.25	0.50	0.75	1

The following modifications are made to chapter V, Performance and Governance indicators:

CHAPTER V: PERFORMANCE AND GOVERNANCE INDICATORS

5.3.4 Compliance and risk management indicators (Pillar IV)

5.3.4.1. Follow-up and supervision (defined)

P IV 1	Follow-up and supervision:	Number of auditing committee sessions
--------	----------------------------	---------------------------------------

5.3.4.2. Fiduciary responsibility and regulatory compliance (defined)

P IV 2	Magnitude of incidents:	<u>Amount in value of penalties and fines received</u> Average number of employees during the period
--------	-------------------------	---------------------------------------------------------------------------------------------------------

5.3.4.3. Risk management system (defined)

P IV 3	Availability of resources for risk management:	<u>Budget designated to the risk and projects area in the period</u> Total Organization budget in the period
--------	------------------------------------------------	-----------------------------------------------------------------------------------------------------------------

5.3.4.4. Definition of decisions of the governing bodies

a) Justification

Standard 34, Risk management system, states that the Governing Body is responsible for and must know of and provide follow-up on comprehensive risk management. Based on this, it is important to evaluate the actions taken by the Governing Body considering the continuous conclusions and recommendations found in the risk area reports.

What is established in the Standard is closely associated with the capacities and experience of the persons that make up the Organization's governing bodies in making timely decisions considering the characteristics of the observations and recommendations.

b) Indicator:

P IV 4	Decisions in minutes of the associated bodies	<u>Decisions in minutes of resolutions of the associated bodies</u> Reports with recommendations presented to the associated bodies
--------	-----------------------------------------------	----------------------------------------------------------------------------------------------------------------------------------------

c) Interpretation:

The indicator has a positive result if:

- **Historical comparison:** increases in relation to previous periods

5.3.4.5. Acting of the comprehensive risk committee

a) Justification

Standard 35, Comprehensive risk committee, states that the Governing Body is responsible for establishing a risk committee made up mostly or exclusively of Board Members with experience in risk management.

Adequate acting on the part of the comprehensive risk committee will allow informing the Governing Body on the risks to which the Organization is exposed and the measures adopted for managing them, as well as making the applicable recommendations.

Hence the information that the Organization presents to the committee and based on which the committee may act or make timely decisions for reducing the risks identified is also important.

b) Indicator:

<i>PIV 5</i>	Acting of the comprehensive risk committee	Meetings of the comprehensive risk committee at which it received information and made decisions on risk management <hr/> Number of committee meetings, considering the minimum number of meetings required by regulations in force
--------------	--------------------------------------------	--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

c) Interpretation:

The indicator shows a positive result if:

- **Historical comparison:** increases in relation to previous periods

Analysis of regulatory compliance: Verification is done of whether the actions are in line with what is stipulated in the regulations, if they are explicitly determined by a regulating entity.

5.3.8 Risk indicators

5.3.8.1. Credit risk indicators

a) Justification (Standard R1: Credit risk management)

Standard R1: Credit risk management, states that the Governing Body is responsible for defining the processes, procedures and persons in charge of the assessment and management of credit risks, with proper attention paid to the Organization’s size and complexity.

With the aim of performing adequate control and follow-up on credit risks, the Governing Body needs to determine individual levels (by segment) and at the consolidated level, allowing to provide alerts regarding the level and trend of the default levels.

On this basis, Senior Management must perform actions for implementing a system of default risk limits allowing to measure, manage and do follow-up on credit risks.

To avoid loss of equity, Organizations need to designate sufficient provisions considering the minimal limits determined for covering potential unrecoverable portfolio amounts.

b) Indicators:

<i>P R1</i>	Compliance with default limits	Number of times that the broad default ¹ indicator proposed by the Governing Body is not complied with, as per regulations in force
<i>P R2</i>	Compliance with default limits, microfinance	Number of times that the broad default ² indicator for microfinance proposed by the Governing Body is not complied with, as per regulations in force
<i>P R3</i>	Unproductive portfolio hedging	<u>Credit portfolio provisions</u> Unproductive gross portfolio ³
<i>P R4</i>	Equity vulnerability	<u>Unproductive portfolio (past-due portfolio over 90 days)</u> Equity

c) Interpretation:

Indicators *P R1* and *P R2* Compliance with default limits have a positive result if:

- **Analysis at a given moment:** The indicator measures the degree of compliance with the limits established by the Governing Body at a given point in time.
- **Historical comparison:** It is necessary to observe the number of times that the established limits were not complied with. The Organization must seek to reduce the number of noncompliance incidents over time.

Indicator *P R3* Unproductive portfolio hedging has a positive result if:

- **Historical comparison:** The Organization must make efforts for the indicator to have a behavior of growth of close to 100% or more over time in relation to the unproductive portfolio.

¹ Broad default is the past-due portfolio + the portfolio that does not generate interest.

² Ibidem

³ Unproductive portfolio is the total past-due portfolio + the total portfolio that does not generate interest.

Indicator P R4 Equity vulnerability has a positive result if:

- **Historical comparison:** The Organization must make efforts for the indicator to have a stable or downward behavior that is not above 15%.

5.3.8.2. Liquidity risk indicators

a) Justification (Standard R2: Liquidity risk management)

Standard R2: Liquidity risk management, states that the Governing Body is responsible for defining the processes, procedures and persons in charge of evaluating and managing liquidity risks, with proper attention paid to the Organization’s size and complexity.

So as to perform adequate control and follow-up on liquidity risk, the Governing Body must establish limits that provide alerts regarding the level and trends of the amount of liquid resources that the Organization has for meeting its obligations.

On this basis, Senior Management must promote actions to implement an alert system of the needs for resources allowing to measure, manage and do follow-up on the level of liquid resources. The liquidity indicator is calculated considering the segment to which the entity belongs, as indicated in the Toolbox.

b) Indicators:

P R5	Compliance with liquidity limits	Number of times that the liquidity indicator proposed by the Governing Body does not comply
------	----------------------------------	---------------------------------------------------------------------------------------------

P R6	Liquidity index	<u>Liquid assets at 180 days</u> (Demand and term deposits + financial obligations up to 360 days)
------	-----------------	-------------------------------------------------------------------------------------------------------

c) Interpretation:

Indicator P R5 Compliance with liquidity limits has a positive result if:

- **Analysis at a given moment:** The indicator measures the level of compliance with the limits established by the Governing Body at a given point in time.
- **Historical comparison:** It is necessary to observe how many times the established limits have not been complied with. The Organization must make efforts for the number of times of such incompliance to go down over time.

Indicator P R6 Liquidity index has a positive result if:

- **Historical comparison:** A stable or growing trend of the indicator is observed over time.

5.3.8.3. Operational risk indicator

a) Justification

Standard R4 Operational risk management, states that the Governing Body is responsible for defining the processes, procedures and person in charge of assessing and managing operational risk, with proper attention paid to the Organization's size and complexity.

On this basis, Senior Management must establish actions allowing to identify the operational risk factors and events that have taken place and those that have the potential to occur, based on an assessment of the processes and control measures of the Organization, taking into consideration the Basel Committee on Banking Supervision definitions, with the aim of generating an operational risk matrix.

The Governing Body must be aware, in a timely manner, of the operational risk events that the entity is exposed to, allowing it to define the timely actions necessary to reduce the likelihood and impact of occurrence of the risk events.

b) Indicator:

P R7	Operational risk	Number of decisions taken recorded in minutes of the <u>associated bodies regarding operational risk events</u> Number of reports on operational risk events made known by the person in charge of risk
------	------------------	------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

c) Interpretation:

The indicator has a positive result if:

- **Historical comparison:** Information is obtained for at least the past year; the Organization must make efforts for the indicator to be close to 1 over time.

5.3.8.4. Business continuity plan

a) Justification

Standard R4: Operational risk management, states that the Governing Body is responsible for defining the processes, procedures and persons in charge of the assessment and management of credit risks, with proper attention paid to the Organization's size and complexity.

On this basis, Senior Management must determine actions allowing the Organization to implement the processes for keeping up a business continuity system through alternate systems, and the physical and human infrastructure required.

The Governing Body must be informed of the continuity trial actions realized and their results, so as to assess the entity’s position for acting in situations of interruption of the business due to unexpected events such as natural disasters, sabotage or attacks.

b) Indicator:

<i>P R8</i>	Business continuity trials	Number of business continuity trials performed during the year
-------------	-----------------------------------	----------------------------------------------------------------

c) Interpretation:

The indicator has a positive result if:

- **Analysis at a given moment:** The indicator measures the number of business continuity trials performed during the year. At least one such trial should be held during the year.

III. GIF TOOLBOX

The following modifications are made to Section 3.2.3, Comprehensive risk management policy; of chapter III, Development of tools; of the GIF Toolbox:

3.2.3 Comprehensive risk management policy

d) Questionnaire for generating tool content

Types or risks:

- How does the Organization define risk?
- What are the types of risk that the Organization has identified?
- What is the definition of each of the types of risk identified by the Organization?

Response strategies:

- What are the possible response strategies of the Organization in relation to each type of risk?
- What measures or mechanisms apply for each of the response strategies?
- What is the procedure if the decision is made to control a particular source of risk?
- What activities will be developed if the decision is made to face a particular source or risk?

Risk management process:

- Who are the persons responsible and the actions for identifying the main risks that the Organization is exposed to? What document states the results of these activities?
- What are the criteria, persons in charge and actions for analyzing the risks that the Organization is exposed to?
- What sphere is responsible for defining the response strategy to be adopted for each risk?
- How are the levels and/or parameters of tolerance defined for determining whether a risk is acceptable or if a response strategy needs to be implemented?
- What does monitoring the main risks consist of?

Mechanisms for managing each type of risk:

Credit risks

- What strategies and procedures allow adequate management of the credit risks in each of the Organization's business segments?
- Is there adequate segregation of functions between the business areas? Measurement and control of risk? Recording of operations?
- Is there adequate hedging of provisions in relation to the portfolio's risk level?
- What are the manual or automated mechanisms that validate the correct application of the activities and tasks of the credit process, considering the phases of origin, administration, collection, and monitoring?
- What are the information systems, and their scope, that allow the Organization to keep

information in a timely, dependable and accurate manner, both internally and externally, on exposure to credit risk?

Liquidity risk

- What is the amount of funds allocated in the budget for attending to the needs relating to Organization's lenders and what are the funding strategies for attending to the planned and potential resource needs? Are these budgets included in the Organization's strategic plan?
- What body of the Organization (Board of Directors, comprehensive risk committee, assets-liabilities committee) is formally aware of risk liquidity management and of assets and liabilities administration?
- Based on what parameters and what are the limits established for managing liquidity risk?
- What are the information systems, and their scope, allowing to keep timely, dependable and accurate information, both internally and externally, on liquidity risk exposure?
- What are the strategies of the liquidity contingency plan?

Market risk

- What does the strategic plan state regarding managing interest rates? Does it consider the Organization's costs, competitors' prices or other factors?
- What body of the Organization (Board of Directors, comprehensive risk committee, assets-liabilities committee) is formally aware of market risk management?
- What is the Organization's measurement system for quantifying exposure to interest rate risk?
- What are the information systems, and their scope, allowing to keep timely, dependable and accurate information, both internally and externally, on exposure to interest rate risk?

Operational risk

- What is the series of processes of the Organization according to the processes manual? Are processes defined by the following areas: governing processes, productive and support processes, and processes according to the business line?
- What monitoring or reporting systems does the Organization have for doing follow-up on the operational risk events that occurred and that are likely? What information do they allow obtaining?
- What procedures does the business continuity plan determine for cases of events that may interrupt the Organization's operations?
- How many times per year have trials been done of the business continuity plan? What modifications were made?

Bibliographic annex to risk management

1. ECUADORIAN LEGISLATION

1.1. For banks

The information reviewed for adjusting Pillar IV, Compliance and risk management, of the GIF Tool, was book I of title X of *Codificación de Resoluciones de la Superintendencia de Bancos*, chapters:

- a) Chapter II, *De la administración del riesgo de crédito*
http://www.superbancos.gob.ec/medios/PORTALDOCS/downloads/normativa/nueva_codificacion/todos/L1_X_cap_II.pdf
- b) Chapter III, *De la administración del riesgo de mercado*
http://www.superbancos.gob.ec/medios/PORTALDOCS/downloads/normativa/nueva_codificacion/todos/L1_X_cap_III.pdf
- c) Chapter IV, *De la administración del riesgo de liquidez*
http://www.superbancos.gob.ec/medios/PORTALDOCS/downloads/normativa/nueva_codificacion/todos/L1_X_cap_IV.pdf
- d) Chapter V, *De la gestión del riesgo operativo*
http://www.superbancos.gob.ec/medios/PORTALDOCS/downloads/normativa/nueva_codificacion/todos/L1_X_cap_V.pdf

1.2. For savings and credit unions and foundations

The information reviewed for adjusting Pillar IV, Compliance and risk management, of the GIF Tool, consisted of resolutions issued by Junta de Política y Regulación Monetaria y Financiera (Monetary and Financial Policies and Regulations Committee), as per the following list:

- a) Resolution no. 128-2015-F, *Normas para la administración integral de riesgos en las cooperativas de ahorro y crédito y cajas centrales*
<http://www.seps.gob.ec/documents/20181/25522/Resol128.pdf/5c74f247-0de4-4862-b5fb-c89ff62817d7>
- b) Resolution no. 129-2015-F, *Norma para la gestión del riesgo de crédito en las Cooperativas de ahorro y crédito*
<http://www.seps.gob.ec/documents/20181/25522/Resol129.pdf/3e459b17-7585-4953-8447-6936ea56b462>

2. BEST PRACTICES

The information on best practices for risk management reviewed for adjusting Pillar IV, Compliance and risk management, of the GIF Tool, is the following:

- a) Basel Committee on Banking Supervision, Core Principles for Effective Banking Supervision, September 2012, (http://www.bis.org/publ/bcbs230_es.pdf)
- b) Basel Committee on Banking Supervision, Microfinance Activities and the Core Principles for Effective Banking Supervision, February 2010, (http://www.bis.org/publ/bcbs167_es.pdf)
- c) Australian legislation: Risk Management Guidelines, companion to AS/NZS 4360:2004
- d) Committee of Sponsoring Organizations of the Treadway Commission (COSO), Applying Enterprise Risk Management – Integrated Framework, September, 2004