Sample Asset Liability Management Policy

SAMPLE BANK LTD
ASSET/LIABILITY MANAGEMENT POLICY
Revised January 1, 2005

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1. Definition of Asset/Liability Management

This Asset/Liability Management Policy encompasses the strategic management of the balance sheet aimed at achieving sustained growth, profitability and solvency. It involves a multiplicity of management activities and responsibilities, including the formulation of long-term strategic goals and objectives and the management of various risks including liquidity risk, interest rate risk and market risk.

2. Purpose

The assets and liabilities of the Sample Bank Ltd shall be managed in order to maximize shareholder value, to enhance profitability and increase capital, to serve customer and community needs, and to protect the institution from any disastrous financial consequences arising from changes in interest rates. These objectives shall be pursued within the framework of written credit, capital, and investment policies. In a capsule, the Bank intends, through sound and dynamic funds management, to realize solid operating results produced against a background of a quality balance sheet.

By extension, therefore, the purpose of the Bank's Asset/Liability Management Policy is to:

- Outline the Scope and Responsibilities of the Asset/Liability Committee (ALCO),
- Define, Measure and Manage on a consistent basis the various Risks facing the Bank,
- Establish guidelines to meet various applicable regulatory rules and statutes,

- Form a consistent co-policy with other policies of the Bank (investments, lending, capital, etc.)
- Coordinate the management of the Bank's financial position.

3. Responsibilities

The Asset/Liability Management Policy of the Bank falls under the authority of the Board of Directors, who in turn assigns authority for its formulation, revision and administration to the Asset/Liability Management Committee (ALCO). Ultimate responsibility for effective asset/liability management rests with the Board of Directors.

3.1 Board of Directors

The Board of Directors has the ultimate responsibility for the implementation of and ensuring adherence to this policy. The Board will, at least annually, formally review this policy with the Bank's management. The Board of Directors will, at least monthly, review the funds management activities of the Bank. This review will include:

- The minutes of the Asset/Liability Committee (ALCO) meetings held since the last board meeting.
- A summary of the Bank's most recent rate sensitivity analysis.
- An analysis of the Bank's liquidity position.
- An analysis of the Bank's financial result for the period just ended compared to the budget for the period, the previous period and the same period in the previous year.

Annually, the Board of Directors will also review and approve the Bank's annual budget and the Bank's strategic plan. The Board of Directors will also review and approve any other data, analyses, and transactions as may be appropriate in view of their overall responsibility for the funds management activities of the Bank.

3.2 Asset/Liability Committee (ALCO)

3.2.1 Membership of the ALCO

The ALCO will consist of the following:

Fixed Members

- Chief Executive Officer (Chairperson of the Committee)
- Deputy Chief Executive Officer
- Chief Financial Officer
- Manager Retail Banking
- Manager, Information Systems & Technology
- Deputy Manager, Credit Administration
- Recording Secretary

Ex-officio Members

- Deputy Manager, Credit Risk Management
- Senior Risk Officer
- Senior Manager Treasury Management

For the purpose of separation of key functions, the Chairperson of the ALCO cannot be the main person performing the monthly update and measuring the ALM position using the Asset/Liability Management system. The monthly update and measurement of the ALM position will be someone without authority to make investment or risk taking decisions. The Chairperson may designate that duty to another member of the ALCO or employee of the Bank.

3.2.2 Duties of the ALCO

The items cited below do not necessarily represent an all-inclusive list of the duties of the ALCO, given the dynamic nature of its responsibilities. On a regular basis the ALCO should:

1. Hold a formal meeting (usually once a month). Informal meetings will be held on an as needed basis.
2. Monitor and discuss the status and results of implemented asset/liability management strategies and tactics.
3. Review the current and prospective liquidity positions and monitor alternative funding sources.
4. Review measurement reports on various risks that can be measured with a reasonable degree of effort. Compare simulated exposures of these risks to policy limits. Discuss and report on the impact of major funding shifts and changes in overall investment and lending strategies.
5. Review the current and prospective capital levels (risk-based as well as net worth) to determine sufficiency in relation to: expected growth, interest rate risk, price risk, and asset mix/quality.
6. Review outlook for interest rates and economy at local, regional and international levels.

7. Review maturity/repricing schedules with particular attention to the maturity distribution of large amounts of assets and liabilities maturing (i.e. jumbo CD's, large investments, etc.)
8. Develop alternate strategies deemed appropriate, which take into account changes in:
    - interest rate levels and trends,
    - deposit and loan products and related markets,
    - banking regulations, and
    - monetary and fiscal policy.
9. Develop parameters for the pricing and maturity distributions of deposits, loans and investments.
10. Report the minutes of each monthly meeting to the Board of Directors.
11. Perform an independent review (using our internal audit staff) of the validation and reasonableness of the input, assumptions, and output of our Asset/Liability Management Model (if installed), or procedures.
12. Coordinate an ongoing appropriate education program on the subject of ALM for the ALCO members, senior management, and the Board of Directors.

Also, the ALCO will ensure that it is aware of the overall financial performance of the Bank and, therefore, will keep abreast of significant changes/trends in its financial results. In this regard it will:

- ➢ Review actual net interest income and asset/liability distribution versus budget.
- ➢ Measure performance against established standards and, if appropriate against peer group data.
- ➢ Review the level and makeup of non-earning assets.
- ➢ Review the liquidity and contingency funding conditions of the Bank.

- Given the importance of the ALCO in the management of the Bank's balance sheet and related earnings stream, the ALCO will review the annual budget.

3.2.3 Meetings of the ALCO

1. The full Committee will meet at least monthly, and minutes will be kept of the meetings. More frequent sessions may be required in periods of increased economic activity, in times of unanticipated liquidity volatility, and when specific issues require immediate further study and follow-up. The minutes of each meeting shall have appended to them copies of all reports, analyses, etc. presented at the meeting. Preparation and retention of the minutes and agenda of the meetings shall be the responsibility of the chairperson of the committee. The ALCO will formulate courses of action designed to impact the Bank's liquidity, profitability and capital position, and will direct the CEO and/or his/her designees to implement the appropriate courses of action and report to the ALCO the results of these actions at the next meeting.

3.2.4 ALCO Reporting Requirements

The ALCO shall provide the Board with the following reports:

Monthly

1. Balance sheet
2. Income statement
3. Interest spread statement and GAP Report
4. Relevant ratios

5. Investment portfolio with a summary approximating portfolio values
6. Reports on various risks, including liquidity risk, credit risk, interest rate risk and currency risk

Quarterly

1. Net interest change analysis attributable to dollar volumes, earning, paying and market rates as well as time (simulation) compared to policy limits
2. Reports on various risks, including liquidity risk, credit risk, interest rate risk and currency risk
3. Projected flow of funds analysis
4. Assessment of performance against the prior quarter's strategy
5. An explanation of any known exceptions to this policy as well as an action plan and timetable to bring the bank into compliance with such policy limits
6. Minutes of the previous three meetings of the ALCO

Annually

1. Recommended Asset/Liability Management plan including a quarterly strategy for the management of interest rate risk, liquidity risk and foreign exchange risk to be presented in conjunction with the budget

4. Primary Objectives

All financial institutions assume some amount of risk as part of normal operations. It is the policy of the Sample Bank Ltd to manage and control the amount of risk it assumes. The primary objectives of the Bank's asset/liability management process include:

1. Consistent earnings-to-growth plan and Net Worth to Assets within acceptable and controllable levels of the following four main risks:

    - Interest Rate Risk (IRR) - risk that changes in prevailing interest rates will adversely affect the earnings stream of the Bank, thus resulting in reduced net interest income.
    - Price Risk (also called Valuation or Market Risk) - risk that changes in prevailing interest rates will adversely affect the values of assets, liabilities, and capital. Price Risk is the Balance Sheet valuation effect due to changes in Interest Rates and other market factors both internal and external to the Bank.
    - Liquidity Risk - risk that not enough cash will be generated from either assets or liabilities or outside sources to respond to the needs of Customers.
    - Credit Risk - risk that some loans and investments may not be repaid (default risk); implications of asset mix on risk-based capital and asset quality on ability to leverage the Bank's capital.

    Other Risks:

    Other risks may be measured from time to time. However, their importance is also key to the Bank's continued successful operations. The ALCO will review these risks at least annually, and more often as conditions may warrant.

    - Operations Risk - risk that errors made in the course of conducting business will result in losses.
    - Compliance Risk – the risk from violations or non-conformance with laws, rules, policies (regulatory or internal), and ethical standards.

- Yield Curve or Mismatch Risk - risk of adverse consequences from a change in interest rates that arises due to differences in the timing of interest rate changes on the Bank's assets and liabilities.
- Basis Risk - risk that the spread between instruments of similar maturities will change.
- Embedded Options Risk - customer options to repay loans before maturity and to make deposits, or break or withdraw deposits before maturity.
- Event Risk - risk that changes in laws, regulations, or other external factors (such as a disaster) may result in losses to the Bank.
- Strategic Risk – The risk from making adverse business decisions.
- Reputation Risk – the risk from adverse public opinion, and its affect on the Bank.

2. Provide for growth that is sound, profitable and balanced without sacrificing the quality of service.

3. Manage and maintain a policy and procedures that are consistent with the short and long-term strategic goals of the Board of Directors.

To this end, the assets and liabilities shall be managed to attempt to achieve the following major objectives:

1. Return on assets	above	1%
2. Return on equity	above	13%
3. Net interest margin	above	5%
4. Productivity (efficiency) ratio	below	70%
5. Solvency ratio	above	6%
6. Capital adequacy	above	10%

These Guidelines and other guidelines forming part of this policy, as well as other financial management Information, are intended to be a guide for the ALCO on measuring different risks, their "tolerance ranges", and other key financial management information. These guidelines are NOT meant to be absolute, but rather to help the ALCO and the Board of Directors in risk management and management of the bank's financial position. There may be additional financial and risk measurements, as well as experience judgement, which will be used, yet not listed here. The guidelines may be amended from time to time.

5. Liquidity and Funds Management

Liquidity is measured in terms of having sufficient funds available at all times, to meet fully and promptly, the legitimate demands for money made on the bank arising from deposit withdrawal, presentation of cheques, maturing investments, draws under committed loan facilities, and other financial commitments. The Bank needs to assure depositors that they can withdraw their funds when desired, borrowers of the availability of funds to meet legitimate demands for credit expansion, and employees of the bank stability & longevity. It must be remembered however that too much liquidity will have a negative impact on profitability, while too little liquidity will increase the risk of insolvency. The Bank is deemed to have adequate liquidity when it can obtain sufficient cash promptly and at a reasonable rate (cost). The determination of the adequacy of the Bank's liquidity position depends upon an analysis of the Bank's position relative to the following factors:

- historical funding requirements,
- current liquidity position,
- anticipated future funding needs,
- present and anticipated asset quality,
- present and future earnings capacity, and

- sources of funds.

5.1 Liquidity Risk

Liquidity risk is the risk of having to fund some assets by the acquisition of additional funds under unfavourable market terms. This might occur when unexpected clearing drains occur in close proximity, when depositors are leaving the bank due to a perception of increased risk, or when loan growth is very strong. These demands are affected by changes in:

A. The Business cycle

- During business cycle contractions when deposit flows are up and loan demand is down, liquidity rises.
- During business cycle expansions when deposit flows are down and loan demand is up, liquidity falls.

B. Changing Demographics

- Banking system liquidity may be affected by population growth bulges & life cycle saving patterns
- Banking system liquidity is low when average age of population is young (personal savings are low, high demand for borrowed funds)
- Banking system liquidity rises as average age of population enters wealth accumulation years (loan demand falls; savings rise)
- Banking system liquidity falls as percentage of population who are retired increases (draw down on savings)

5.2 Measuring Liquidity Exposure

Liquidity exposure will be measured by calculating the Bank's Net Liquidity Gap and by comparing current ratios with targets.

The Net Liquidity Gap will be calculated as follows:

Net Liquidity Gap as of June 30, 2003

	Up to one year	One to five years	Over five years	Total
Assets	180	46	284	509
Liabilities	471	4	4	479
Net Liquidity Gap	**-291**	**42**	**280**	**30**

Ratios

The ALCO will monitor the Bank's liquidity position by reviewing the following measures:

1. Cash reserve	Minimum 6%
2. Liquid assets	20% - 26%
3. Loans/Deposits	70% - 80%

The cash reserve ratio is calculated by expressing cash reserves (comprising local cash and net balances with the Central Bank) as a percentage of total deposits. The Banking Act requires that commercial banks hold 6% of their deposits with the Central Bank. The liquid assets ratio is calculated as liquid assets expressed as a percentage of total deposits, and the Central Bank guidelines provide that this should be between 20% and 25%. Liquid assets comprise total cash reserves including foreign cash, treasury bills and other risk free investments, cheques held for collection and net balances with Central Bank and other banks. The loans to deposits ratio is calculated as net loans and advances expressed as a percentage of deposits. The ECCB prudential guidelines require a ratio between 75% and 85%. A very high ratio suggests a less liquid position and presents the risk that some loans may have to be sold at a loss to meet depositors' claims. A low ratio indicates excess liquidity and potentially low profits.

5.3 Funding

Forecasting future events is essential to adequate liquidity planning. Sound financial management can help buffer negative changes in the Bank's economic climate and accentuate positive ones. Forecasting of future events is very subjective and fraught with potential error. Management must therefore develop contingency plans in case its projections are wrong. Effective contingency planning involves identifying minimum and maximum liability needs and weighing the alternative courses of action designed to meet the needs. Monthly cash flow projections will be sought from large customers.

The following are alternative ways the Bank can meet its liquidity needs:

- Increase core (retail) deposits
- Acquire interbank deposits
- Sell large time or notice deposits in domestic money market
- Borrow from Lender of last resort (Central Bank)
- Borrow on the Inter-Bank Market
- Lengthen the average life of the bank's liabilities portfolio
- Maintain unused lines of credit with other financial institutions
- Loan participations

The ALCO will review annually, as part of the annual budget preparation, or as often as necessary, the Bank's deposit structure in relation to volume and trend of various types of deposits, maturity distribution of time deposits and rates paid compared to rates offered by competitors.

5.4 Investments

Investments purchased will be consistent with a separate written investment policy. The objectives of the investment policy are to (1) provide liquidity (2) provide for interest rate risk management, and (3) provide additional profit. The investments portfolio shall be diversified to minimize the risk of loss resulting from over concentration of assets in specific class, currency, Country, or economic sector.

The Bank shall adopt a flexible weightings approach (strategic asset allocation) involving the periodic adjustments of the weights for each category based either on the market analysis or on technical analysis (i.e., market timing). A new allocation therefore may be constructed to capture greater returns in a changing market. The initial allocation is as follows:

Class	Initial Allocation	New Allocation
Short-term investments (Money Market)	55%	
Fixed Income (Bonds)	45%	
Equities	15%	

6. Interest Rate Risk Management

Interest rate risk arises when there is a mismatch between positions which are subject to interest rate adjustments within a specified period. The most important source of interest rate risk is the Bank's lending, funding and investment activities, where fluctuations in interest rates are reflected in interest margins and earnings. Interest rate risk also arises in trading activities, where changes in interest rates may cause fluctuations in portfolio market values.

6.1 Gap Management

The interest rate gap is a common form of interest rate sensitivity measurement. GAP is equal to rate sensitive assets (RSA) minus rate sensitive liabilities (RSL). A rate sensitive asset/liability is one whose yield/cost varies with base rate fluctuations. With the GAP methodology the Bank’s assets and liabilities will be organised into repricing “buckets” using book values. The analysis will allow the Bank to determine the effect in the bank’s income due to a change in interest rates. A positive GAP exists when there is more RSA than RSL, and a negative GAP exists when there is more RSL than RSA.

The Bank will strive to achieve a balance between reducing risk to earnings from adverse movements in interest rates, and enhancing net interest income through correct anticipation of the direction and extent on interest rate changes. By running a positive GAP the Bank will benefit if interest rates rise, and by running a negative GAP it will benefit if interest rates fall. The Bank's GAP and interest rate exposure will be compiled and reviewed on a monthly basis. The GAP reports will be used to measure risk to net interest income arising from the repricing of assets and liabilities over time. The Bank will focus on net repricing imbalances (RSA - RSL) in the 30, 90, 180, and 365-day cumulative time frames, while measuring the risk based upon the size of the repricing balances, how long the repricing imbalances remain open, and potential movements in interest rates. While the GAP reports will be used to indicate the timing and sources of interest rate risk, it is understood that maintaining a balanced position for all time periods in a GAP report does not ensure immunity from interest rate risk.

The Bank will take into account the following limitations of GAP reporting:

1. Interest rates on assets and liabilities do not always move in the same magnitude or velocity
2. Significant risk may be hidden in the repricing time frames of the GAP report
3. Option features of many deposit instruments and loans are not readily determinable
4. Exposures arising from new business generally are not captured.
5. Repriceable investments/funds may roll off at rates significantly different from current rates

To address the limitations of GAP reports, the bank will concentrate on simulation modelling.

6.2 Simulation

The focus of simulation is to measure risk to net income by projecting the future composition of the bank’s assets and liabilities and applying different interest rate scenarios. Simulation modelling will be incorporated to run "what if" analyses to determine the effect of different strategies on the bank's risk profile and profitability.

By using simulation, the Bank will consider the varying interest rate spreads (Basis Risk) between deposits, CD rates, loans, investments, etc. The impact of prepayment rates on loans and securities will also be taken into account. Further, management will carefully assess and document the assumptions underlying the simulations including anticipated management reaction to a rise or decline in interest rates or changes in the yield curve.

While simulation can adequately assess short-term (1-2 years) interest rate risk, the Bank will not rely on this analysis to capture and isolate the risks associated with longer term repricing imbalances. Subjective analysis of the balance sheet will be utilized to evaluate long-term fixed-rate positions.

Market interest rates will be shocked using +/- 100, 200 and 300 basis point shifts. The rate risk limits are as follows:

1 Year Change in Market Rates	**Net Interest Change As a Percent of Net Interest Income**
+300 basis points	-30%
+200 basis points	- 20%
+100 basis points	-10%
Base	
-100 basis points	-10%
-200 basis points	-20%
-300 basis points	-30%

6.3 Asset Allocation / Strategies

Interest rate risk will be managed through (1) investments (2) loan pricing, and (3) deposit pricing. Asset/Liability policies and strategies will be formulated upon the examination of how interest rate risk affects overall business risk, i.e., capital risk, and liquidity risk, credit risk, interest rate risk. After review of the current situation, the ALCO will devise various strategies to minimize risk while maximizing earnings and net worth. The following methods for managing the asset/liability mix will be reviewed:

1. Buying and selling assets
2. Changing liability structure and mix
3. Balance sheet growth, structure, and maturity

4. Hedging

The proper strategy will depend on the current level of risk, the time frame, and the current interest rate environment. If the Bank determines that there is a good chance that interest rates will increase, an attempt will be made to extend fixed-rate liabilities to longer maturities while purchasing variable rate assets in order to widen the net interest margin. If it is perceived that interest rates will decline, an attempt will be made to shorten fixed rate liabilities while securing longer-term fixed-rate assets in order to increase the net interest margin. Asset maturities will be managed as a result of the liability structure to maintain compliance within the ranges detailed.

7. Credit Risk Management

Credit risk is the risk of loss resulting from the failure of a borrower or counterparty to honour its financial or contractual obligation. Credit risk arises both in the Bank's direct lending operations or in its funding, investment and trading activities, where counterparties have repayment or other obligations to the Bank. The management of the Bank's credit risk shall be consistent with separate written credit policies and procedures.

7.1. Credit Policy Objectives

The Bank's credit policies will seek to achieve the following major objectives:

- Provision for loan losses / unsatisfactory assets – Maximum 10%
- Net losses / average loans - Maximum 1%
- Classified non-performing loans / total loans - Maximum 7.5%

7.2. Credit Process

Sample Bank's credit disciplines shall be based on a division of authority, a committee system for dealing with all major exposures, and periodic independent review by the Audit Department.

Banking officers, who have client contact, will develop and structure individual proposals, and will approve credits within their individual limits. Retail credits will be assessed and authorized in branches within the criteria established by the Bank. All proposals outside the officers' limits will be adjudicated by the Credit Committee which will analyse the financial strength of the customers and the risks inherent in the proposals. All exceptions to the credit policy of the Bank, or credits outside of the authority of the Credit Committee, must be referred to the Executive Committee for its decision or recommendation to the Board of Directors. Higher risk exposures are subject to mandatory referral to the Board of Directors.

Credit lines for off-balance sheet instruments such as credit card limits, letters of credit and guarantee, shall be managed as an integral part of the same process.

At least annually, banking officers will meet formally with each commercial client to review their financial affairs and to assess the appropriateness of their credit requirements. The results will be formulated into a presentation which will be adjudicated in the same manner as a new credit. Where unusual risks exist, credits will be reviewed more frequently. In this way, the Bank will remain fully aware of customers' risk profiles. Risk ratings will be reassessed with each credit presentation or review.

To minimize risk the Bank will only accept those credits where there is reasonable confidence that the asset will be redeemed at face value.

Limits and maximum maturity periods for various types of loans will be outlined in the Bank's Credit Policy.

7.3. Risk Diversification

The Bank's credit policies and limits are intended to ensure broad diversification across various types of credit risk. Limits will be set for individual borrowers, particular industries and certain types of lending. There various risks will be determined taking into account the relative risk of the borrower, economic activity or product type.

7.4. Pricing for Risk

The Bank will classify loans into risk categories by economic sector and by product and will price the loans to compensate for the risk involved.

7.5. Accounting for Problem Loans

The Board of Directors understand that in any portfolio there will be delinquent loans which require special accounting procedures. The Bank has therefore adopted the ECCB Prudential Guidelines with respect to loan review, loan classification, loan provisioning, suspension of interest and loan write-offs. The guidelines require an annual review of at least 70% of the Bank's credit portfolio taking into consideration; the terms of the loan, the business of the borrower, evaluation of the project being financed, security, and debt service. The loans are classified into five categories: pass, special mentioned, substandard, doubtful, and loss. Any loan classified as substandard, doubtful or loss requires a provision of 10%, 50% or 100% respectfully. A 1% provision is required for the percentage of the portfolio not reviewed. Interest should stop accruing on non-performing credits classified as substandard, doubtful or loss unless adequate security exists and full collection is expected within three months. Interest on Government guaranteed loans should continue to accrue up to the limit of the guarantee. Write-off is recommended for loans that have been classified as loss for over three months.

8. Market Risk

Market risk refers to the uncertainty of future earnings resulting from changes in interest rates, exchange rates, market prices and volatilities. The Bank assumes market risk from consumer and corporate loans, position taking, and trading and investment activities.

The strategy for controlling market risk shall involve:

- Stringent control and limits
- Strict segregation of front and back office duties
- Daily reporting of positions
- Regular independent review of all controls and limits
- Rigorous testing and auditing of all pricing, trading, risk management and accounting systems

8.1 Trading Risk

The Bank conducts some trading activities on behalf of its customers, but also trades for its own account. Trading portfolios shall be managed with the intent to buy and sell financial instruments over a short period of time rather that hold positions for investments. Continued enhancement of the Bank's trading risk management systems and processes will be kept up-to-date with market developments.

Trading on behalf of customers will be done only for securities listed on the ECSE, including bonds, treasury bills and shares. Such trading will be done by the Bank's Licensed Representative under the supervision of the Licensed Principal. There will be no limit for trades done on behalf of customers. Securities, whether listed on the ECSE or not, traded on the Bank's own account will be traded by the Bank's Licensed Representative under the supervision of the Licensed Principal but will be authorised by the Bank's officers in accordance with established investments limits. The current limits are as follows:

➢ Board	Unlimited
➢ Executive Committee	$10 million per transaction
➢ Asset/Liability Management Committee	$6 million per transaction
➢ Chief Executive Officer	$4.5 million per transaction
➢ Chief Financial Officer	$3 million per transaction

Daily reports of profit and loss, limit overruns and compliance will be circulated to all appropriate departments and management for evaluation. Rigorous analysis and testing programs will be applied to measure risk, and to verify accuracy of various controls and limits. These will include stress testing, and sensitivity analysis.

8.2 Foreign Exchange Risk

The operational currency of the Bank is the EC Dollar. However, in order to meet customer needs, the Bank buys and sells a number of foreign currencies, and also holds assets and liabilities denominated in several foreign currencies. Also, as a result of its investments in foreign currencies and its international trading activities, the Bank receives income and pays expenses in foreign currency. The Bank is therefore exposed to foreign exchange risk associated with the effect of fluctuations in the rates of exchange in various currencies. To mitigate the risk of loss due to rate changes the Bank will match its positions as closely as possible. However as it is not possible to match positions perfectly, the following exposure limits have been set for the various foreign currencies:

- US$10 million – long position
- GBP 100 thousand – long or short position
- EURO 150 thousand – long or short position
- CDN 100 thousand – long or short position
- BDS 150 thousand – long or short position
- TT$ 250 thousand – long or short position
- JA$ 150 thousand – long or short position
- Guyana $150 thousand – long or short position

Where any currency holding is out of guidelines, trading will be conducted as soon as possible to bring the relative balance within the currency limit. Forward contracts may also be used where necessary to hedge credit commitments or to buy or sell cash to meet required limits. Positions will be analysed on a daily basis, a currency risk report will be produced for the Board at the end of each month.

9. Annual Budgeting

The ALCO will be responsible for reviewing the Annual Budget, which should have, as its foundation, a set of economic and interest rate assumptions. The Bank's interest rate risk exposure, liquidity, and other limits must be incorporated into this planning process. Potential impacts of changes in rates on new product introduction, expansion, deposit and loan pricing, investment strategy and customer behaviour must be considered.

If during the period under review of the budget, the ALCO should determine that major budget goals are not being achieved, and that the potential effect of this variance will have a material adverse impact on the Bank's financial performance objectives, then the ALCO shall consider altering budget expectations for the planning period.

10. Productivity

The Bank will seek to achieve commercial growth targets while maintaining a tight rein on all cost. The following **Cost Management Strategies** will be applied as necessary and in the most effective way to achieve the desired results:

Productivity enhancements

- Economies of scale
- Economies of scope
- Economies of experience
- Computerization (electronic banking)
- Process re-engineering

Management Information

- Budgetary control
- Cost centre analysis
- Product & business unit profitability analysis

Appropriate pricing of Products & Services

- Link charges to real costs
- Establish pricing to encourage cost conscious behaviour from customers
- Avoid cross-subsidies
- Set up necessary systems measure customer and product profitability

- Classify customer groups to ascertain profitability

Measuring Cost & Productivity

The Bank will seek to achieve market levels for the following measures of productivity:

- $\frac{\text{Non-interest expenses}}{\text{Total Income}}$ (Efficiency ratio with provision) Maximum 70%

- $\frac{\text{Non-interest expenses - provision}}{\text{Total Income}}$ (Efficiency ratio without provision) Max. 62%

Average staff cost per employee	$45,000
Net income per employee	$50,000
Staff costs to total expenditure	20%
Staff cost to total income	25%
Staff cost to non-interest income	80%

11. Profitability

The Bank will seek to achieve the following profitability ratios:

Return on assets (net income / average assets)	Minimum 1%
Return on equity (net income / shareholders' equity)	Minimum 13%
Net interest margin (net interest income / average earning assets)	Minimum 5%

12. Income Tax

The rate of Income tax is 40%. However due to the expenses allowable against income tax, including capital allowances, tax-free securities and interest on residential mortgages under $150,000, the Bank pays an annual effective rate of between 20% and 30%. The Bank will seek to manage the tax position to the maximum benefit of shareholders.

13. Dividends

Actual dividend payout, as a percentage of net income, will be determined by the capital position relative to loans, deposits, total assets, and projected growth trends. The dividend amount will be recommended by the Board for approval by the shareholders at the Annual General Meeting. For the next five years the dividend payout ratio will not exceed 5% of profits after tax, to a maximum of 5% of paid-up capital. When deciding on the dividend to be paid the Board should keep the following in mind:

- No dividends shall be paid out of unrealised profits, in compliance with Section 52(2) of the St. Vincent and the Grenadines Companies Act No 8 of 1994.
- Whenever the Statutory Reserve Fund is less that the paid-up or assigned capital at least 20% of the profits for the year must be transferred to the Statutory Reserve Fund, as required under Section 14(1) of the Banking Act.
- Section 14(2) of the Banking Act stipulates that no financial institution shall declare, credit or pay any dividend or make any other transfer from profits whenever such declaration, credit, payment or transfer would result in an impairment of the capital required under section 13 of the Banking Act.

14. Capital

Capital planning will be done in accordance with a separate written policy. The Bank shall measure capital using the capital solvency ratio and the risk-based capital adequacy ratio. The solvency ratio is calculated by expressing primary (Tier 1) capital as a percentage of total deposits. The Banking Act requires that the ratio must be greater than or equal to 5%. The risk-based capital adequacy is computed by expressing total capital (tier 1 capital plus tier 2 capital) as a percentage of on-balance sheet and off-balance sheet risk weighted assets. The ratio must be greater than or equal to 8%. See **Appendix 1** to this policy for description of classes of capital for regulatory purposes.

Risk Weighting of Assets

On Balance Sheet Items	Risk Weight
1. Cash & deposits with ECCB	0 %
2. Deposits with other banks	20 %
3. Securities issued by/guaranteed by an gov't	0 %
4. Other securities	100 %
5. Loans issued by/guaranteed by an gov't	0 %
6. Residential mortgages	50 %
7. Other loans	100 %
8. Customers liability under Acceptances	100 %
9. Other assets	100 %

A detailed worksheet for the risk weighting of assets is found in **Appendix 2**.

15. Compliance with Banking Laws and Regulations

Current laws and regulations, as well as prudent and generally accepted banking practices, will be the foundation for and will act as the guiding hand in the development of policies, procedures, strategies and tactics relating to the management of the Bank's assets and liabilities.

16. Policy Considerations

16.1 Exceptions

All funds management activities pre-dating the adoption of this policy and not in conformity with its various sections will be considered as exceptions to this policy.

Management will make a concerted effort to bring the funds management activities of the Bank into compliance with the various guidelines and provisions of this policy as quickly as possible, subject to sound financial practices.

In those situations where it seems prudent to act in a manner that is contrary to this policy, and where it is impossible for the entire ALCO to meet, any two of the CEO, Deputy CEO, CFO or Manager Retail Banking may act for the entire ALCO; provided, however, that all actions taken in the absence of the entire ALCO shall be reported in full at the next regularly scheduled ALCO meeting.

16.2 Revision

The Chief Financial Officer shall review the policy annually and shall recommend all necessary changes to the Board for consideration and adoption.

This policy is intended to be flexible to deal with rapidly changing conditions; therefore, this policy can be amended by the unanimous vote of the members of the ALCO. Any and all modifications of this policy are to be reported to the Board of Directors at its next regularly scheduled meeting.

16.3 Adoption

This policy and any changes made during the annual reviews shall be adopted by resolution of the Board of Directors.

Adopted:
By the Board of Directors
Sample Bank Ltd

Chairman

Secretary

Appendix I

CAPITAL COMPUTATION WORKSHEET

				$000'S
			CAPITAL ITEMS	**$000'S**
Tier I	(a)		Paid up ordinary share capital	
	(b)		Paid up ordinary share capital surplus	
	(c)		Paid up perpetual non-cumulative preference shares	
	(d)		Paid up perpetual non-cumulative preference shares surplus	
	(e)		Statutory reserves	
	(f)		Capital Reserves - excluding asset revaluations	
	(g)		General reserves - excluding reserves losses on assets	
	(h)		Retained earnings (accumulated losses) - audited	
	Tier I Capital before deductions			**-**
	Less deductions			**-**
		1	Current year losses	
		2	Bonus shares from capitalisation of unrealised asset revaluation reserves	
		3	Goodwill	
		4	Other intangibles	
	Total Core Capital - Tier I			**-**
Tier II	(a)		Fixed assets revaluation Reserves (limited to 20% on Tier I capital)	
	(b)		General Provisions/Reserves for losses on assets (limited to 1.25% of total risk-weighted assets)	
	(C)		Paid up perpetual cumulative preference shares	
	(d)		Paid up perpetual cumulative preference shares surplus	
	(e)		Bonus shares from capitalisation of unrealised asset revaluation reserves	
	(f)		Unaudited undivided profits	
	(g)		Asset revaluation reserves	
	(h)		Mandatory convertible debt instruments	
	(I)		Other hybrid capital instruments	
	(j)		Subordinated term debt and limited life preference shares (limited to 50% of Tier I Capital)	
	Total Tier II Capital			**-**
	Allowable Tier II Capital (the lesser of Tier I or Tier II Capital)			**-**
	Total Capital before deductions (Tier I and allowable Tier II Capital)			**-**
	Less deductions			-
			Investments in financial subsidiaries not consolidated in the group	
TOTAL QUALIFYING CAPITAL				**-**

CAPITAL COMPUTATION WORKSHEET
Calculation of Risk-Based Capital ratios

			EC$000
1	Total risk weighted on-balance sheet assets (Schedule 11 - WS 1)		-
2	**Less** deductions as per Schedule 11(b) (I) & (ii)		-
3	Net risk weighted on-balance sheet assets (1 - 2)		-
4	Total risk weighted off-balance sheet assets (Schedule 11 a -WS II)		-
5	Total risk weighted assets (3 + 4)		-
6	**Less** specific accumulated provision for losses on assets		
7	**Less** General reserve/provisions for losses on assets disallowed in capital (Tier II Capital, Item b)		
8	Total adjusted risk weighted assets (5 - 6)		-
	Capital Ratios		
	Tier I Capital to Total adjusted risk weighted assets (item 8)		0.00%
	Total qualifying capital to Total adjusted risk weighted assets (item 8)		0.00%
	Tier I Capital to Deposits	1:	-
	Single Largest Loan Facility to Tier 1 Capital		0.00%
	Single Largest Group Loan to Tier 1 Capital		0.00%
	Top 20 Largest Loan Groups to Tier 1 Capital		0.00%

Appendix II

CAPITAL ADEQUACY COMPUTATION WORKSHEET
On Balance Sheet Items
All figures in EC$000's

Category			Assets	Value (V)	Weight (w)	Weighted Value (V x W) $000's
Zero Weight	(a)		Cash	-	0	
		1	Local			
		2	Foreign			
	(b)		Due from Central Bank	-	0	
		1	Current Account			
		2	Fixed Deposits and Call Accounts			
		3	Other Claims			
	(c)		Securities issued or guaranteed by the territory's Government	-	0	
		1	Treasury Bills			
		2	Government Securities			
		3	Other Claims on Government			
	(d)		Claims on government, statutory bodies and other public sector entities (Guaranteed by the territory's Government)	-	0	
		1	Loans to Government			
		2	Loans to Statutory Bodies			
		3	Other (Government Guaranteed)			
	(e)		Claims on other CARICOM and approved Foreign Government[1]	-	0	
		1	Deposits at CARICOM Central Banks			
		2	Other claims on CARICOM Central Banks			
		3	Securities issued by CARICOM Governments			
		4	Other claims on CARICOM Governments			
		5	Deposits at approved foreign central banks			
		6	Other claims on approved foreign central banks			
		7	Securities issued by approved foreign governments			
		8	Other claims on approved foreign governments			
	(f)		Fully Secured Claims (inclusive of credit)	-	0	
		1	By Cash			
		2	By Government Securities[1]			
	Sub-Total of Zero Weight Category			-		

[1]Securities of Governments of countries listed in Appendix I

CAPITAL ADEQUACY COMPUTATION WORKSHEET

On Balance Sheet Items

All figures in EC$000's

Risk Weight			Assets	Value (V)	Weight (w)	Weighted Value (V x W) $000's
20% Risk Weight	(a)		Due from Banks	-	0.2	-
		1	Locally Incorporated			
		2	Incorporated in CARICOM Territories			
		3	Incorporated in approved foreign countries			
	(b)		Due from Financial Institutions *(inclusive of Fixed Deposits)*	-	0.2	-
		1	Locally Incorporated			
		2	Incorporated in CARICOM Territories			
		3	Incorporated in approved foreign countries			
	(c)		Other claims and loans guaranteed by Financial Institutions	-	0.2	-
		1	Locally Incorporated			
		2	Incorporated in CARICOM Territories			
		3	Incorporated in approved foreign countries			
		4	Incorporated in other foreign countries with a residual maturity of up to 1 year			
	(d)		Claims on state owned enterprises not guaranteed by gov	-	0.2	-
		1	Securities Issued			
		2	Loans			
	(e)		Claims on or guaranteed by multilateral development banks or collaterised by securities issued by such banks		0.2	-
	(f)		Bankers' Acceptances		0.2	-
	(g)		Cash items in a process of collection		0.2	-
			Sub-Total of 20% Risk Weight	-		-
50%			Fully secured real estate residential mortgages		0.5	-
100% Risk Weight	(a)		**Loans and Advances**	**-**	1.0	-
		1	Commercial			
		2	Personal			
		3	Other			
	(b)		Claims on loans guaranteed by financial institutions incorporated in other foreign countries with a residual maturity of over 1 year		1.0	-
	(c)		Claims on foreign governments	-	1.0	-
		1	Claims on other foreign central banks			
		2	Claims on and obligations guaranteed by other foreign central gov'ts			
	(d)		Fixed Assets	-	1.0	-
		1	Land and buildings			
		2	Plant and equipment			
		3	Other fixed assets			
	(e)		Investments	-	1.0	-
		1	Investments in financial institutions			
		2	Quoted shares/stocks			
		3	Other Investments			
	(f)		Other Assets		1.0	-
			Sub-Total of 100% Risk Weight	-		-
			TOTAL ON-BALANCE SHEET ITEMS	-		-

CAPITAL ADEQUACY COMPUTATION WORKSHEET
Off Balance Sheet Items
All figures in EC$000's

Risk Weight			Off - Balance Sheet Items	Value (V)	Conversion factor (C)	Weight (w)	Converted Weighted Value (V xCx W) $000's
0 % Risk Weight	(a)		Domestic and Foreign Entities	-			
		1	Bankers' Acceptances		1.00		
		2	Bills of collection		1.00		
		3	Unused loan funds		1.00		
		4	Unused portion of overdraft facilities		1.00		
		5	Unused portion of credit card facilities		1.00		
		6	Documentary credits (collaterised by underlying shipments)		0.20		
		7	Documentary Credit s -Other		1.00		
		8	Unconditional formal standby letters of credit and other commitments with an original maturity of up to 1 year		1.00		
		9	Formal standby letters of credit and other commitments with a maturity of over 1 year		0.50		
		10	Other standby letters of credit		1.00		
		11	Performance bonds, warranties and transactions related contingent items		0.50		
		12	Financial guarantees and items which substitute for loans and advances		1.00		
		13	Sale and repurchase agreements with recourse		1.00		
		14	Forward asset purchases, forward deposits and partly paid shares and securities with certain drawdown		1.00		
		15	Other		1.00		
	(b)		Domestic, CARICOM and Approved foreign Public Sector Entities and Local governments (Guaranteed by central government)	-			
		1	Bankers' Acceptances		1.00		
		2	Bills of collection		1.00		
		3	Unused loan funds		1.00		
		4	Unused portion of overdraft facilities		1.00		
		5	Unused portion of credit card facilities		1.00		
		6	Documentary credits (collaterised by underlying shipments)		0.20		
		7	Documentary Credit s -Other		1.00		
		8	Unconditional formal standby letters of credit and other commitments with an original maturity of up to 1 year		1.00		
		9	Formal standby letters of credit and other commitments with a maturity of over 1 year		0.50		
		10	Other standby letters		1.00		
		11	Performance bonds, warranties and transactions related contingent items		0.50		
		12	Financial guarantees and items which substitute for loans and advances		1.00		
		13	Sale and repurchase agreements with recourse		1.00		
		14	Forward asset purchases, forward deposits and partly paid shares and securities with certain drawdown		1.00		
		15	Other		1.00		
	Sub-Total of 0% Risk Weight			-			

Appendix II (cnt'd)

CAPITAL ADEQUACY COMPUTATION WORKSHEET
Off Balance Sheet Items
All figures in EC$000's

Risk Weight			Off-Balance Sheet Items	Value (V)	Conversion factor (C)	Weight (w)	Converted Weighted Value (V xCx W) $000's
20% Risk Weight	(c)		Domestic, CARICOM and Approved Foreign Financial Institutions and Public Sector Entities and Multilateral Development Banks	-			-
		1	Bankers' Acceptances		1.00	0.20	-
		2	Bills of collection		1.00	0.20	-
		3	Unused loan funds		1.00	0.20	-
		4	Unused portion of overdraft facilities		1.00	0.20	-
		5	Unused portion of credit card facilities		1.00	0.20	-
		6	Documentary credits (collaterised by underlying shipments)		0.20	0.20	-
		7	Documentary Credit s -Other		1.00	0.20	-
		8	Unconditional formal standby letters of credit and other commitments with an original maturity of up to 1 year		1.00	0.20	-
		9	Formal standby letters of credit and other commitments with a maturity of over 1 year		0.50	0.20	-
		10	Other standby letters		1.00	0.20	-
		11	Performance bonds, warranties and transactions related contingent items		0.50	0.20	-
		12	Financial guarantees and items which substitute for loans and advances		1.00	0.20	-
		13	Sale and repurchase agreements with recourse		1.00	0.20	-
		14	Forward asset purchases, forward deposits and partly paid shares and securities with certain drawdown		1.00	0.20	-
		15	Loans managed on behalf of the Home Mortgage Bank		0.50	0.20	-
		16	Other		1.00	0.20	-
100% Risk Weight			Sub-Total of 20% Risk Weight	-			-
	(d)		Private Sector and Other Institutions	-			-
		1	Bankers' Acceptances		1.00	1.00	-
		2	Bills of collection		1.00	1.00	-
		3	Unused loan funds		1.00	1.00	-
		4	Unused portion of overdraft facilities		1.00	1.00	-
		5	Unused portion of credit card facilities		1.00	1.00	-
		6	Documentary credits (collaterised by underlying shipments)		0.20	1.00	-
		7	Documentary Credit s -Other		1.00	1.00	-
		8	Unconditional formal standby letters of credit and other commitments with an original maturity of up to 1 year		1.00	1.00	-
		9	Formal standby letters of credit and other commitments with a maturity of over 1 year		0.50	1.00	-
		10	Other standby letters		1.00	1.00	-
		11	Performance bonds, warranties and transactions related contingent items		0.50	1.00	-
		12	Financial guarantees and items which substitute for loans and advances		1.00	1.00	-
		13	Sale and repurchase agreements with recourse		1.00	1.00	-
		14	Forward asset purchases, forward deposits and partly paid shares and securities with certain drawdown		1.00	1.00	-
		15	Other		1.00	1.00	-
			Sub-Total of 100% Risk Weight	-			-
			Total off-Balance Sheet Items	-			-