BANK VAN DE NEDERLANDSE ANTILLEN
("Central Bank")

CORPORATE GOVERNANCE

GUIDANCE NOTES FOR THE SUPERVISORY BOARD OF SUPERVISED FINANCIAL INSTITUTIONS

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Board.

I. INTRODUCTION

A supervised financial institution (hereinafter "the institution"), like any other corporate organization has shareholders and a Board of Supervisory Directors (hereinafter "the Supervisory Board"), elected by the shareholders, to oversee and supervise the management of the institution's resources and activities. The members of the Supervisory Board must exercise reasonable care and sound judgement in governing the affairs of the institution.

The members of the Supervisory Board of financial institutions face special challenges, because these institutions differ from other corporations in that most of the funds they put at risk belong to others. Customers' deposits of banks and other depository institutions and policyholders' premiums of insurance companies are loaned out or invested to provide a reasonable return to shareholders and other beneficiaries of these institutions.

This activity, generating return to the shareholders with mainly third party funding, creates limits on the risks that a supervised institution can prudently undertake. Proper managing of risks to serve these competing interests - profitability versus the safe use of third party funding - is one of the most important challenges the Supervisory Board and Management of the institution face.

Through these guidance notes the Bank, as the supervisor for regulated financial institutions in the Netherlands Antilles, will review and comment on some critical areas in the functioning of a Supervisory Board in financial institutions. When assessing the involvement of a Supervisory Board in overseeing the activities and management of an institution the notes made here are considered by the Bank as reference points for its evaluation. In this respect, the Bank recommends all individuals acting as member of the Supervisory Board of supervised institutions to take appropriate notice of the guidance notes that follow.

II. THE REGULATION AND SUPERVISION OF FINANCIAL INSTITUTIONS

Because of its various public functions, the financial industry is usually regulated in most countries and individual institutions operating in the industry are supervised by an independent supervisory authority.

Supervision is generally aimed at ensuring the safety and soundness of the individual institutions and the financial system as a whole, and at fostering an efficient allocation of funds within the economy.

Banking and insurance undertakings in the Netherlands Antilles are subject to restrictions by means of law, in that these undertakings may not be carried out without a license issued by the Central Bank ("the Bank"). In addition, after being licensed, institutions carrying out these businesses are required to comply with several rules and regulations that apply to their business.

In general, the Bank requires that these institutions avoid unsafe and unsound practices. The Bank therefore monitors the performance of the institutions in various critical areas to determine compliance with laws, rules and regulations and to encourage safe and sound practices to preserve the financial soundness of the institution in particular and a sound development of the financial sector in general.

III. THE IMPORTANCE OF THE SUPERVISORY BOARD

An institution's Supervisory Board is ultimately responsible for the conduct of the institution's affairs. The Supervisory Board controls the institution's direction and, hence, its overall policy. By doing this, the Supervisory Board determines how the institution will conduct its business on the long term. In general, the Supervisory Board establishes or approves and monitors the policies by which Management will operate.

The financial stability and continuity of an institution is very much dependent on the strength and quality of the Supervisory Board, its independence from management and its degree of involvement in the institution's affairs. In favorable times the Supervisory Board contributes by setting the tone and direction, it oversees and supports Management's efforts by testing and probing their recommendations before approving them. The Supervisory Board also makes sure that adequate systems and controls are in place to identify and address problems before they become a threat. In adverse times an active and involved Supervisory Board can help an institution survive by taking the necessary corrective actions and, when needed, keep the institution on track until effective management can be re-established.

The Supervisory Board should periodically evaluate its own effectiveness and take appropriate steps to improve its performance. In this respect orientation programs for new members of the Supervisory Board and ongoing education programs that keep all members of the Supervisory Board abreast of developments in the industry should be considered. Additionally, periodic reviews by third parties (e.g. auditors, supervisory authorities or management advisors) may help the Supervisory Board assess how well it and its committees are meeting their responsibilities.

IV. THE RESPONSIBILITIES OF THE SUPERVISORY BOARD AND ITS MEMBERS

Besides the collective responsibilities of the Supervisory Board, each member has his individual responsibilities.

The responsibilities of the ***Supervisory Board*** as a whole can be sub-divided in the following seven distinct areas:

a) ensure competent management on an ongoing basis;
b) ensure appropriate plans and policies for the institution;
c) monitor operations to ensure compliance and adequate control;
d) oversee business performance;
e) ensure that the institution serves the (credit, insurance or investment) needs of the community well;
f) ensure that the individuals involved in the daily management and operation of the institution are of professional, social and moral integrity; and
g) ensure that timely and accurate disclosure is made on all material matters regarding the institution.

IV.1 Supervisory Board's Responsibilities

a. To ensure competent management on an ongoing basis

Capable management is perhaps the most important element of a well-functioning institution. Capable management entails among others the following skills:

1. industry expertise to assist the Supervisory Board in planning for the institution's future in a changing marketplace;
2. technical expertise to design and administer the systems and controls to carry out policies and comply with applicable laws, rules and regulations;
3. ability to manage the day-to-day operations to achieve the institution's performance objectives.

Capable management is a critical element in the difference between success and failure of the institution. Therefore, another important responsibility of the Supervisory Board is selecting and retaining capable management. Integrity, technical skills and experience should be key considerations in the selection process of Managing Directors or other senior officers. The individuals appointed should share the Supervisory Board's philosophy and vision for the future direction of the institution.

The Supervisory Board should have a formal appraisal process in place to supervise and evaluate management performance. Although the Supervisory Board primarily supervises the Management of a financial institution, the Supervisory Board should require performance appraisals at all levels. Audit reports, management

presentations to the Supervisory Board and business performance indicators are some of the systems that provide information which the Supervisory Board can use in the supervision and evaluation of management.

The Supervisory Board should also develop policies to retain competent managers and staff. Such policies should include appropriate compensations and benefit packages, as well as training programs tailored to the institution's operation and business plan. The training programs are to support needed skill levels and keep personnel abreast of the developments in the financial services industry. The Supervisory Board should be able to evaluate on a periodic basis the institution's effectiveness in retaining expertise and the necessary human resources to achieve its goals and objectives.

In the same spirit, the Supervisory Board should develop management succession policies as well as addressing issues such as identifying potential replacements of management and critical positions, either internal or external. Occasionally, the Supervisory Board may find it necessary to dismiss management for valuable reasons. Therefore, the management employment contract should make explicit the Supervisory Board's statutory and/or contractual removal authority in order to ensure that the Supervisory Board's right of dismissal is not unnecessarily questioned.

b. To ensure appropriate plans and policies for the institution

Planning

Rapid changes in the financial industry call for clear strategies and business planning. By knowing the institution's strength and weaknesses and its future direction, the Supervisory Board can evaluate whether the institution has the financial and human resources, and the technical skills and capabilities necessary to reach its goals and directions.

Long term strategic planning is done at Supervisory Board level and forms the broad policy framework, containing the Supervisory Board's philosophy and vision as to the institution's future. Strategic planning entails major decisions that affect the development of the institution and the allocation and/or commitment of resources to reach the objectives.

Short term business plans, on the other hand, are prepared by management and approved by the Supervisory Board. Deviations from the strategic plans should be reviewed by the Supervisory Board after careful consideration of the available resources, conditions and circumstances requiring such deviations.

The Supervisory Board should also ensure that management has adequate contingency plans to address major operational disasters. Insurance coverage should be addressed and back-up procedures and facilities identified and adequately provided for.

Policies
The Supervisory Board is responsible for defining what levels and types of risks are acceptable, by adopting policies and procedures that direct management on how to make balanced choices between risks and rewards. The Supervisory Board should ensure that management is adequately aware of generally applied risk (management) principles in the main areas of operation.

All major activities must be covered by adequate policies and no such activity should be initiated before appropriate policies and procedures are in place. Policies should be specified in writing and supported by procedures for implementation that also include steps for getting the Supervisory Board's approval in case of exemptions or deviations from policies.

Policies can either be developed by or on behalf of the Supervisory Board. When policies are developed by the Supervisory Board, it sets only the broad policy guidelines while the details are worked out by management.

The Supervisory Board can also delegate the entire responsibility for policy development to the Management or an outside consultant. In whatever way policies are developed, the Supervisory Board must always review and approve them and remains responsible for the policies adopted. In complicated matters, the Supervisory Board should make sure that the persons developing the policies and procedures are knowledgeable, and that they have adequately taken into account the institution's specific circumstances and operational environment.

Policies should be reviewed annually to ensure that they remain adequate, consistent and realistic. Also, policies should be revised when necessary to address the changes in resources in the institution's operating environment. Furthermore, policies should be communicated clearly through all levels, preferably in writing in order to promote consistency of interpretation throughout the organization as a whole.

c. To monitor operations to ensure compliance and adequate control

While the Supervisory Board may depend on management's expertise to run the day-to-day operations, the Supervisory Board remains responsible for ensuring that those operations are properly controlled and that they comply with Supervisory Board policies and applicable laws and regulations. To assist in meeting this responsibility the Supervisory Board needs to ensure that management has put adequate internal controls in place, that the Supervisory Board's policies have been implemented and that both controls and policies are implemented effectively. There are three sources of information for the Supervisory Board to accomplish this objective.

I. *Comprehensive audit programs*
These programs provide for on-going focus on control issues and periodic review of all aspects of the institution's operations. The Supervisory Board needs to ensure that selected internal auditors are experienced in the types of activities that comprise the

daily operation. Their judgment depends to a large extent on their understanding of these activities. With the Supervisory Board rests the responsibility for selection, retention, evaluation and compensation of those performing the audit/review.

In principle, the internal auditors should be independent from management and should report their findings directly to the Supervisory Board or an Audit Committee appointed by the Supervisory Board. Management, on the other hand, should report on the progress in addressing problems raised by the internal auditors, so that the Supervisory Board can ensure that the necessary corrective actions are taken on a timely basis. Failure to do the latter undermines the value of audits and breaches the responsibility of the Supervisory Board.

II. *Compliance activities*

From the Bank's point of view it is desirable to establish a compliance function besides the internal audit function. A compliance officer or compliance committee performs: (1) periodic compliance reviews of laws and regulations, (2) develops management information systems to ensure compliance, (3) assesses the impact of (new) laws and regulations on operations and procedures, and (4) provides guidance on compliance issues as new products or services are developed.

The Supervisory Board should visibly support the compliance officer's or committee's efforts. The compliance officer or committee should have a senior position in the institution to ensure adequate attention and response from all stakeholders of the institution.

III. *Other sources*

Other sources that could assist in keeping the Supervisory Board abreast of potential problem areas and developments in the industry include: works council, (management) consultants, external auditors and the supervisory authorities. The Supervisory Board should ensure that it is well aware of the issues discussed with management during and after external reviews of any kind or examinations conducted by the Bank and see that any specific follow-up is done. The Supervisory Board can also meet with mentioned parties without the presence of management. The Supervisory Board should, however, not rely solely on consultants and supervisors to identify problem areas in the operations. If it were to do so the Supervisory Board would not be fulfilling its responsibilities in a pro-active manner.

d. To oversee business performance

The financial performance of an institution is of critical importance to the position of the depositors and other creditors or policy holders, to the return on shareholders' investment and hence the ability of the institution to raise the necessary funds to support its growth. Therefore, sound business performance should be one of the primary objectives of the Supervisory Board.

In general, the quality of earnings should be of equal importance as the level of these earnings. Quality earnings result from sound fundamentals, such as good quality assets, stable funding sources, well controlled expenses, sound funds-management systems and knowledge of the markets in which the institution operates.

The members of the Supervisory Board need to ensure, for instance, that earnings levels are not inflated by such factors as delayed charge-offs or inadequate provision for losses on assets.

The Supervisory Board should be provided with financial analyses designed to provide answers to the issues of importance to the Supervisory Board.
The Supervisory Board should also be able to use this information to evaluate the general performance of the institution and of management, and to make

comparisons against peer group performance. This evaluation is made possible by highlighting key ratios, trends and anomalies. The Supervisory Board should furthermore identify what information is needed and request that management provides the information together with the other reports that are required.

e. To ensure that the institution serves the (credit, insurance or investment) needs of the community well

The Supervisory Board's planning and policies should not only address profits and safety and soundness, but it should also reflect efforts to help meet the (banking, insurance or investment) needs of the entire community that the institution serves. In this context the Supervisory Board should consider whether otherwise sound policies and procedures are having unintended effect of discouraging good quality business in some income classes of the community.

The Supervisory Board should therefore encourage management to be innovative and committed to serving the needs of the community in which the institution operates.

f. To ensure that the individuals involved in the daily management and operation of the institution are of professional, social and moral integrity

The Supervisory Board is responsible for the formulation of internal policies and guidelines with regard to the fitness and probity of management and other employees of the institution, in an effort to minimize non-integer behavior amongst the personnel. Furthermore, the Supervisory Board should assess the potential involvement of the personnel in money laundering activities, fraud, counterfeit, dishonesty, malpractice, and insider trading.

g. To ensure that timely and accurate disclosure is made on all material matters regarding the institution

The Supervisory Board should at all times practice transparency while supervising their financial institutions. This is also strongly supported by international financial organizations, such as the Basel Committee and the OECD. Transparency is defined as: *public disclosure of reliable and timely information that enables users of that information to make an accurate assessment of a financial institution's financial condition and performance, business activities, risk profile and risk management practices.* To achieve transparency, a financial institution must provide timely and accurate, relevant and sufficient public disclosures of qualitative and quantitative information that enables users to make proper assessment of the institution's activities and the risks inherent in those activities. Public disclosure and supervisory information should promote safety and soundness in the financial sector.

With regard to the public disclosure of quantitative information, financial institutions in the Netherlands Antilles should at least disclose their audited financial statements, including but not limited to, their balance sheet, profit and loss statement and notes to the financial statements. These financial statements should be prepared, audited,

and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit. Public disclosure should be promoted and encouraged by the Supervisory Board and should be provided at least on an annual basis.

IV.2 Individual Responsibilities of a Member of the Supervisory Board

Supervisory Board membership serves as an opportunity for the individual member to contribute to the growth and development of the local economy. Furthermore, it provides an invaluable business education to the members of the Supervisory Board. The job brings with it distinct duties, responsibilities, but also liabilities. Generally, the individual responsibilities of a member of the Supervisory Board are to:

a) be aware of the institution's operating environment;
b) be diligent in performing the job;
c) exercise independent judgment; and
d) be loyal to the institution's interests.

a) ***Be aware of the institution's operating environment***

Each member of the Supervisory Board should be generally informed of both the business environment and the legal and regulatory framework affecting the institution's activities.

b) ***Be diligent in performing the duties***

Individual members of the Supervisory Board must devote adequate time and attention necessary to fulfill their duties in a proper manner and should be knowledgeable enough to contribute in a meaningful sense to the activities of the Supervisory Board as a whole.

c) ***Exercise independent judgment***

Notwithstanding the fact that members of the Supervisory Board may feel pressure from management or the shareholders, each member must ask the questions and know the facts necessary to satisfy himself that management's or shareholders' recommendations are feasible and in the institution's best interest. If a member of the Supervisory Board disagrees with a Supervisory Board's decision, the member should indicate so and formally register and explain his disagreement. Objective judgment is critical to the Supervisory Board's effectiveness.

d) ***Be loyal to the institution's interests***

The members of the Supervisory Board must ensure that their own business and personal relationships do not interfere with Supervisory Board's decisions. The members must also ensure that neither they nor others take advantage of their position to benefit personally from the institution. They should structure their business with and personal ties to the institution in such a manner to avoid even the appearance of a conflict of interest.

To meet these responsibilities each individual member of the Supervisory Board is expected to actively contribute to the work of the Supervisory Board. Before agreeing to serve as a member of the Supervisory Board, prospective members should consider whether they are willing and able to commit the necessary time and efforts in the interest of the institution.

V. THE COMPOSITION OF THE SUPERVISORY BOARD

The Supervisory Board's effectiveness depends largely on how well its members function individually and together. One of the factors affecting the functioning of the Supervisory Board as a whole is its size. National regulations have established requirements for the minimum number (three) of Supervisory Board members for insurance companies and credit institutions. On the other hand, a Supervisory Board consisting of too many members might not be effective at all in exercising its duties.

A second factor that will affect the Supervisory Board's effectiveness is the knowledge and experience of its members. The institution should select individuals who are likely to exercise independent judgment and will participate actively in decision making. Substantial participation of Supervisory Board members is essential to the Supervisory Board's effectiveness as each provide important perspective and objectivity in evaluating management and daily operations.

In principle, candidates for Supervisory Board positions in supervised institutions need expert knowledge of the financial service industry. But, also persons in other endeavors may offer knowledge, skills, and important perspective to a Supervisory Board. However, the Supervisory Board as a whole must possess sufficient knowledge and experience in financial services. All candidates for the Supervisory Board are subject to prior approval by the Bank, in which process the experience level, knowledge of the industry and integrity of the candidates are evaluated by the Bank.

VI. THE ORGANIZATIONAL STRUCTURE OF THE SUPERVISORY BOARD

For the purpose of adequate allocation of duties and efficiency, the Supervisory Board should consider working with special committees.

Committees can work on matters that require detailed review or in-depth consideration. The way committees function is of varying degrees of importance to the Supervisory Board's own functioning. These committees help the members of the Supervisory Board to be involved and provide them with important insight. A more direct contact with management will help put the members of the Supervisory Board in a position to better evaluate management's performance. Overlapping committee membership can help integrate Supervisory Board activities, while rotational assignments can expose the members of the Supervisory Board to different areas and activities of the institution.

All assignments or delegations to committees should be done by written statements of mission, responsibilities, authorities and duration. Written committee guidelines are critical to help ensure that important Supervisory Board functions are not neglected because of misunderstandings or incomplete delegations.

The committees should report to the Supervisory Board as a whole, while the Supervisory Board as a whole remains responsible for its decisions. The Supervisory Board therefore should make sure that the committee has done its work responsibly and that its recommendations are reasonable.

The following are some examples of typical committees in the financial industry:

Executive Committee: This committee is generally authorized to act on behalf of the Supervisory Board as a whole and to maintain regular contacts with management.

Audit Committee: This committee serves to monitor compliance with Supervisory Board's policies, applicable laws and regulations and to review financial and auditing matters. See section VII for detailed guidelines on the functioning and structure of the Audit Committee.

Risk Management Committee: This committee ensures that the institution maintains acceptable risk limits and that appropriate risk-control techniques are used to monitor and minimize losses to the institution. See section VIII for the role of the Supervisory Board in connection with risk management.

Credit Committee: The credit committee ensures that an institution's lending policies are adequate and adhered to as well as to applicable laws and regulations regarding credit extension.

Reinsurance Committee: This committee ensures that the institution's insurance risks are properly reinsured to the extent necessary and that the extent of own retention is acceptable for the institution.

Remuneration Committee: This committee ensures that the institution maintains appropriate and competitive compensation plans for management and employees of the institution. Matters usually dealt with by the committee include: CEO compensation arrangements, general remuneration policies and practices for the institution, recruitment and termination policies and practices, incentive schemes and remuneration arrangements for Supervisory Board members.

Investment/Asset-Liability Committee: This committee ensures that the institution's investment policies and assets/liabilities mix are adequate and that the institution's investments comply with Supervisory Board policies, general principles of asset and liability management, principles of risk management and applicable laws and regulations.

Trust Policy and Trust Audit Committees

A *Trust Policy Committee* oversees the trust activities of the institution to ensure that Supervisory Board responsibilities are adequately met and that the institution complies with the laws and regulations governing these activities.

A T*rust Audit Committee* oversees the review and (annual) audit of the institution's fiduciary activities.

Nomination Committee: This committee considers the size and composition of the Supervisory Board and Management, devises criteria for membership thereof and, where necessary, pre-selects and proposes candidates for consideration by the Supervisory Board.

VII. FUNCTIONS AND OPERATIONS OF AN AUDIT COMMITTEE

One of the most used and effective working instruments of the Supervisory Board is the Audit Committee. An Audit Committee assists the Supervisory Board to discharge of its responsibilities in respect of its oversight on the preparation of the annual financial statements, on the internal controls and on the independence of the institution's auditors. The Audit Committee functions independent from line management. This independence is of primary benefit to the Supervisory Board. The Audit Committee should not take over any functions of management nor should management in any way exert undue influence over the work of the Audit Committee. The role of the Audit Committee should be clearly defined to ensure this independent position.

In general, the following duties may be assigned to the Audit Committee:

- to consider the effectiveness of accounting and internal control procedures;
- to consider the information system which is used by the Supervisory Board or other key personnel to make the decisions affecting the institutions activities;
- to review all areas of significant financial risk and the arrangements in place to contain those risks to acceptable levels;
- to review all published financial information, including the annual financial statements, regarding the institution;
- to nominate the external auditors and to review all aspects of the institution's relationship with external auditors, including existing arrangements, scope and quality of the audit;
- to review the activities and effectiveness of internal and external auditors and the compliance officer;
- to review the effectiveness of management information systems and other systems of internal control; and
- to report findings, conclusions and recommendations to the Supervisory Board as to all of the above.

Chairman

It is important that the Chairman of the committee and the CEO or the Supervisory Board of the institution can work well together, in order for the committee to obtain all relevant information in a timely manner.

The Chairman of the Audit Committee is typically a person who has significant experience in the business of the institution and sufficient knowledge of accounting standards and reporting requirements.

Frequency of meetings

The frequency of the meetings depends largely on the extent of duties of the Audit Committee. The Bank suggests a minimum of one meeting per month. However, the committee must have the ability to call a meeting at any time at the request of one of its members, the external auditor or senior management.

During the first meeting held at the beginning of the fiscal year the planning of the activities is done and the areas of particular concern highlighted. After the external auditors' interim visit, a meeting with the auditors will provide opportunity to audit committee members to review the progress of the audit and discuss any matters that have arisen during the interim audit. It is also appropriate for the committee to meet after an examination by the Bank to discuss the findings.

Prior to the adoption and consideration by the full Supervisory Board of the annual accounts, the Audit Committee should discuss these accounts and the material accounting matters and weaknesses in internal control or systems found by the external auditors.

Finally, it is recommended for the committee to meet prior to the general meeting of shareholders to discuss any matters that could be raised by the shareholders, as well as the effect of any other event that might have occurred since the accounts were issued.

Minutes of meetings

Regular minutes and reports of the meetings ensure that the Supervisory Board is kept informed on the deliberations of the Audit Committee and that a clear and effective trail of review and communication is created on behalf of the Supervisory Board.

The Audit Committee should set high standards for internal control and accuracy of financial reporting and require the standards to be maintained at all times. It should recognize that financial and accounting systems and controls need constant review and that the committee should constantly maintain dialogue with internal and external auditors. Furthermore, an Audit Committee should have explicit authority to investigate any matters within its terms of reference and the committee should be able to obtain external professional advice and invite outsiders with relevant experience to attend meetings of the committee if necessary.

VIII. RISK MANAGEMENT AND THE ROLE OF THE SUPERVISORY BOARD

Taking and especially managing risks are fundamental to the business of a financial institution. Accordingly, the Bank places significant supervisory emphasis on the adequacy of an institution's management of risk, including its system of internal controls, when evaluating the management of supervised institutions.

An institution's failure to establish a management structure that adequately identifies, measures, monitors, and controls the risks involved in its various products and lines of business is considered unsafe and unsound conduct. Principles of sound management should apply to the entire spectrum of risks facing a financial institution including, but not limited to, credit, market, liquidity, operational, legal, and reputational risk.

- **Credit risk** arises when a borrower or counterparty will potentially fail to perform on an obligation vis-a-vis the institution;
- **Market risk** is the risk to a financial institution's equity position and hence its condition resulting from adverse movements in market rates or prices, such as interest rates, foreign exchange rates, or equity prices;
- **Liquidity risk** is the potential that an institution will be unable to meet its obligations as they come due because of an inability to liquidate assets or obtain adequate funding (referred to as " funding liquidity risk") or that it cannot easily unwind or offset specific exposures without significantly lowering market prices because of inadequate market disruptions ("market liquidity risk");
- **Operational risk** arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud, or unforeseen catastrophes will result in unexpected losses;
- **Legal risk** arises from the potential that unenforceable contracts, lawsuits, or adverse judgments can disrupt or otherwise negatively affect the operations or condition of a financial institution;
- **Reputational risk** is the potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation, or revenue reductions.

In practice, an institution's business activities present various combinations and concentrations of these risks depending on the nature and scope of the particular activity. The following provides guidelines for determining the institution's formal or informal systems for identifying, measuring and containing the above mentioned risks.

When evaluating the quality of risk management at financial institutions as part of the evaluation of the overall quality of management, the Bank considers primarily the following elements of a sound risk management system:

- active Supervisory Board and senior management oversight;
- adequate policies, procedures, and limits;
- adequate risk measurement, monitoring, and management information systems; and
- adequate and comprehensive internal controls.

Each of these elements is described further below, along with a list of considerations relevant to assessing the adequacy of each element of the risk management system.

Adequate risk management programs can vary considerably in sophistication, depending on the size and complexity of the institution and the level of risk that it accepts. For smaller institutions engaged solely in traditional activities and whose senior managers and directors are actively involved in the details of day-to-day operations, these systems may consist only of written policies addressing material areas of operations.

However, larger organizations will require far more elaborate and formal risk management systems in order to address their broader and typically more complex range of financial activities and to provide senior managers and directors with the information they need to monitor and direct day-to-day activities.

The risk management processes of larger organizations would typically contain detailed guidelines that set specific prudential limits on the principal types of risks relevant to their consolidated activities.

Furthermore, because of the diversity of their activities and the geographic dispersion of their operations, these larger institutions will require timely and relatively more sophisticated reporting systems in order to manage their risks properly. These reporting systems, in turn, should comprise of an adequate array of reports that provide the levels of detail about risk exposures that are relevant to the duties and responsibilities of individual managers and directors.

VIII.1. Active Supervisory Board and Senior Management Oversight

Supervisory Boards have ultimate responsibility for the level of risk taken by their institutions. Accordingly, they should approve the overall business strategies and significant policies of their institutions, including those related to the managing and taking of risks, and they should also ensure that senior management is fully capable of managing the activities that their institutions conduct. While all Supervisory Boards are responsible for understanding the nature of the risks significant to their institutions and for ensuring that management is taking the steps necessary to identify, measure, monitor, and control these risks, the level of technical knowledge required of members of the Supervisory Board may vary depending on the particular circumstances at the institution.

The members of the Supervisory Board of large institutions that conduct a broad range of technically complex activities, for example, cannot be expected to understand the full details of their institutions' activities or the precise ways risks are measured and controlled. They should, however, have a clear understanding of the types of risks to which their institutions are exposed and should receive reports that identify the size and significance of the risks in terms that are meaningful to them. In fulfilling this responsibility, the members of the Supervisory Board should take steps to develop an appropriate understanding of the risks their institutions face, possibly briefings from auditors and experts external to the organization.

Using this knowledge and information, members of the Supervisory Board should provide clear guidance regarding the level of exposure acceptable to their institution and have the responsibility to ensure that senior management implements the procedures and controls necessary to comply with adopted policies.

Members of the Supervisory Board of institutions that conduct more traditional and less complicated business activities may require significantly less knowledge of complex financial transactions or capital markets. They may, however, be more involved in the day-to-day activities and decision-making of their institutions than are their counterparts at larger institutions and should have a level of knowledge commensurate with the nature of their involvement.

Senior management is responsible for implementing strategies in a manner that limits risks associated with each strategy and that ensures compliance with laws and regulations on both a long-term and a day-to-day basis.

Accordingly, management should be fully involved in the activities of their institutions and possess sufficient knowledge of all major business lines to ensure that appropriate policies, controls, and risk monitoring systems are in place and that accountability and lines of authority are clearly delineated. Senior management is also responsible for establishing and communicating a strong awareness of and need for effective internal controls and high ethical standards.

Meeting these responsibilities requires senior managers to have a thorough understanding of financial market activities and detailed knowledge of the activities their institution conducts, including the extent and nature of internal controls necessary to limit the related risks.

In assessing the quality of the oversight by the Supervisory Board and Management, the Bank will consider whether a supervised institution follows policies and practices such as those described below.

- The Supervisory Board and Management have identified and have a clear understanding and working knowledge of the types of risks inherent in the institution's activities and make appropriate efforts to remain informed about these risks as financial markets, risk management practices, and the institution's activities evolve.
- The Supervisory Board has reviewed and approved appropriate policies to limit risks inherent in the institution's lending, insurance, investing, trading, trust, fiduciary and other significant activities or products.
- The Supervisory Board and Management are sufficiently familiar with and are using adequate record keeping and reporting systems to measure and monitor the major sources of risk to the institution.
- The Supervisory Board periodically reviews and approves risk exposure limits to conform with any changes in the institution's strategies, addresses new products, and reacts to changes in market conditions.

- The Supervisory Board and Management ensure that the lines of business are managed and staffed by personnel with knowledge, experience, and expertise consistent with the nature and scope of the institution's activities.
- The Supervisory Board and Management ensure that the depth of staff resources is sufficient to operate and manage soundly the institution's activities and that its employees have the integrity, ethical values, and competence that are consistent with a prudent management philosophy and operating style.
- Management provides adequate supervision of the day-to-day activities of officers or heads of business lines at all levels.
- Management is able to respond to risks that may arise from changes in the competitive environment or from innovations in markets in which the institution is active.
- Management identifies and reviews, before embarking on new activities or introducing products new to the institution, all risks associated with the activity or product and ensures that the infrastructure and internal controls necessary to manage the related risks are in place.

VIII.2. Adequate Policies, Procedures, and Limits

An institution's Supervisory Board and senior management should tailor their risk management policies and procedures to the types of risks that arise from the activities the institution conducts. Once the risks are properly identified, the institution's policies and its more fully articulated procedures provide detailed guidance for the day-to-day implementation of broad business strategies, and generally include limits designed to shield the institution from excessive and imprudent risks. While all financial institutions should have policies and procedures that address their significant activities and risks, the coverage and level of detail embodied in these statements will vary among institutions.

A smaller, less complex institution that has effective management that is heavily involved in day-to-day operations generally would be expected to have only basic policies addressing the significant areas of operations and setting forth a limited set of requirements and procedures. In a larger institution, where senior managers must rely on widely-dispersed staffs to implement strategies in an extended range of potentially complex businesses, far more detailed policies and related procedures would generally be expected. In either case, however, management is expected to ensure that policies and procedures address the material areas of risk to an institution and that they are modified when necessary to respond to significant changes in the institution's activities or business conditions.

The following guidelines are considered by the Bank in evaluating the adequacy of a supervised institution's policies, procedures, and limits.

- The institution's policies, procedures, and limits provide for adequate identification, measurement, monitoring and control of the risks posed by its lending, insurance investment, trading, trust, fiduciary and other significant activities.
- The policies, procedures, and limits are consistent with management's experience level, the institution's stated goals and objectives, and overall financial strength of the institution.

- Policies clearly delineate accountability and lines of authority across the institution's activities.
- Policies provide for the review of new activities of the financial institution to ensure that the infrastructure necessary to identify, monitor, and control risks associated with an activity are in place before the activity is initiated.

VIII.3. Adequate Risk Measurement, Monitoring and Management Information Systems

Effective risk monitoring requires institutions to identify and measure all material risk exposures. Consequently, risk monitoring activities must be supported by information-systems that provide senior managers and members of the Supervisory Board with timely reports on the financial condition, operating performance, and risk exposure of the consolidated institution, as well as with regular and sufficiently detailed reports for line managers engaged in the day-to-day management of the institution's activities.

The sophistication of risk monitoring and management information systems should be consistent with the complexity and diversity of the institution's operations. Accordingly, smaller and less complicated institutions may require only a limited set of Management and Supervisory Board reports to support risk monitoring activities. These reports include, for example, daily or weekly balance sheets and income statements, a watch list for potentially troubled assets, a report for past due receivables, a simple interest rate risk or market risk report, and similar items. Larger, more complicated institutions, however, would be expected to have much more comprehensive reporting and monitoring systems that allow, for example, for more frequent reporting, tighter monitoring of complex activities, and the aggregation of risks on a fully consolidated basis across all business lines and activities.

Financial institutions of all sizes are expected to have risk monitoring and management information systems in place that provide members of the Supervisory Board and senior management with a clear understanding of the organization's positions and risk exposures.

In assessing the adequacy of a supervised institution's measurement and monitoring of risk and its management reports and information systems, the Bank will consider whether these conditions exist:

- the institution's risk monitoring practices and reports address all of its material risks;
- key assumptions, data sources, and procedures used in measuring and monitoring risk are appropriate and adequately documented and tested for reliability on an on-going basis;
- reports and other forms of communication are consistent with the institution's activities, are structured to monitor exposures and compliance with established limits, goals, or objectives, and as appropriate, compare actual versus expected performance; and
- reports to management or to the institution's members of the Supervisory Board are accurate and timely and contain sufficient information for decision-makers to identify any adverse trends and to evaluate adequately the level of risk faced by the institution.

VIII.4. Adequate and Comprehensive Internal Controls

An institution's internal control environment is critical to the safe and sound functioning of the institution and, in particular, to its risk management system. Establishing and maintaining an effective system of controls, including appropriate separation of duties, is one of management's more important responsibilities.

Appropriately segregating duties is a fundamental and essential element of a sound risk management and internal control system. Failure to implement and maintain an adequate separation of duties can constitute an unsafe and unsound practice and possibly lead to serious losses or otherwise compromise the financial integrity of the institution. Serious lapses or deficiencies in internal controls, including inadequate segregation of duties, may warrant supervisory action.

When properly structured, a system of internal controls promotes effective operations and reliable financial and regulatory reporting. Moreover, the system safeguards assets and helps to ensure compliance with relevant laws, regulations and institutional policies. Ideally, internal controls are tested by an independent internal auditor who reports directly either to the institution's Supervisory Board or its designated committee, which typically is the Audit Committee. However, smaller institutions whose size and complexity do not warrant a full scale internal audit function may rely on regular reviews of essential internal controls conducted by other personnel or external auditors. Other personnel performing these reviews should generally be independent of the function they are assigned to review.

Given the importance of appropriate internal controls to financial institutions of all sizes and risk profiles, the results of audits or reviews, whether conducted by an auditor or by other personnel, should be adequately documented as should management's responses to them. In addition, communication channels should exist that allow negative or sensitive findings to be reported directly to the Supervisory Board or to the relevant Committee of the Supervisory Board.

In evaluating the adequacy of a supervised institution's internal controls and audit procedures, the Bank will consider whether the following conditions are met.

- The system of internal controls is appropriate to the type and level of risks posed by the nature and extent of the institution's activities.
- The institution's organizational structure establishes clear lines of authority and responsibility for monitoring adherence to policies, procedures, and limits.
- Reporting lines provide sufficient independence of the control areas from the business lines and adequate separation of duties throughout the organization such as those relating to trading, custodial and back-office activities.
- Official organizational structures reflect actual operating practices.
- Financial, operational, and regulatory reports are reliable, accurate, and timely; wherever applicable, exceptions are noted and promptly investigated.
- Adequate procedures exist for ensuring compliance with applicable laws and regulations.
- Internal audit or other review related practice provide for independence and objectivity.

- Internal controls and information systems are adequately tested and reviewed; the coverage, procedures, findings, and responses to audits and review tests are adequately documented; identified material weaknesses are given appropriate and timely attention at Supervisory Board level; and management's actions to address material weaknesses are objectively verified and reviewed.
- The institution's Audit Committee or Supervisory Board reviews the effectiveness of internal audits and other review activities on a regular basis.

IX. THE RELATIONSHIP BETWEEN THE SUPERVISORY BOARD AND MANAGEMENT AND THE PROVISION OF INFORMATION TO THE SUPERVISORY BOARD

It is critical that the Supervisory Board and Management of the institution work together to ensure that the best interest of the institution is pursued at all times.

In principle, Management runs the day-to-day activities using a sound system of internal controls and in compliance with Supervisory Board policies, laws and regulations. In order to fulfill its duties, Management should provide the Supervisory Board with the information it needs to meet its responsibilities. Management also provides the Supervisory Board with new ideas and recommendations. The Supervisory Board should review carefully and discuss Management's recommendations until it is certain that these recommendations are in the institution's best interest.

The Supervisory Board and Management must support each other with each fulfilling their distinct responsibilities in an adequate manner. While the Supervisory Board leaves day-to-day operation to management it must retain overall control on the business. Through its right on information, the duty to control can be fulfilled taking into account timely and reliable information in its possession.

X. THE SUPERVISORY BOARD AND THE GROUP

Group companies are composed of a parent or holding company, branches, subsidiaries and other affiliates. While the Supervisory Board of a legally independent institution remains responsible for the institution's safety and soundness, the Supervisory Board of an institution in a Group is also responsible for the actions initiated by a holding company involving the institution. The Supervisory Board should therefore carefully review the policies of the holding company that apply to the institution and satisfy itself that these policies serve the needs and interests of the institution.

No financial institution operates in a vacuum and an affiliate's unsafe and unsound activities could adversely affect the soundness or the public perception of the institution. Therefore, the Supervisory Board should also remain aware of the possibility that certain transactions with an affiliate may adversely affect the institution.

An institution's Supervisory Board's primary duty is to protect the institution which it serves. Therefore, if the holding company is engaging in practices which the members of the Supervisory Board fear may harm the institution and the holding company does not answer to the institution's concerns, or the institution's Supervisory Board is not otherwise satisfied that actions are appropriate, members of the Supervisory Board should dissent on the record and consider appropriate action to protect the institution. In such a situation, a Supervisory Board might initiate a special investigation by an independent (legal) counsel or accountant reporting to the Supervisory Board and/or raise the issue with the supervising authority.

With regard to the subsidiaries and branches of the institution, the Supervisory Board should carefully oversee their operations and maintain appropriate controls on these subsidiaries. Representation in the subsidiaries' Supervisory Board is potentially an effective way of achieving participation in policy making for the subsidiary. The Supervisory Board should also ensure that it has the authority to audit the operations and review the findings of the internal and external auditors and compliance officer of the subsidiaries.

XI. THE SUPERVISORY BOARD AND THE EXTERNAL AUDITORS

The external auditor of each supervised institution should be appointed by or with the consent of the Supervisory Board. Usually a more direct working relationship will exist between the auditors and the Audit Committee, but at least once a year the auditors must communicate their audit findings and concerns to the entire Supervisory Board and discuss the management letter with the Supervisory Board. The Supervisory Board should maintain a healthy relationship with the external auditors and, where necessary, consider the engagement of the external auditors to review certain areas of operations or transactions that are of interest or concern to the Supervisory Board.

XII. MEETINGS AND MINUTES OF MEETINGS OF THE SUPERVISORY BOARD

The Bank expects that the Supervisory Board of an institution which is incorporated in the Netherlands Antilles and under the supervision of the Bank meets at least once every four to six weeks.

Although the Bank usually does not request the agenda's and minutes of these meetings of the Supervisory Board, it retains the right to do so at any time it is necessary. If the Bank wishes to exercise this right it will submit a request to the Supervisory Board of the institution. However, the Bank's examiners' standard examination approach includes the consultation and review of the minutes of the Supervisory Board during an on-site examination.

Willemstad, October 2001
BANK VAN DE NEDERLANDSE ANTILLEN